



CommBank **Retail Insights**

Edition 4



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Key insights

Growth through innovation

In this edition of CommBank Retail Insights, we meet the Australian retailers creating new growth opportunities in a changing market by unleashing the power of innovation.



Key insights

Retail never stands still — but the six months since our last edition of CommBank Retail Insights have been especially eventful.

High profile business closures have altered the competitive landscape across sectors from hardware to fashion. Meanwhile, established overseas players are lining up to enter the Australian market. Some, like Williams-Sonoma, Zara and H&M are already here. Others, most notably the retail giant Amazon, are reported to start operating in Australia soon.

These companies are heading here for a reason. Despite subdued wage and employment conditions, Australian consumers are still spending. Our research shows that online sales volumes for multi-channel retailers increased 32% in 2016, while 42% of businesses with physical outlets reported higher foot traffic, leading almost one in three to open new stores. At a time of low global growth and heightened competition, overseas retailers look at the Australian market and they like what they see.

These new entrants have deep pockets and ambitious growth plans. That means local businesses need to become increasingly innovative to compete in an evolving market.

In this edition of CommBank Retail Insights, we explore innovation and growth in Australian retail. Our research shows that many Australian retailers are already innovating. However, the scope of those innovations is often relatively limited, reducing both return on investment and the resulting competitive advantage retailers may gain.

The industry's response to Amazon is a case in point. In our survey, 70% of retailers were aware that Amazon is coming, 47% of whom saw it as a threat. Yet even among businesses that are aware of Amazon's plans and consider it a threat, only 14% had a strategy in place, while another 51% were still working on their response. Most were focused on outcompeting Amazon on its own ground by providing a superior customer experience (33%) or offering better products (30%). Few planned to respond with truly disruptive change.

The good news is that there is still time, and that many retailers already have many of the skills they need to drive genuine change. But it's important to start acting now, before the competitive landscape is transformed even further.

We'd love to hear from you about your own experiences and frustrations in pursuing innovation and managing growth in a changing environment. And if you'd like to learn more about how you can put our insights into practice in your own business, please get in touch with our team of retail specialists at insights@cba.com.au

Jerry Macey

National Manager, Retail Industry
Business and Private Banking
Commonwealth Bank of Australia

About CommBank Retail Insights

CommBank Retail Insights is an exclusive, wide-ranging analysis of the Australian retail sector. This special edition is based on two separate surveys:

- An in-depth online survey of Australian retailers carried out by ACA Research on behalf of the Commonwealth Bank in January and February 2017. ACA Research's survey involved a total of 505 decision makers from small, medium and large retailers across Australia, with turnover ranging from less than \$1 million to over \$500 million.

- A wide-ranging quantitative survey of 2,195 business owners, decision makers and managers carried out by DBM Consultants on behalf of the Commonwealth Bank between August and September 2016. Of these, responses from a sub-set of 193 retail industry participants was subject to additional analysis. Participants were drawn from businesses across Australia with an annual turnover over \$500,000 and at least two employees. The survey was designed to benchmark the innovation performance of

each business, identifying the key motivations and drivers influencing that performance, and highlighting best practice. The results were subject to further analysis by Commonwealth Bank Data and Analytics specialists and ACA Research.

How innovative are Australian retailers?



- Innovating
- Making improvements
- Neither improving nor innovating

	Retailers	All industries
Innovating	49%	44%
Making improvements	30%	38%
Neither improving nor innovating	21%	18%
CommBank Innovation Index	26.2	24.0
Estimated benefits of innovation		
Average improvement in earnings	\$197,000*	\$405,000

*Small sample size, indicative only.

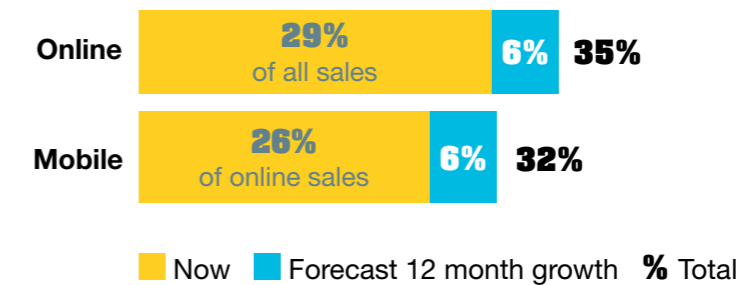
Business confidence

	H2 2016	H1 2017
Improve	35%	34%
Stay the same	47%	46%
Decline	18%	20%



	Pure play online	Multi-channel	Physical stores only
Improve	35%	37%	26%
Stay the same	43%	44%	51%
Decline	22%	19%	23%

Average online and mobile sales (among multi-channel retailers)



Channel growth strategies

- 43%** of bricks and mortar only retailers plan to open a new channel in 2017
- 26%** of bricks and mortar only retailers plan to launch a website
- 22%** of bricks and mortar only retailers plan to sell on social media

Who's growing?

- 44%** of multi-channel retailers increased foot traffic in 2016
- 39%** of retailers with increased foot traffic are growing store footprints
- 46%** of businesses with 4+ channels plan to open new physical stores

The impact of Amazon

- 70%** of retailers knew of Amazon's reported plans to open in Australia
- 41%** of retailers see Amazon as a threat
- 11%** of retailers see Amazon as an opportunity
- 5%** of retailers have a strategy in place

State by state



WA



SA and NT



QLD



NSW and ACT



VIC and TAS

Forecast business conditions over the next 12 months

- ▲ improve
- ▬ stay the same
- ▼ decline

	H2 2016	H1 2017	H2 2016	H1 2017	H2 2016	H1 2017	H2 2016	H1 2017	H2 2016	H1 2017
▲ improve	22%	25%	26%	26%	36%	39%	29%	30%	44%	41%
▬ stay the same	50%	43%	42%	48%	43%	47%	52%	50%	44%	43%
▼ decline	28%	32%	32%	26%	21%	14%	19%	20%	12%	16%

Innovations and improvements (out of 100%)

Innovations	N/A*	N/A*	50%	55%	34%
Improvements	N/A*	N/A*	46%	21%	31%

Focus of innovation activities



Social media:	47%	Social media:	35%	Quality of products and services:	48%	In-store customer experience:	43%	Quality of products and services:	47%
In-store customer experience:	43%	Quality of products and services:	30%	Social media:	35%	Quality of products and services:	39%	In-store customer experience:	42%
Diversifying products and services:	43%	In-store customer experience:	24%	In-store customer experience:	34%	Social media:	37%	Social media:	41%

Growth



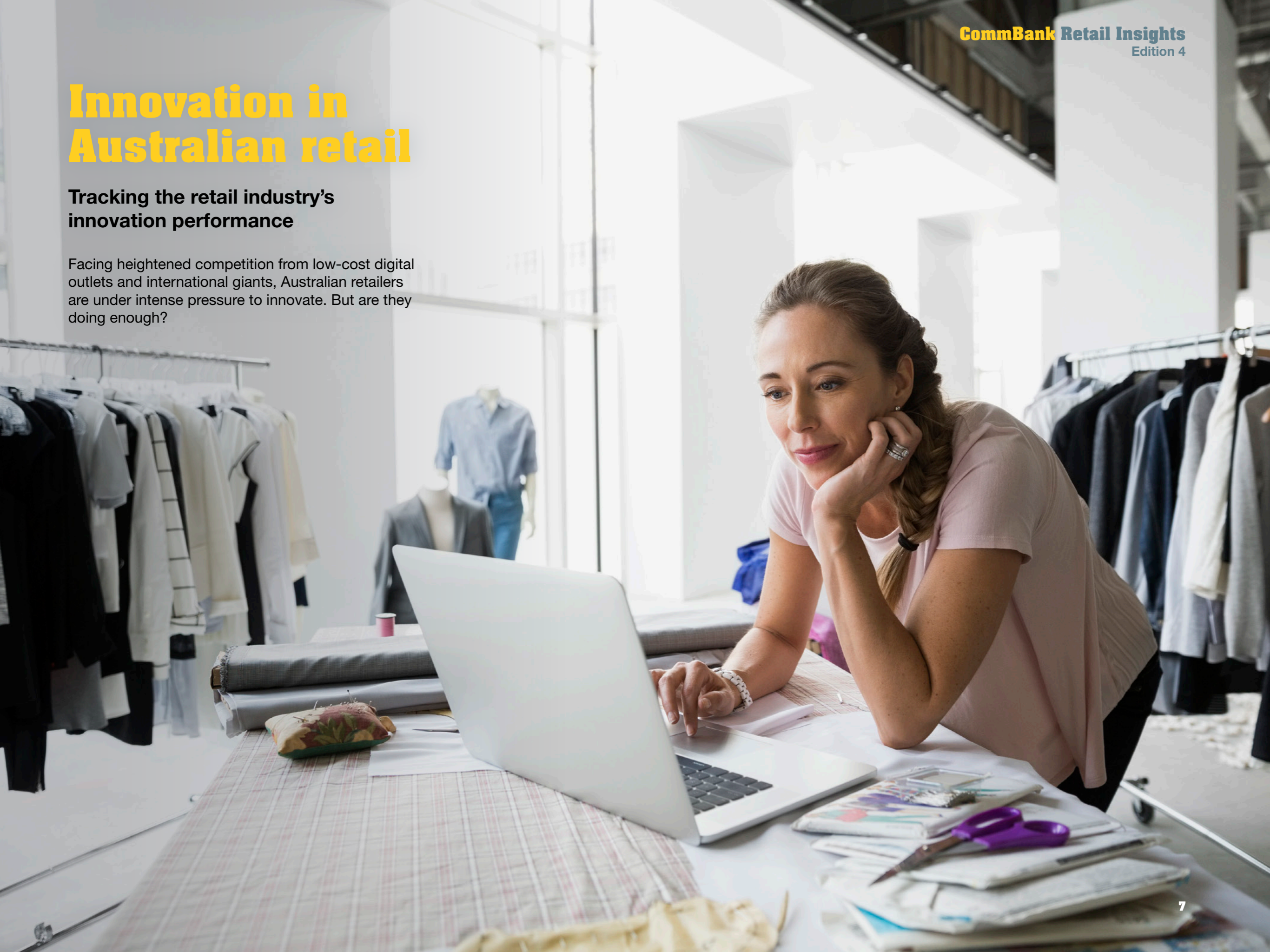
Experienced increase in foot traffic in 2016:	26%	Experienced increase in foot traffic in 2016:	31%	Experienced increase in foot traffic in 2016:	54%	Experienced increase in foot traffic in 2016:	37%	Experienced increase in foot traffic in 2016:	50%
Plan to increase brick and mortar stores:	26%	Plan to increase brick and mortar stores:	23%	Plan to increase brick and mortar stores:	33%	Plan to increase brick and mortar stores:	36%	Plan to increase brick and mortar stores:	40%
Sales generated online (multi-channel):	28%	Sales generated online (multi-channel):	37%	Sales generated online (multi-channel):	36%	Sales generated online (multi-channel):	29%	Sales generated online (multi-channel):	25%

*N/A as a result of small sample size.

Innovation in Australian retail

Tracking the retail industry's innovation performance

Facing heightened competition from low-cost digital outlets and international giants, Australian retailers are under intense pressure to innovate. But are they doing enough?



Measuring innovation

CommBank Innovation Index

Our survey measured 15 core elements of innovation identified by assessing innovation literature and academic source materials, covering management capability and entrepreneurial behaviour. Together, they comprise the CommBank Innovation Index. The index combines the results into a single numerical indicator, enabling us to rank businesses along an innovation spectrum from -100 (innovation restrictive) to +100 (disruptive innovation).

Defining innovation

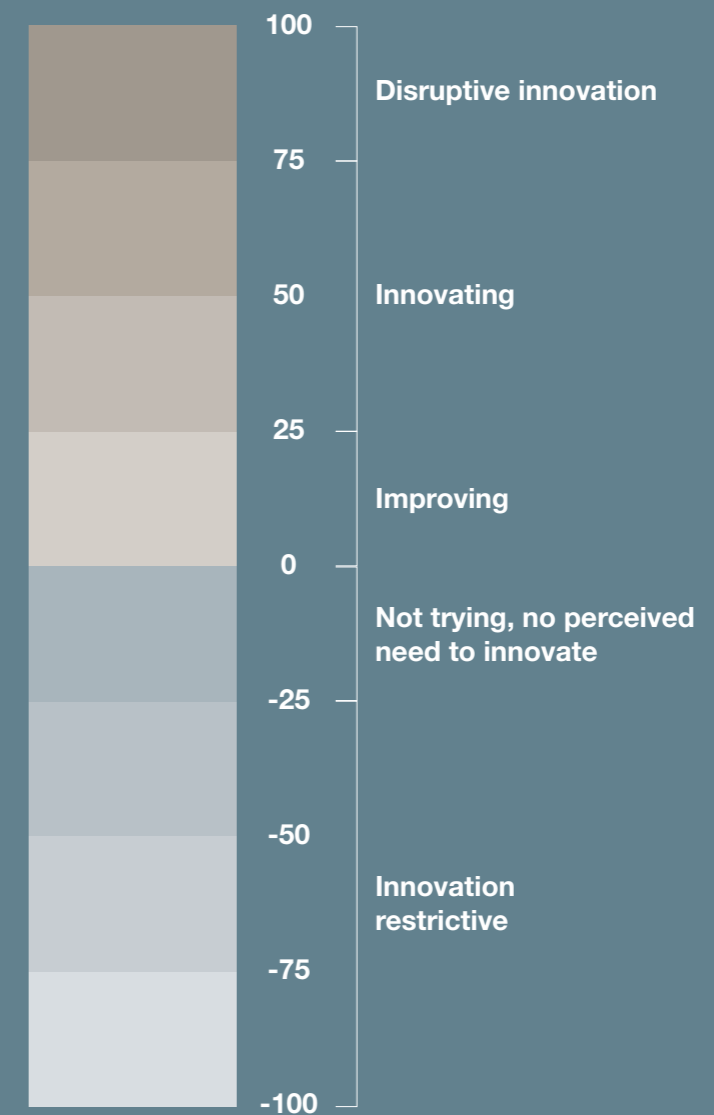
To determine which business initiatives were truly innovative, we applied the definitions in the Organisation for Economic Co-operation and Development (OECD) Oslo Manual. Used by organisations around the world, including the Australian Federal Government and the Australian Bureau of Statistics, the manual is constructed around four key innovation areas: products, processes, marketing and organisation.

What is innovation?

“A new or significant improvement in one or more of the following areas: product, process, marketing and organisation.”

OECD
Oslo Manual

The CommBank Innovation Index:
Measuring business innovation performance



Measuring the core drivers of innovation

The CommBank Innovation Index brings together 15 essential management capabilities and entrepreneurial behaviours.

“Any competition in the market place is good for rethinking our business. We have become more innovative and are pushed to expand in areas we may not have otherwise.”

Homewares & Hardware multi-channel retailer, turnover \$10–\$500 million

Measuring 15 core drivers of innovation

Management capabilities¹



Process

- Brainstorm for new ideas
- Encourage staff to ask questions
- Give staff opportunities to observe customer experiences
- Experiment and test new ideas



People

- Hire staff with creativity in mind
- Evaluate staff with creativity in mind
- Facilitate networking outside business



Philosophy

- Allow staff to take risks and fail
- Expect staff to give ideas for improvement

Entrepreneurship behaviours²



Seizing opportunities

- Look for new ways to benefit from market changes and technology
- Respond to attractive opportunities



Taking risks

- Willing to take financial risks
- Invest time and capital in uncertain capital ventures



Focus

- Limit focus to a small number of opportunities



Adapting

- Adapt products and services to make the most of opportunities

1. Source: Dyer et al (2011) The Innovator's DNA.

2. McGrath et al (2000) The Entrepreneurial Mindset: Strategies for Continuously Creating Opportunity in an Age of Uncertainty.

The new ideas reshaping retail

Lately, it seems like everyone's been talking about innovation — from the Prime Minister with his National Innovation and Science Agenda, to the CEOs of some of Australia's largest retailers. And there can be no doubt that the face of retail is changing rapidly, with new technologies transforming the way we shop in-store and online, and new business models reshaping the way products are sold and distributed.

However, looking beyond the headlines, how many Australian retailers are actively innovating? How transformative are the changes they are implementing? And are they delivering a tangible return on investment?

To answer these questions, we asked businesses across Australia to describe their business improvement initiatives, both current and planned. That helped us understand which businesses were truly innovating, and which were simply making improvements, according to the OECD definition. We also asked retailers to tell us in detail about the focus of their innovation efforts, and the management capabilities and entrepreneurship behaviours contributing to their innovation culture.

“We can only get better. With the competitors already in the market... we really need to be better than them.”

Other Retail, multi-channel, turnover \$10–\$500 million



How innovative are retailers in Australia?

Retailers scored 26.2 on the CommBank Innovation Index. That put the Retail sector in the middle of the pack in seventh place — two points above the all-industry average, but 11 points behind the highest scorer, Information, Media & Telecommunications, on 37.1.

When we analysed retailers’ business initiatives using the OECD definition, we also found that almost one in two retailers were ‘Innovation Active’, with another 30% making changes, which, while valuable, qualified as improvements rather than innovations.

So while retailers were more likely to be innovating than many other businesses, they performed less well on the innovation capabilities measured by the CommBank Innovation Index. This suggests there is room for retail businesses to hone their skills so they can get more from their innovation activities.

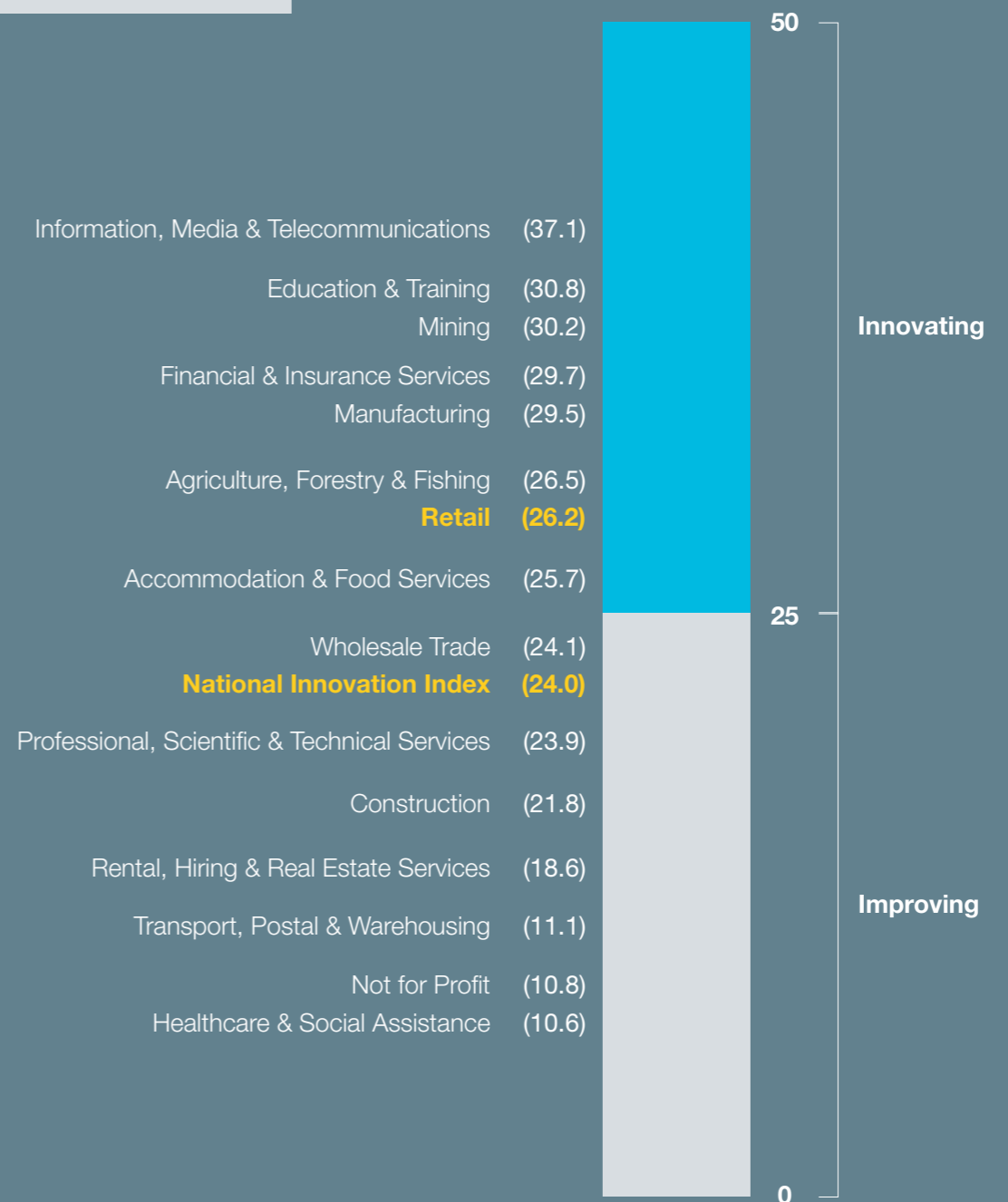
“The first step towards true innovation is to be honest with yourself. Are you being genuinely innovative, or are you simply making refinements to the same business model and product lines?”

Jerry Macey

National Manager, Retail Industry,
Business and Private Banking
Commonwealth Bank of Australia

Australian retailers’ innovation performance

Retail	26.2
National Innovation Index	24.0

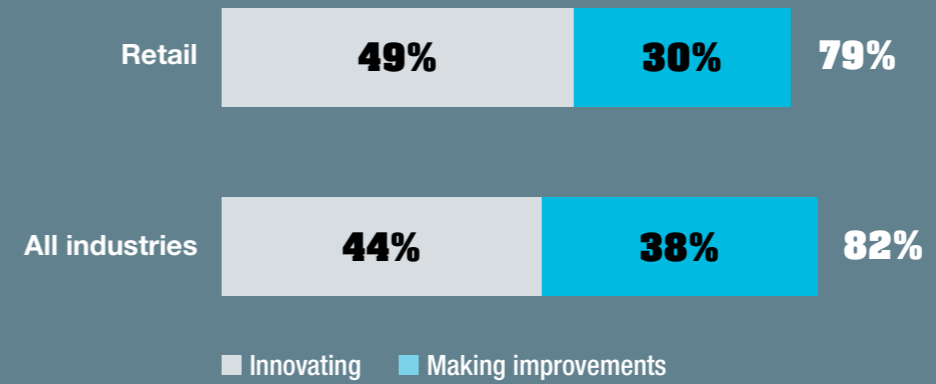


Smaller and more agile competitors may be working harder to cut through in a crowded marketplace.

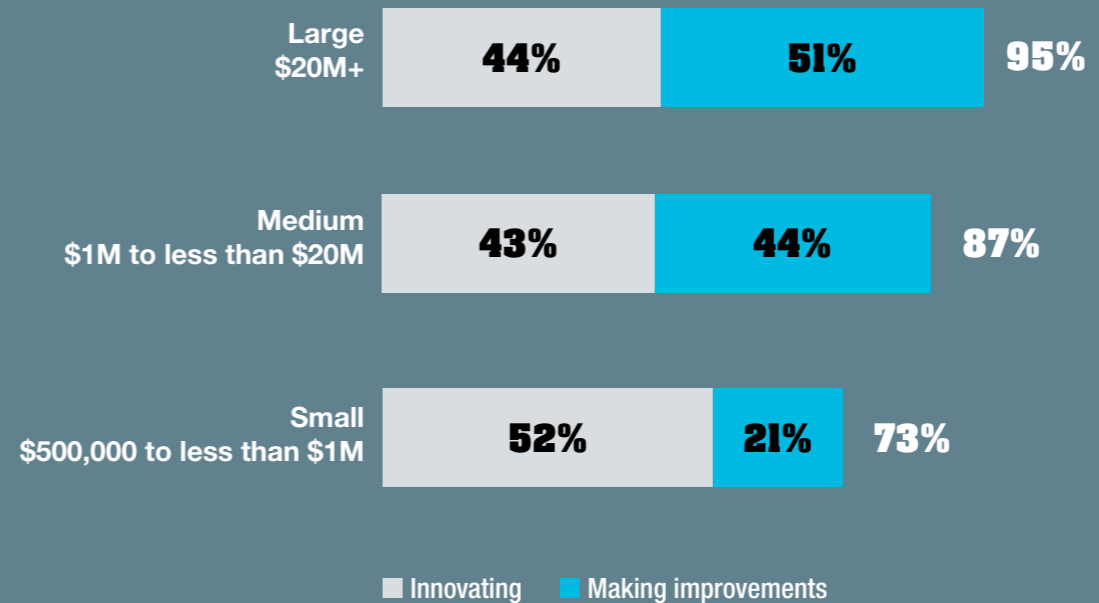


Our research also suggests that larger firms, in particular, could benefit from moving further up the innovation curve. While almost every business with annual revenues over \$20m was investing in business improvement initiatives, only 44% were implementing genuine innovations. In contrast, small businesses turning over between \$500,000 and \$1m a year were much more likely to be innovating, and less likely to be simply making improvements. It seems that while larger retailers may be content to fine tune their processes and reap the benefits of scale, their smaller and more agile competitors may be working harder to cut through in a crowded marketplace.

Proportion innovating: all retailers



Smaller businesses outperform: innovation activity by business size



Innovation in action

Harris Farm Markets

From improving to strong,
focused innovation

Key areas of innovation

 Product

 Organisation

Key drivers of innovation

- **Adapting** – adapting products and services to make the most of opportunities
- **Process** – give staff opportunities to observe customer experiences/ experiment and test new ideas
- **Focus** – careful in limiting focus to a small number of opportunities

Harris Farm has emerged as a leader in fresh food and grocery retailing in the Australian market, and continues to experience stellar growth in a market dominated by the major super market chains. The family owned business has grown from one fruit and vegetable shop in Villawood opened in 1971, to 25 stores today employing over 2,000 people.

Harris Farm's Co-CEO, Angus Harris, explains, "Our business has changed a lot even in the last 15 years, and when I came on board 80% of our revenue was from fruit and vegetables. We realised that customers were happy to buy more from us, but our range was limited."

"The first step was to expand our product range and we



started small, introducing our own yoghurt, then orange juice and a range of gourmet cheeses. Our expansion from that point came on category by category. Simply, we needed a reason for more customers to come through our doors.”

Further down the track, Harris Farm were running multiple stores and continued to experiment with new product lines including seafood and fresh meat. When renovating the Manly store, Harris Farm looked at how they could improve on the existing store.

The team realised that their customers came to Harris Farm for specialty products, and as a result they fundamentally changed their business model. Harris Farm introduced external specialised businesses into their stores in areas such as seafood, butcher shops, bakeries and coffee.

“We came up with the concept of ‘co-opetition’ to ensure that customers had access to specialist products and people that could do it better than we could ourselves. The difference is that these arrangements were non-exclusive and in most cases we were offering the same product lines and competing directly with these specialists in-store.”

“We put the customer first, and in doing so were the beneficiaries of greater overall foot traffic as the concept gained traction. We also selected specialists that aligned with our value proposition – for example, Burke Street Bakery’s Bread and Butter Project that supports training and employment for refugees.”

When Harris Farm selected its next store location at Bondi Beach, the team shifted their focus to the physical space and in-store experience and made significant upgrades to the look and feel of its stores, which was immediately successful.

“We loved the co-opetition model of Manly and the look and feel of Bondi Beach, and looked at Drummoyne as the opportunity to create the store of the future. This is where the importance of innovation reached a

tipping point. Until that stage, I don’t think we had even been calling it innovation.”

To embed innovation within their business, Harris Farm took their management and specialists to the US on a tour to experience how leaders in retail were doing things differently, with the aim to make their stores a more customer focused and exciting experience.

Harris Farm used the US tour as a catalyst to embed innovation within their overall strategy and started talking to a wider group of staff. This ultimately underpinned further product innovation, and the business introduced a number of successful initiatives such as milk vending machines that let the customer know the specific farm from where it was sourced.

“We immediately started to see the benefits of getting everyone on board with the vision. This resulted in ideas like getting rid of generic milk and offering imperfect picks, designed to reduce food waste by selling fruit and vegetables that otherwise couldn’t be sold due to a blemish or imperfection.”

“We even went as far as including innovation performance within everyone’s KPIs, but quickly realised we had swung the pendulum too far and took a step back to focus our efforts around innovation on the drum beat of the business – our stores.”

As a result of a focus on innovation and the impact this had on its staff and customers, Harris Farm continues to experience strong bottom line growth, with the pace of profitability improving substantially over time.

“We used to talk in years about how long it would take a store to become profitable. We now talk in weeks.”

Angus Harris
Harris Farm’s Co-CEO



Return on investment

There was further evidence of unrealised opportunities when we asked Innovation Active retailers about the benefits they expected to earn from their investment in change. Many nominated multiple benefits, including an improved customer experience, cost savings and competitive advantages. But higher revenues were by far the most frequently mentioned objective, cited by three in four businesses, a significantly higher proportion than the cross-industry average. Yet when we asked retailers to estimate the financial return from their investment in innovation, they nominated an average figure of \$197,000 a year — less than half the average across all industries.

Of course, a \$197,000 benefit is still significant, particularly given that many 'Innovation Active' retailers turn over less than \$1m a year.

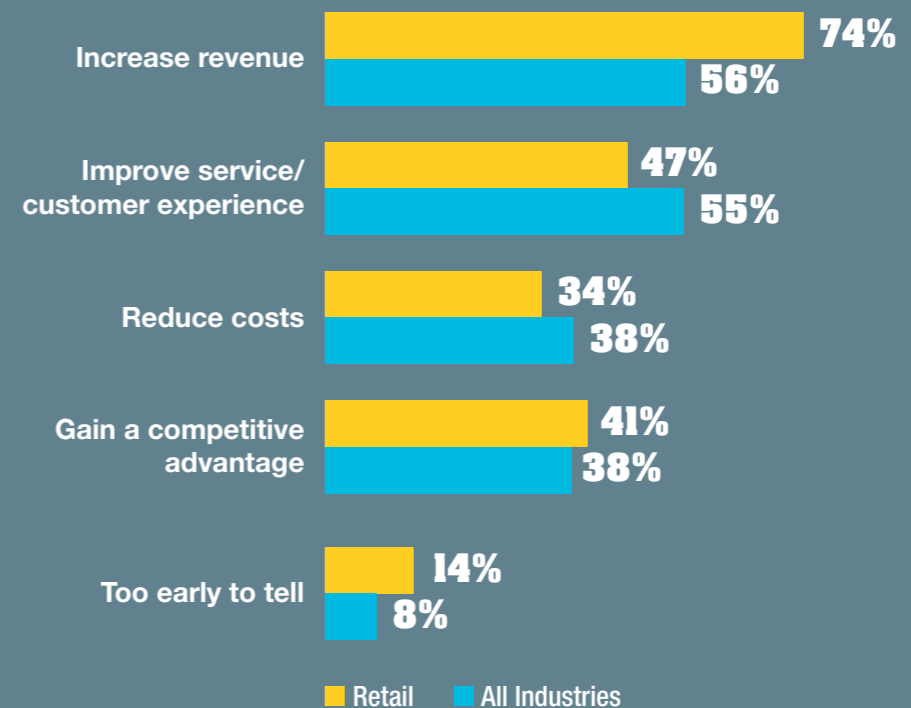
Nonetheless, the fact that retailers are achieving less than half the estimated return from their investment in innovation than the Australian average does suggest that many in the sector could be doing more.

“The real payoff from innovation comes when businesses turn it into a systematic process of continuous change reaching right across the enterprise — not just a new product line or marketing channel.”

Jerry Macey

National Manager, Retail Industry,
Business and Private Banking
Commonwealth Bank of Australia

Anticipated benefits of innovation



Unlocking value for business and the Australian economy

	All industries	Retailers
Average improvement in business earnings	\$405,000	\$197,000*

* Small sample size, indicative only.

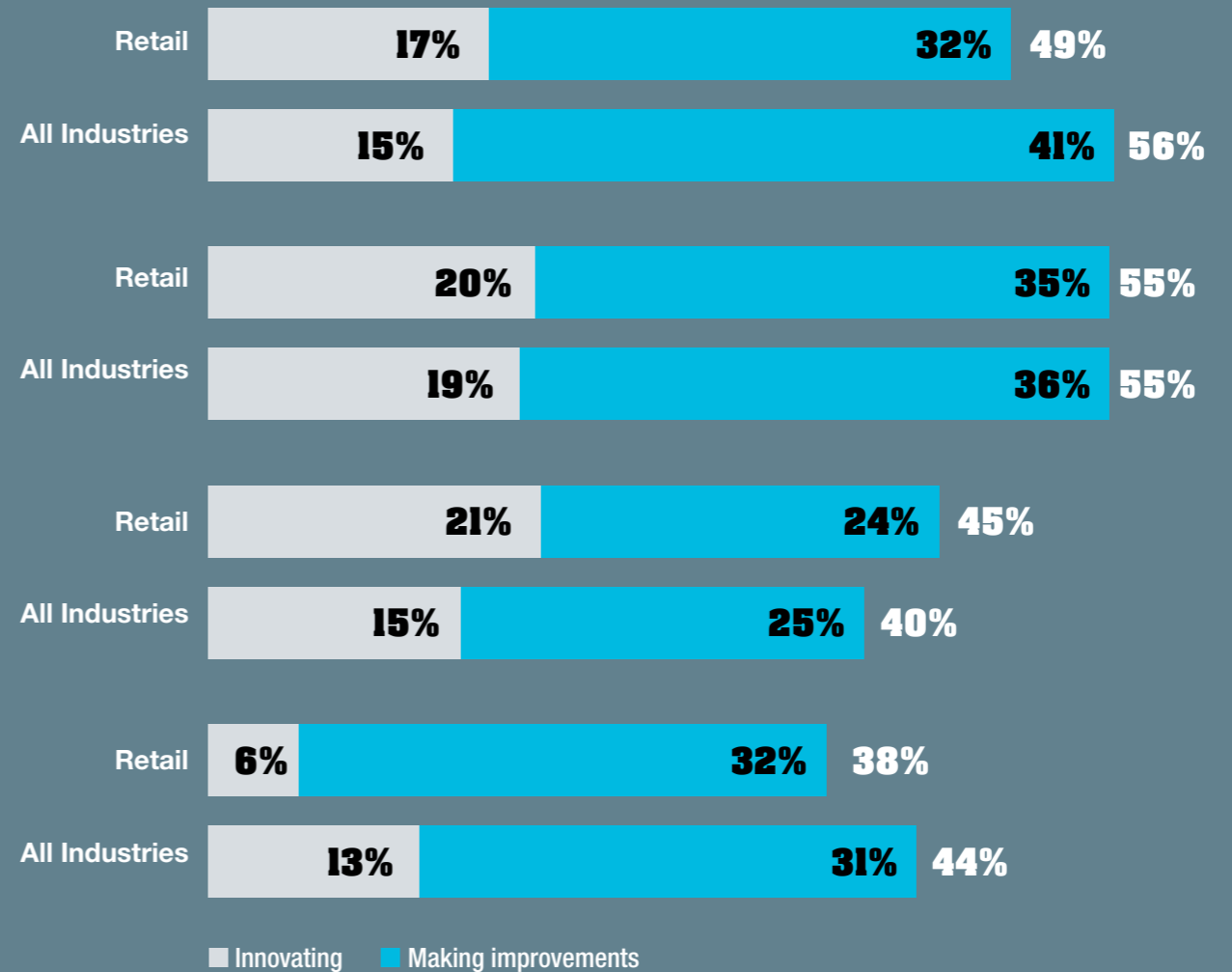
Where are retailers innovating?

When we analysed retailers' business initiatives according to the four areas of innovation defined by the OECD framework, we found they outperformed in some areas but underperformed in others.

Retailers led the way in marketing innovation, an area of where other Australian businesses were more likely to claim innovation but were merely improving. As we have highlighted in previous editions of Retail Insights, Australian retailers place a high priority on marketing and promotion, including pricing strategies and the customer experience. Their innovation activities reflect this focus, with one in five businesses innovating in this area and another 24% introducing improvements.

Retailers were closer to the all-industry average for process and product innovation, although less likely than average to make product and service improvements (32% versus 41%). However, they underperformed on organisational innovations such as outsourcing, restructuring and cultural transformation. Just 6% of retailers were 'Innovation Active' in this area — less than half the proportion across all industries. That suggests Australian retailers have been hesitant to introduce the kind of far-reaching business model transformations that have allowed retailers like Amazon to reshape markets and overturn industry leaders.

The four dimensions of innovation



Unleashing your innovation potential

While their overall innovation report card was mixed, retailers scored strongly in key innovation behaviours, suggesting the sector has unrealised potential to achieve greater returns from innovation in the future.

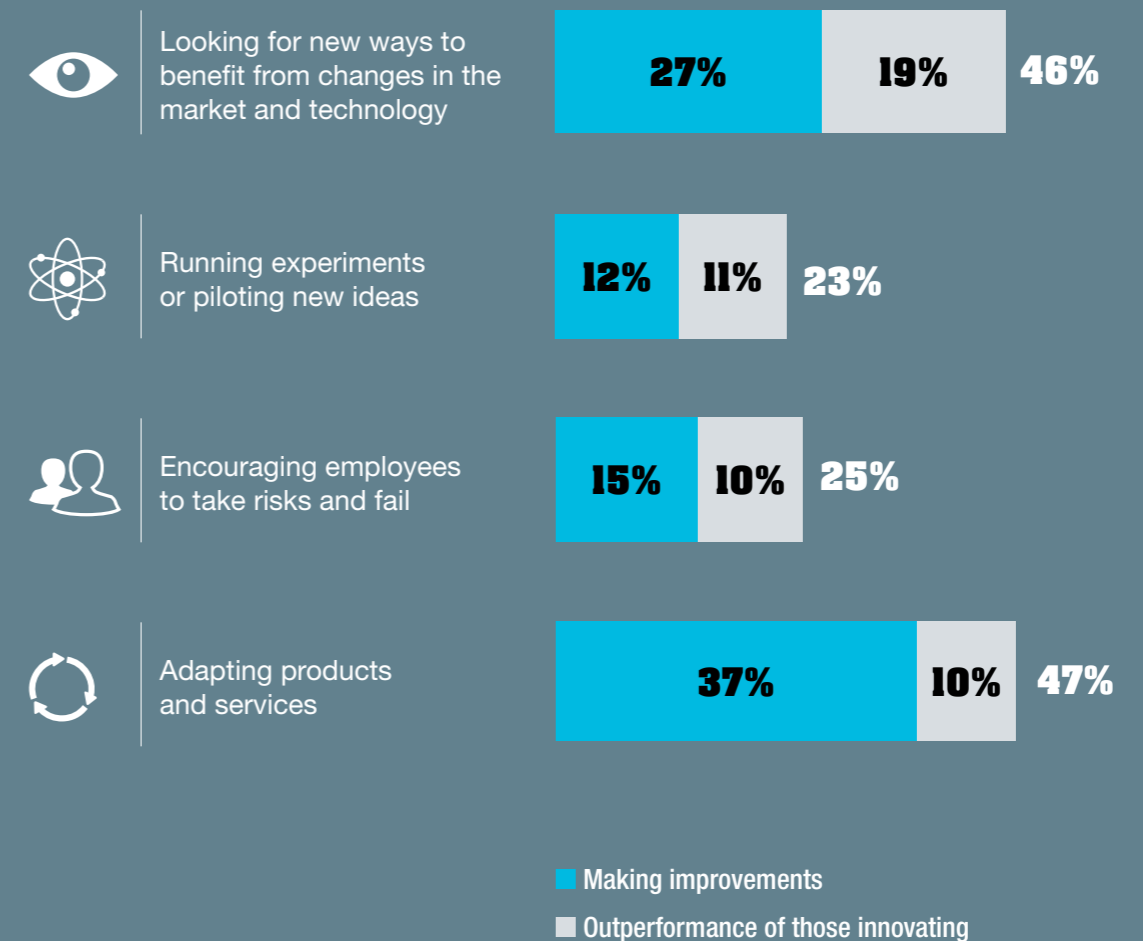
Our analysis identified four capabilities separating innovative retailers from those simply making improvements.

This suggests that retailers who want to start innovating should focus on:

- 1** Looking for new ways to benefit from changes in the market and technology.
- 2** Running experiments or piloting new ideas.
- 3** Ensuring employees are not afraid to take risks and fail.
- 4** Adapting products and services to make the most of opportunities.

Encouragingly, retailers outperform the average across all industries in three out of four of these capabilities. But while many retailers are well positioned to innovate, are they ready to take the next step, closing the gap on those businesses already disrupting the industry?

Breakthrough factors for kickstarting innovation in retail



Unleashing your innovation potential

Our analysis found four additional factors that played a critical role in helping businesses move up the innovation curve, from innovating in one area to innovating in multiple areas. Businesses who had successfully done so reported significantly higher earnings growth as a result.

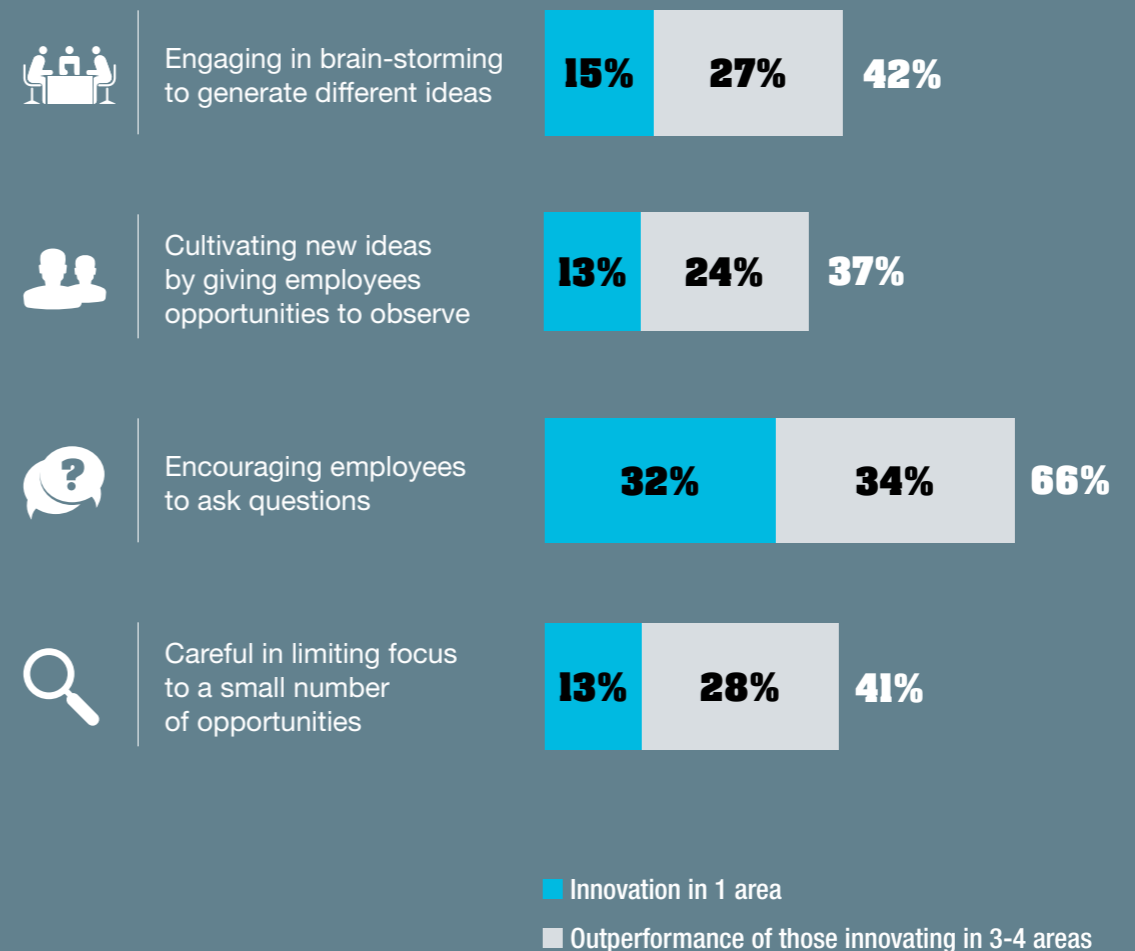
That suggests retailers seeking to gain additional benefits from their investment in innovation should focus on:

- 5** Engaging in brain-storming to generate different ideas.
- 6** Cultivating new ideas by giving employees opportunities to observe.
- 7** Encouraging employees to ask questions that challenge accepted ways of doing things.
- 8** Carefully limiting their innovation focus to a small number of opportunities.

Retailers scored less strongly on these capabilities. They were also less likely to be active in the 'people' category of innovation, including recruiting and managing for creativity, and building formal innovation networks outside the business.

Clearly, retailers could benefit from tapping into the creative potential of their staff by brainstorming and harvesting new ideas, then turning innovation into a repeatable and disciplined process.

Moving towards more holistic innovation in all industries



Innovation in action

Adore Beauty

Pioneering online beauty retail

Key areas of innovation

- Process
- Philosophy

Key drivers of innovation

- **Process** – experiment and test new ideas
- **People** – hire staff with creativity in mind
- **Philosophy** – allow staff to take risks and fail
- **Seizing opportunities** – invest time and capital in uncertain ventures

Adore Beauty's founder has grown the business from its beginnings as a pioneer in the online retail space 17 years ago to running Australia's largest online retailer in the beauty category, stocking 165 leading global brands and over 12,000 products.

This growth has been credited to both persistence, and an unwavering commitment to adapting to the changing market environment with innovation embodied within many facets of the business.

Adore Beauty was started before broadband, smartphones or social media existed and was Australia's first online beauty store.



As Kate Morris, Founder of Adore Beauty, points out: “When we started out, the retail industry was dramatically different. While we had the first online mover advantage, we also had the unenviable task of convincing the entire beauty retail industry of the benefits and safety of online as a channel.”

For Adore Beauty, innovation has been a key driver behind its ability to continually adapt to a rapidly changing market and remaining agile during the ongoing disruption of the retail sector that impacts the sustainability of retail businesses.

In its pursuit to rival its local competitors such as the major department stores, and the big international businesses such as Sephora, Adore Beauty first worked towards getting their customer proposition right.

“You first need to have a clear idea of what your business does and doesn’t do because innovation can send you down some wild paths. You need to identify the problem you are trying to solve and work towards that goal.”

For Adore Beauty this was to create a beauty shopping experience that was empowering for shoppers compared to traditional beauty retail – something that made people feel confident. “From there, everything we have done is geared to solving that problem in a slightly different way.”

To achieve this, Kate set out to create a culture where failure isn’t seen as a bad thing, rather “a necessary by-product of trying new things.”

“Having the courage to fail is one of Adore Beauty’s core values – finding small and measurable ways to test new ideas and report back.”

One of the larger projects Adore Beauty tackled was creating a database of foundation colours to address the influx of customer requests for advice on colour matching - something that didn’t exist in the industry at the time.

“We built a database with over 1.7m data pairs within it, but also an e-commerce widget on our website that improves conversion rates for foundation by almost 70%.”

As Adore Beauty continued to grow, innovation was more broadly adopted across other areas of the organisation such as in the hiring process.

“We now have about 55 staff, and as a business grows it’s more challenging to maintain a culture of innovation. Innovation is much easier when you have a team of one.”

To address this, Adore Beauty included innovation as part of the hiring criteria, opting for the right attitude and people that will thrive in an environment that was always changing.

“We like to hire ‘swimmers’ – I would prefer to hire someone that may not have the experience but has the right attitude and you can throw them in the deep end and they will swim.”

“The nature of innovation is that you have to be doing things you don’t know how to do, all the time – it’s important to find people that actually enjoy this experience.”

The value of innovation is illustrated not just in Adore Beauty’s 17 years in operation, but in its sustained growth in a very competitive market.

“Having the courage to fail is one of Adore Beauty’s core values - finding small and measurable ways to test new ideas and report back.”

Kate Morris
Founder, Adore Beauty



Kickstarting your innovation journey

There are a range of areas that businesses can focus on to move themselves up the innovation curve, particularly when looking at advancing beyond improvement into the territory of true innovation.

The following are some of the simpler tactics that businesses have used to cultivate genuine innovation, and that have the potential to positively impact a retailer's Innovation Index score.

Management capabilities

Process: Start experimenting

Find projects or ideas stuck in the traditional business case funding queue and divert them into low cost experimentations.

People: Inject different talent

During the hiring process, consider the benefits of different thinkers, go-getters, alternatively skilled candidates, toe-steppers, and opinionated thought leaders, who can disrupt the status quo.

Philosophy: Shift the mindset

Reset the definition of peak performance to include failing in the pursuit of excellence, and its contribution to learning within broader organisational growth. Walk-the-talk on this by embedding reward and recognition and setting formal KPIs.

More Strategic Activities

When innovation becomes firmly embedded within a business' organisational culture, firms can look at how to implement more disruptive change. This could include creating a centralised innovation team with a defined operating model, nominating champions of innovation across a business and re-defining traditional roles to integrate innovation, establishing partnerships to tackle common problems, or allocating funds to incubation or acceleration programs.

Entrepreneurship behaviours

Seizing opportunities: Adopt a bold view

Use scenario planning to identify a link between your business and the emerging trends in market, and then form a view on how that trend will directly impact your organisation in the future. Develop strategies you can experiment with to be future fit.

Taking Risks: Heighten awareness of innovation blockers

Encourage people to speak up about poor innovative behaviour, or blockers, as much as they would an operational or financial risk.

Focus and adapting: Create Headroom for Innovation

Create groundswells by removing the biggest barrier to bottom up innovation – not enough time. Whatever time you free-up for staff in productivity or continuous improvement programs, re-direct to innovation activities.

“While technology is foundational to innovation, I believe that the disrupters of tomorrow will be the firms that tap into the hearts, minds and purposes of the teams that walk through their doors every day. By doing this, they can build a world-beating innovative culture that chases down missions in innovation on a daily basis.”

Heath Brown

Executive Manager
Customer Innovation and Engagement
Innovation Lab
Commonwealth Bank of Australia

Creating growth opportunities

Adapting to a changing retail landscape

In a challenging market, successful retailers continue to drive customer traffic and discover new growth opportunities.



Business conditions set to stay steady

With economic growth still subdued, full time employment falling, and wage increases at record lows, it's still a tough market for many retailers. Yet most remained confident that business conditions will either improve or stay the same over the next 12 months, with only 20% expecting them to decline.

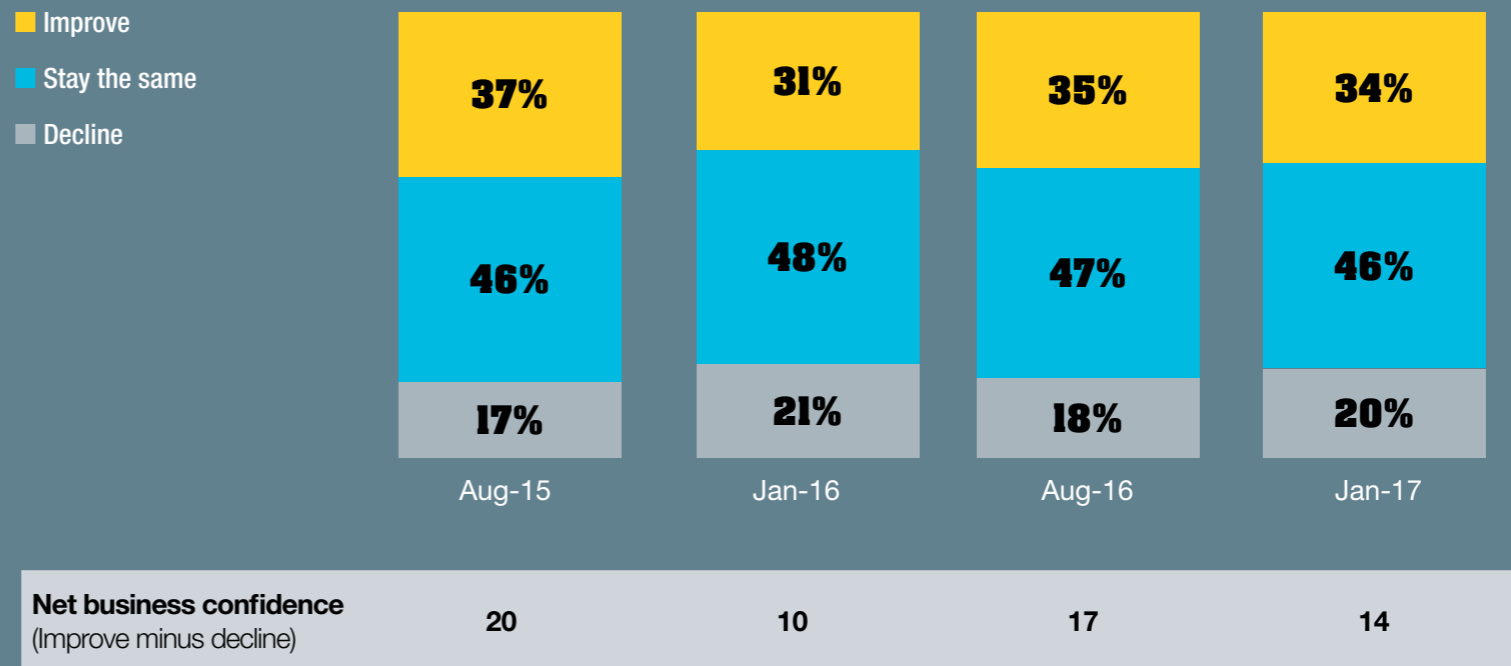
Meanwhile, successful retailers have been creating their own growth opportunities through innovation and business improvement. One in three retailers said they expect business conditions to improve in 2017. When asked why, they were most likely to say it was because of their business strategies (22%) or new business initiatives (15%), with only 9% relying on economic growth.

Many of those strategies are likely to involve an integrated customer experience across multiple channels. That's because multi-channel retailers were the most confident retail type in our survey, with 37% expecting better conditions ahead. In contrast, pure play online retailers have fallen back to earth, after riding high during 2016 on the back of strong digital sales growth. Meanwhile, bricks and mortar only retailers were least optimistic, with just 26% expecting conditions to pick up.

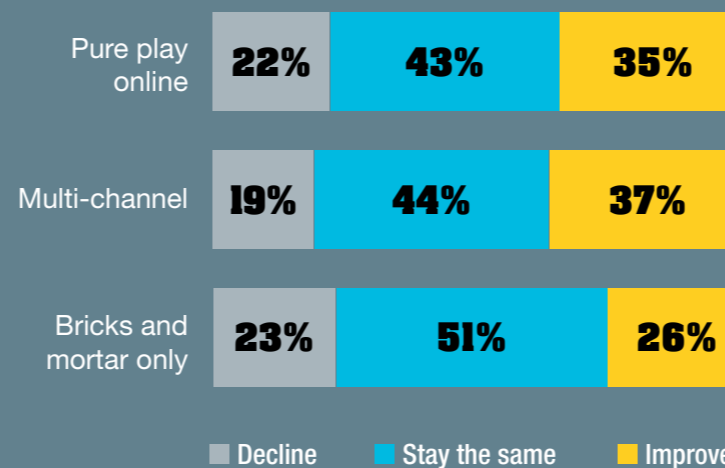
“Despite a struggling economy, managers and department heads have been reassigned and hired to ensure a strong presence moving forward.”

Homewares & Hardware multi-channel retailer, turnover \$1-\$10 million

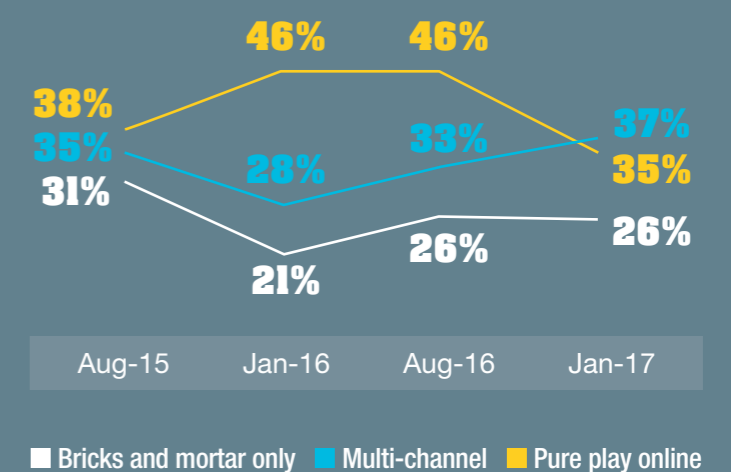
Forecast business conditions for the next 12 months



Confidence by channel, January 2017



Proportion expecting conditions to improve



Channel strategies

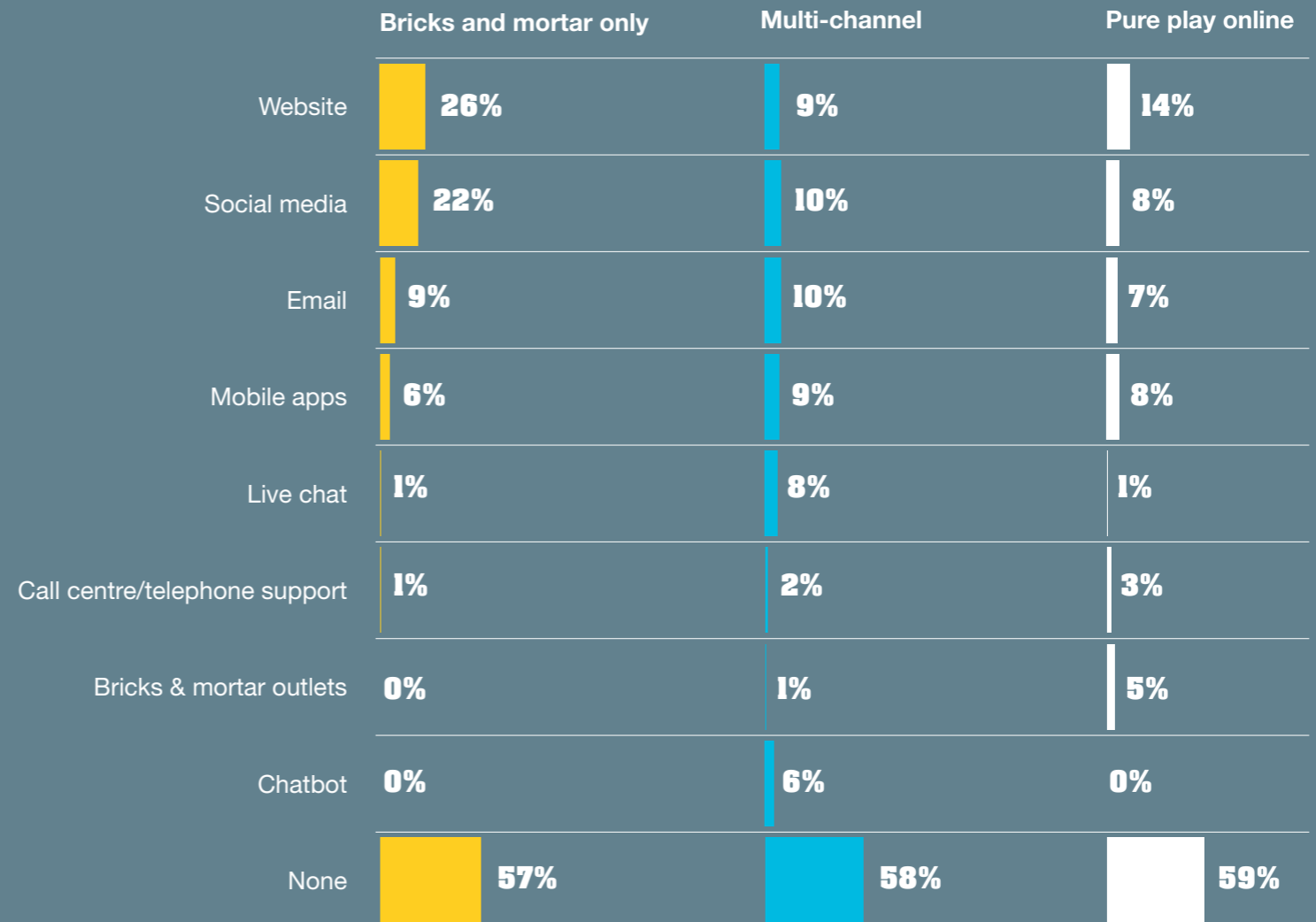
Given the apparent success of multi-channel strategies, it's not surprising many bricks and mortar retailers were preparing to expand into new sales channels. Forty-three per cent were planning to open at least one new channel, with a website (26%) or social media (22%) the most popular options. But 42% of multi-channel retailers and 41% of pure play online businesses were also looking to create additional channels, including 5% of online businesses planning to open physical stores.

At the same time, there has been some channel consolidation among existing multi-channel and online businesses. After growing strongly in 2015 to an average of 4.1 in January last year, the number of channels per multi-channel business has gradually fallen to 3.7 a year later. Similarly, the number of channels used by pure play online businesses has dropped from an average of 2.5 in August 2015 to just 2.0 in January 2017.

It appears that, after trialling a variety of options, many businesses have been choosing to consolidate their offerings by focusing on the most profitable. Email and mobile apps have become less popular among both multi-channel and pure play online businesses, while multi-channel businesses have become less likely to offer telephone support or to sell through social media. However, the number of businesses using live chat has grown steadily, although from a low base.

Channels planning to introduce in the next 12 months

Expanding online



Digital sales growth

The reason so many bricks and mortar retailers are moving online becomes very clear when we look at online sales growth. Looking at transaction volumes (rather than dollar values), the proportion of sales made online by multi-channel retailers jumped 61% between August 2015 and January 2017, from just 18% of transactions to 29%. Retailers forecast a further increase to 35% over the next 12 months.

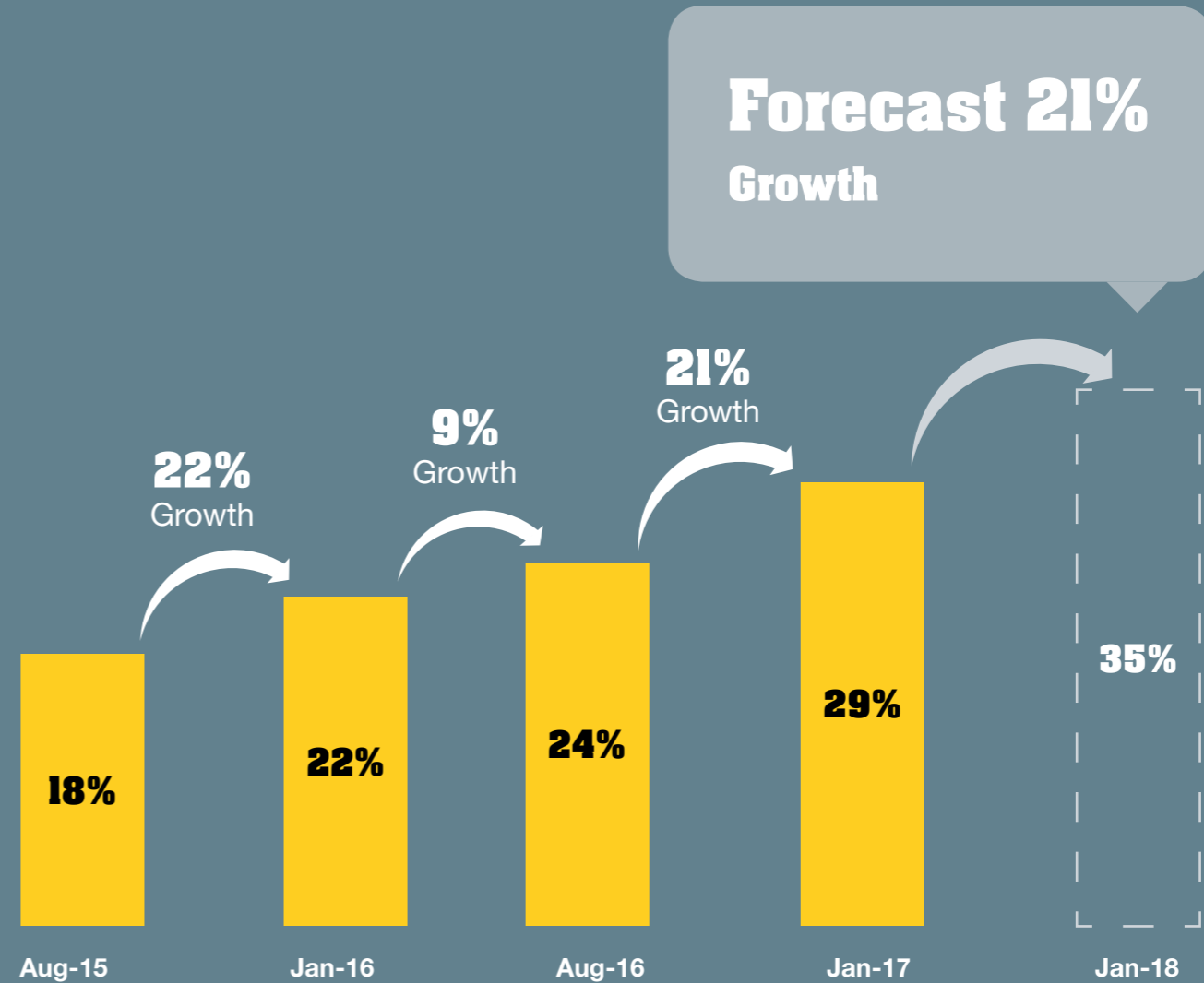
That forecast is likely to understate reality. Retailers have consistently underestimated future growth in online sales, predicting 24% growth over the 12 months from January 2016, compared to actual growth of 32%, and 20% in the year from August 2016 — a rise which was actually achieved in half the time.

“We’re now seeing businesses realise the benefits of a true omnichannel strategy, with a strong market presence driving traffic both online and on the high street.”

Jerry Macey

National Manager, Retail Industry,
Business and Private Banking
Commonwealth Bank of Australia

Online sales surge



Bricks and mortar growth

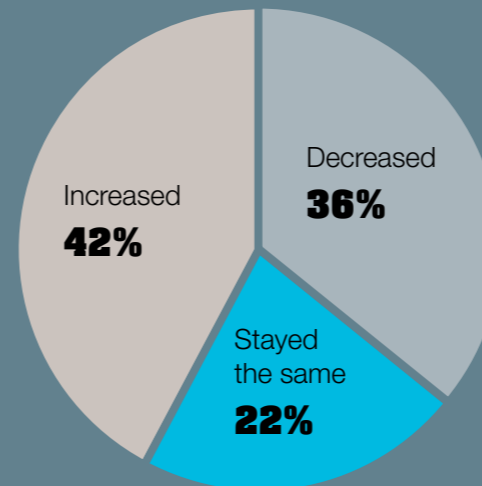
While digital sales have been rising strongly, a significant minority of bricks and mortar stores have also succeeded in driving growth. Here we see a striking divide between the 42% of retailers who have increased store foot traffic during 2016 and a similar number who have seen traffic decline. Some have responded by adding extra space, with one in four retailers reporting that their store footprint has increased — a significant result at a time when online sales growth offers the potential for businesses to achieve cost savings by shrinking their physical stores.

Meanwhile, around one in three retailers opened new stores in 2016, with the same proportion planning to add more outlets in the year ahead.

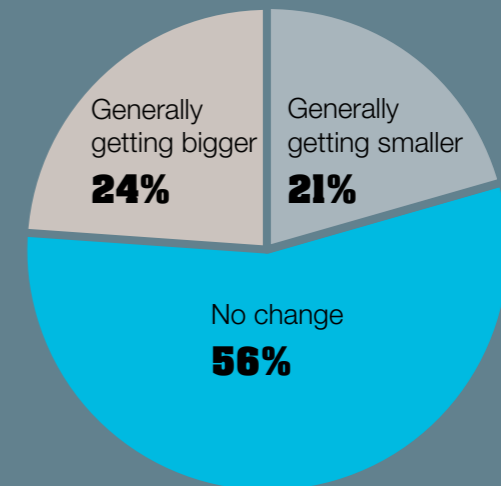
Much of that anticipated growth in store numbers was concentrated among larger businesses with turnover above \$10m and already operating more than 20 stores. Yet they were also overwhelmingly likely to be multi-channel businesses, with the largest cohort operating four channels or more — further confirmation of the benefits of an omnichannel strategy in driving growth.

Store growth

Change in foot traffic since January 2016

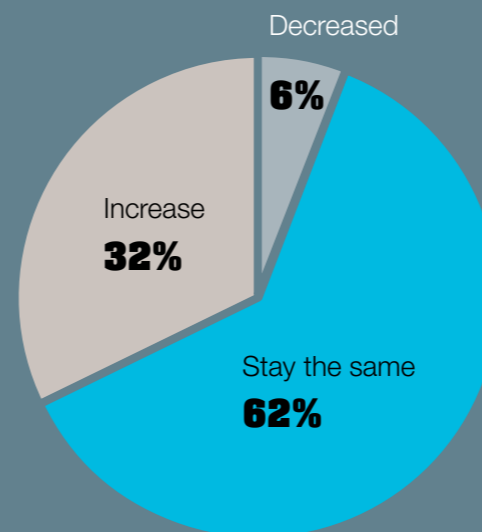


Changes in store footprint since January 2016

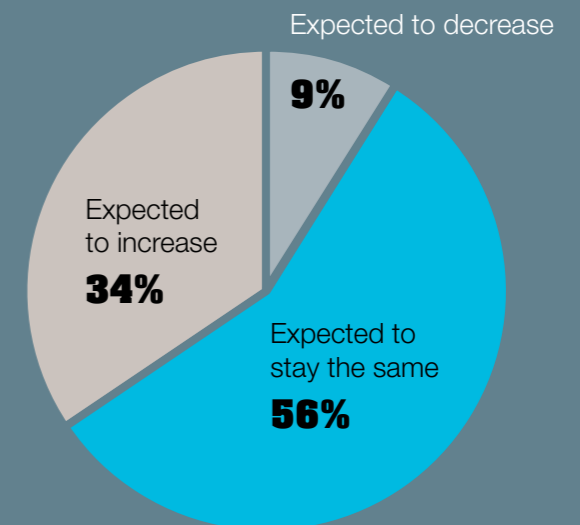


Number of stores

Growth since January 2016



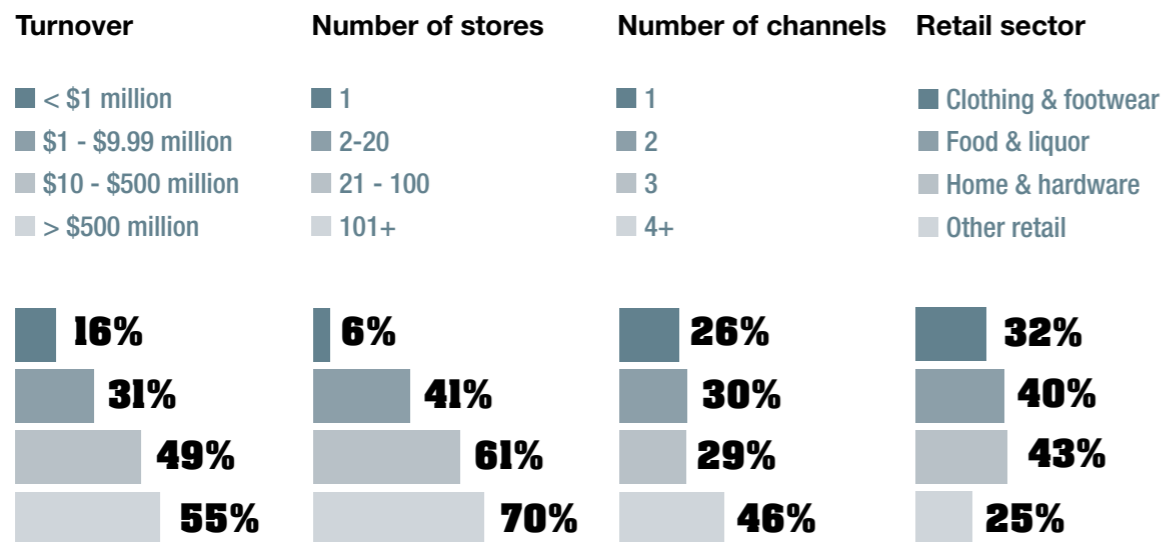
Forecast growth to January 2018



Who's growing?

Multi-channel businesses were also more likely to report increased foot traffic in 2016, with 44% saying customer visits had risen, compared to 33% of bricks and mortar only retailers. And increasing foot traffic was also strongly linked to enlarged store footprints. That leads to an interesting conclusion: businesses who are active online are likely to experience more foot traffic, and so have larger stores. It also raises the question whether these businesses could leverage their online growth more effectively with a strategy allowing them to reduce spending on physical infrastructure, delivering a higher return from their investment in online innovation.

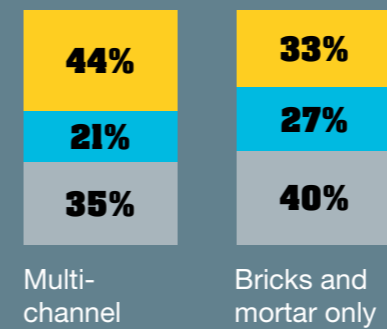
Percentage expecting to increase bricks and mortar stores in the next 12 months



Drivers of growth

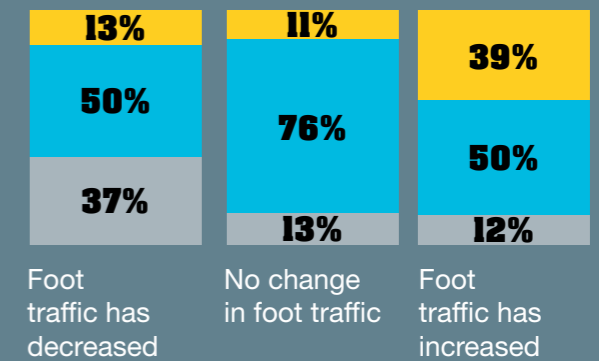
Foot traffic and channels

- Foot traffic has increased
- No change in foot traffic
- Foot traffic has decreased



Footprint and foot traffic

- Footprints are generally getting larger
- No change
- Footprints are generally getting smaller



Sector insights

Focusing on four leading retail sectors

Clothing & Footwear and Food & Liquor retailers are leading the innovation charge.

Clothing & Footwear

1 in 3

plan to open
new stores in
2017



Outlook

With low cost international entrants contributing to a spate of high profile business failures, it is no surprise that Clothing & Footwear is among the least confident sectors. But while only 30% expect better conditions ahead, fewer anticipate a further decline.

Forecast business conditions over the next 12 months

H2 2016

35% improve

47% stay the same

18% decline

H1 2017

30% improve

51% stay the same

19% decline

Innovation

When it comes to innovation, Clothing & Footwear retailers are highly focused on product quality as a key differentiator in a crowded marketplace. But social media, marketing and promotion are also high on their list of priorities, with many planning to launch a website (21%) or begin using email for marketing (14%) in the coming year.

Innovation focus areas

51% Quality of products and services

48% Social media, marketing and promotion

42% In-store customer experience

Growth

Clothing & Footwear retailers report the greatest decline in foot traffic. They are also the most likely sector to reduce the number of bricks and mortar stores in the year ahead.

Change in foot traffic (2016)

32% Increase

17% No change

51% Decrease

Planned change in store numbers (2017)

32% Increase

53% No change

15% Decrease

22% of multi-channel retailer sales by volume are generated from online orders

Food & Liquor

52%
increased
foot traffic in 2016



Outlook

Food & Liquor retailers have become less optimistic over the last six months, with almost half now expecting business conditions to remain unchanged in 2017.

Forecast business conditions over the next 12 months

H2 2016

41% improve

41% stay the same

18% decline

H1 2017

35% improve

48% stay the same

17% decline

Innovation

As well as introducing innovations in product quality and the in-store experience, Food & Liquor retailers are strongly focused on using loyalty programs to generate repeat business and increase market share. They are also the sector most likely to have undertaken structural change (40%).

Innovation focus areas

55% Quality of products and services

49% In-store customer experience

43% Loyalty programs

Growth

Food & Liquor retailers are the most likely to have grown their foot traffic, with one in two reporting an increase. Helping to drive that growth has been an investment in mobile apps and 'click and collect' services, assisting in creating a more unified experience across physical and digital channels.

Change in foot traffic (2016)

52% Increase

20% No change

28% Decrease

Planned change in store numbers (2017)

40% Increase

49% No change

11% Decrease

15% of multi-channel retailer sales by volume are generated from online orders

Homewares & Hardware

39%
expect
business conditions
to improve



Outlook

Homewares & Hardware is the most confident of the four sectors, and the only one to have seen optimism rise over the last six months.

Forecast business conditions over the next 12 months

H2 2016

32% improve

54% stay the same

14% decline

H1 2017

39% improve

46% stay the same

15% decline

Innovation

As well as seeking out innovations in customer experience and product quality, Homewares & Hardware retailers are focused on diversifying their offering, with products and services that allow them to capture a larger share of wallet. Many are also actively building their digital presence, with a relatively high proportion planning to introduce email marketing (14%), social media (13%) and mobile apps (11%).

Innovation focus areas

44% In-store customer experience

40% Quality of products and services

39% Diversification of products and services

Growth

Homewares & Hardware retailers are the most likely to open new stores in 2017, despite below average foot traffic growth. But they are also actively supporting their bricks and mortar outlets with a range of delivery services, including order in store and deliver (56%), click and deliver (51%) and return online purchases in store (50%).

Change in foot traffic (2016)

39% Increase

26% No change

35% Decrease

Planned change in store numbers (2017)

43% Increase

50% No change

7% Decrease

20% of multi-channel retailer sales by volume are generated from online orders

Other Retail

25%

plan to increase
store numbers
in 2017



Outlook

The outlook for the Other Retail sector continues to be subdued, with one in four expecting conditions to decline further.

Forecast business conditions over the next 12 months

H2 2016

32% improve

46% stay the same

22% decline

H1 2017

31% improve

44% stay the same

25% decline

Innovation

Overall, Other Retail businesses tend to be less engaged in innovation than other sectors, although many are still active. Social media, marketing and promotion are a key focus, helping to drive the sector's high online sales volume.

Innovation focus areas

37% Social media, marketing and promotion

34% Quality of products and services

31% In-store customer experience

Growth

While 42% have experienced higher foot traffic in 2016, just one quarter of Other Retailers businesses plan to open new stores.

Change in foot traffic (2016)

42% Increase

24% No change

34% Decrease

Planned change in store numbers (2017)

25% Increase

67% No change

8% Decrease

44% of sales by volume are generated from online orders

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