

Online retailing

A new era of agile commerce

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2 Overseas retailers have first mover advantage

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3 The response of major Australian retailers has been slow and unimaginative

In 2010 an alliance of major Australian retailers unsuccessfully lobbied the government to impose restrictions on international online retail. The campaign was a failure and the media coverage of “bargains” available from overseas may have prompted uninitiated consumers to join the growing army of online consumers.

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The ease of price comparison between retailers offering similar products has meant price competitiveness is arguably the key battleground online. However, research suggests the majority of online consumers are driven by non-price factors such as convenience and product range.

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Whilst the Australian online market has seen tremendous growth and the emergence of innovative pure play retailers, growth has not been matched with development and the market is still immature when compared with more established markets in the US and UK. There is much to learn but there is significant upside potential for those retailers who get it right.

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Can Australian bricks and mortar retailers successfully manage the transition into the new paradigm of agile commerce? The shift will be a difficult one and there will likely be some casualties along the way. The biggest impediment is the mindset of the retailers themselves.

9 Growth outlook

Despite the recent surge in online purchasing, Australia still has relatively low penetration rates (around 4%) as compared with markets such as the US and UK (around 7–10%). Given the similarities between these markets, the overseas penetration rates provide a guide as to where the local market is heading.

1 Introduction

During 2011, the growth of online retailing attracted considerable media attention. The incumbent bricks and mortar retailers preoccupied themselves with an ill-conceived and ultimately unsuccessful campaign against overseas retailers “muscling in” on their territory. In contrast, smaller domestic startups recognised and met growing consumer demand for online purchasing and were rewarded with astonishing growth.

There is no official data on the value of online purchases in Australia. A range of industry estimates, and analysis of credit card spending by the Commonwealth Bank of Australia (‘CBA’), suggests the market is currently around \$10 billion, representing approximately 4% of total retail spending. Of this, 40% is spent with overseas retailers.

The growth rate is staggering. CBA analysis of credit and debit card transactions suggests spending at pure online retailers has increased by 90% in the year to May 2011.

\$10 billion Estimated size of the Australian market

40% Overseas retailers’ share of the Australian market

90% Prior year growth

3–5 yrs Australian market trails the US and UK

59% Online customers who made only one online purchase last year

NIL Number of major Australian retailers who had an online presence in 2010

2 Overseas retailers have first-mover advantage

International retailers have moved quickly to capitalize on the growth of online retailing in Australia.

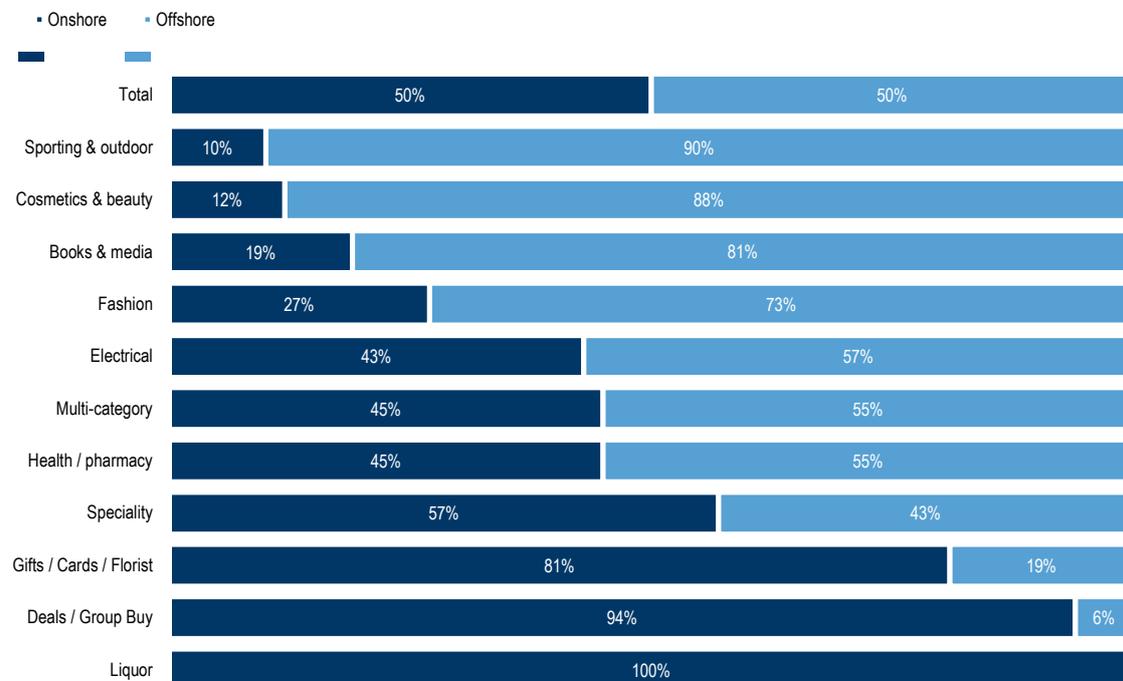
Estimates suggest as high as 40% of all online retail purchases go outside of Australia. This has been driven, in part, by a strong Australian dollar, growth in Asian Ebay merchants selling into Australia and an increased focus on Australia by US online retailers in particular.

The US focus is significant. The combined populations of Australia and New Zealand amount to only one third of the UK and Ireland's population, but in 2011, Australia became the largest customer for goods shipped outside of North America, with sales more than double those to the UK.

Australia's emergence as an online retailing market has been swift. During 2011, US sales to Australia grew 107% (compared with a world wide average of 58%) and now account for 30% of all overseas sales from the US.

The focus by US retailers on Australia has paid off handsomely and given the positive uptake, it will not be going away any time soon. Overseas retailers are increasingly offering a localised web presence with product prices and shipping in Australian dollars, in addition to the establishment of local returns warehouses.

Offshore penetration varies by product category



Source: CBA, Online Retail Data 27 July 2011

3

The response of major Australian retailers has been slow and unimaginative

The reaction of the major Australian retailers to the opportunities offered by online retailing has been disappointing.

In late 2010, an alliance of major Australian retailers (including Harvey Norman, Myer and David Jones) established the Retail Coalition to lobby the Australian government to impose restrictions on international online retailers selling into Australia. They argued that the exclusion of goods under \$1,000 from GST meant Australian retailers were unfairly disadvantaged.

The campaign was a failure. For those consumers who were already transacting online, it was acutely obvious they were motivated by something more than just a 10% price differential and for those consumers who had not yet ventured online, the considerable

media coverage of the “bargains” available from overseas may have prompted some to join the growing army of online consumers.

Consumers were not alone in rejecting the Retail Coalition. A government initiated investigation into the competitiveness of Australian retail by the Productivity Commission found retailer competitiveness was more influenced by rents and wages than the internet.

The campaign only served to highlight the lack of progress any of the major retailers had made towards establishing an effective online sales platform.

“Online people do not make any money. The whole world was conned with online retailing... it’s a con, a complete con. Sure, it has a future, but the problem is it costs a lot of money to do it properly. There’s an awful lot trying though. If you said to me in 50 years will people be successful, then yeah, but mostly not now.”

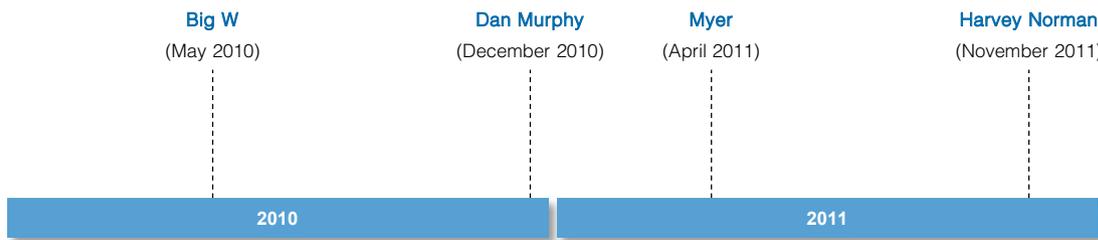
Gerry Harvey, in 2008.

Major domestic retailer inactivity has restricted the development of the local online sector

Despite the online activity of many smaller local retailers, the Australian online presence has, as a whole, lagged that of international retailers. Australia is estimated to trail behind the UK and US by three to five years. This lag is primarily due to the lack of online presence of the large domestic retail chains and department stores.

Anecdotal evidence suggests the failure to act is due in part to the lack of sufficient internal support from senior management of the larger domestic retailers, as well as the strong physical store presence in capital cities and metropolitan areas.

But the new paradigm could not be denied indefinitely. During 2010 and 2011, the larger retailers finally launched their own online stores.



For the larger retailers the move online was a reluctant one although it appears major retailers are now beginning to reap returns which may, in turn, encourage greater investment. Woolworths (which, in addition to online groceries, also sells online through Big W and Dick Smith) reported a 58% growth in total revenue from online sales in 2009/10, and is expected to see further increases in 2010/11 with the expansion of the Big W online website.

“Offline retailers in Australia need to get away from this attitude of moving online not to lose; they need to move online to win”

Daniel Jarosch, Co-founder of Styletread

Smaller Australian pure play online retailers are leading the way forward

Whilst the larger retailers hesitated, smart investors moved quickly to catch the Australian online retail wave and helped fuel the phenomenal growth of pure play online retailers.

- 34,000 Australian businesses transact online with PayPal, with no single operator controlling more than 5% of the market. Australia's largest retailers do not even feature in the top 10.
- Ebay has reinvented itself as an online sales platform for small and medium sized retailers. In early 2011, Ebay reported that six million Australians visit its website each month, with the website's top 2,000 Australian sellers recording revenue growth of 38% during 2010.
- The pure play retailers are nimble and innovative. It took less than a year from launch for StyleTread to raise \$4 million and become Australia's largest shoe retailer.
- Spreets (a group buying site) was in business for less than a year before Yahoo's Australian joint venture acquired it for an unconfirmed \$40 million. In May 2011, 40% of CatchOfTheDay was acquired for \$80 million.

“Australian businesses that are willing to experiment, innovate and learn from their customers and their peers could find themselves in the perfect position to exploit this growth”

PayPal, November 2010

4 It is not all about price

The ease of price comparison between retailers offering similar products has meant price competitiveness is arguably the key online battleground.

While the battle for a share in Australia's online spend is intensifying, it has not reached the ferocity seen in more mature online markets, such as the US.

Time will tell whether Australian consumers follow the path taken by their US counterparts, where aggressive purchasing tactics such as shopping around and splitting orders across a large number of online retailers has driven down margins.

Australia v US – key metrics

A 2010 survey of Australian online consumers confirmed price is the single largest driver for shopping online (nominated by 39% of respondents). However, the majority of respondents nominated something other than price.

Research recently undertaken by PayPal highlights a range of non-price related factors that are driving Australia's online expenditure. These factors include product range, website navigation, checkout experience, accessible customer support and packaging and handling solutions.

Demographic trends also suggest the explosion in online retail has been driven by convenience. An increase in the number of women returning to the workforce, along with busy work-home lifestyles and increasing time constraints, has led consumers to the convenience of online shopping.

	Australia	US
Average conversion rate	4.9%	2.9%
Cart abandonment rate	30%	55%
Average return rate	3.3%	8.0%
Average order value	A\$339	US\$132

Source: Online Retailing in Australia 2011: Performance and Channels, Forrester Research

Information asymmetry

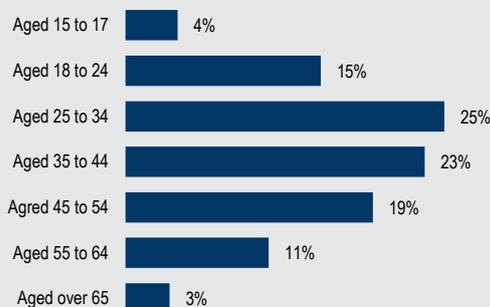
The economic theory of supply and demand assumes there is no cost in time or money to gather all the information you need to be a fully informed buyer or seller in a market. The reality is very different. Sellers (businesses) typically have the resources to obtain more information than buyers (individuals). This imbalance is known as information asymmetry and has allowed Australian retailers to enjoy higher margins by charging prices for globally available goods at higher prices than those charged in some other countries. Restrictions on

“parallel imports” have provided a safe haven for this practice to continue, at the expense of the Australian consumer. The internet is breaking down this model. Consumers are now able to obtain price information relatively easily for goods such as books, music, DVDs and branded apparel and, if they identify a lower price offered by an international retailer, they are able to order directly, thus breaking down the protection once afforded by national boundaries and geographic distance.

“What online does best is compete on price....That doesn't create value. It's a race to bottom”

Ron Johnson, ex Retail Vice President, Apple Computers

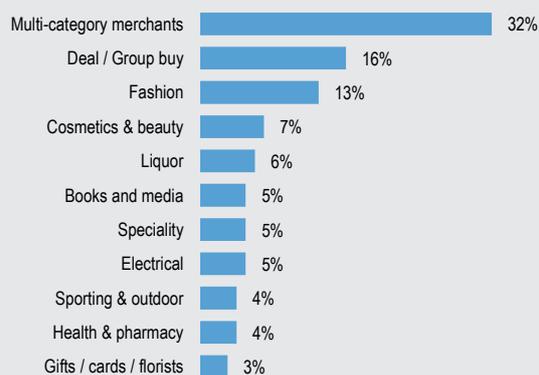
Who is buying?



While consumers aged under 25 are the most IT literate and most likely to early adopt, they lack the financial resources to account for a significant share of online sales. It is the 25 to 34 year old consumers who are the dominant purchasers. They are IT literate, demand the most innovative goods and services and have the financial resources to satisfy their consumer desires.

Source: IBIS, Online Shopping in Australia, October 2011

What are they buying?



Australia's love affair with deal sites continues... spend increased over 500% last year.

Product category competitiveness

	Books	Apparel
Price		
Prices often lower online	High	Medium
Digitized products create lower costs	High	Low
Value of price comparisons	High	Medium
Selection		
Value of broad assortments	High	High
Value of customisation	Low	Medium
Searches in store often futile	High	Medium
Convenience		
Research and information intensity	High	Medium
Web tools trump store experience	Medium	Low
Ease of delivery and returns	High	Medium
Trust		
Reliability of product descriptions	High	Low
Frustration in stores	High	High
Trust in online retailers	High	Medium

Online competition increases as online prices, selections, convenience and customer trust improve relative to physical stores.

Some product categories are more exposed to online retailing than others.

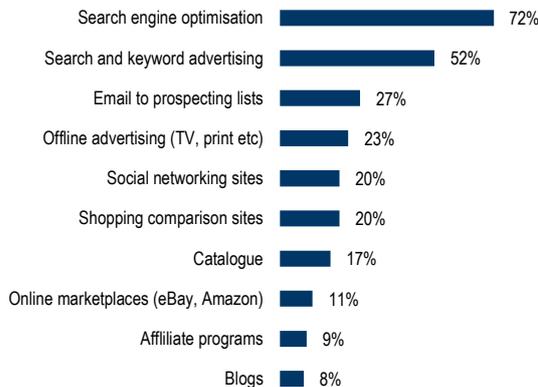
Harvard Business Review, December 2011

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Development has lagged growth – there is much to learn, but tremendous upside for those retailers who get it right

Whilst the Australian online market has seen enormous growth and the emergence of innovative pure play retailers, growth has not been matched with development and the market is still immature when compared to more established markets in the US and UK.

Top three most effective marketing sources



Australian online retailers remain focused on the basics of customer engagement. They recognize the importance of online marketing, though the focus to date has been on search engine optimization and search and keyword advertising. Online retailers rate these as the two most effective sources of marketing. This devotion is understandable as search and keyword advertising allows marketing dollars to be tightly controlled and ROI is easily measured.

Site investment priorities in the next 12 months



However, other forms of marketing will need to be engaged if online retailers wish to effectively compete with their international counterparts. Traditional offline advertising has been used to great effect by a number of startups, who have been willing to accept higher customer acquisition costs in order to accelerate their growth curve (such as big brand seller Ohki).

Affiliate marketing is currently grossly underutilized by international standards. Only 9% of Australian online retailers rank affiliate marketing as a top three marketing tactic, compared with almost half (49%) of US online retailers.

Source: Forrester Research

Marketing trends

Visual content drives sales

44% of Australian online retailers say multiple product photos are a top-three driver of sales.

Customer reviews build trust but are difficult to implement

Aside from technological issues, retailers are discovering customers do not rush to review products.

Social media does not drive sales but it builds brands

Facebook fan pages are becoming important forums for customer service.

Live chat growing off a very low base

Despite technology and resourcing issues, some retailers are trialling live chat.

Source: Online Retailing in Australia 2011: Marketing, Merchandising, And Customer Service, Forrester Research

6 Mobile Commerce = next paradigm shift

Australian retailers are making up some of the online retailing ground initially lost to overseas retailers, however, they still lack initiative in the dynamic sphere of Mobile Commerce.

Australia has the third highest 3G phone penetration globally and both domestically and internationally Mobile Commerce is driving a new wave of online spending. The adoption rate is dramatic. The volume of mobile data used by Australians during 2010 was 260% higher than in 2009 and in 2010 25% of Australians purchased goods online using their mobile devices. The increasing use of mobile devices will intensify price competition in some categories as consumers are able to access online price comparisons and product reviews from virtually anywhere. Opportunities for encouraging impulse purchasing will also increase.

Despite the new opportunities afforded by Mobile Commerce, many Australian online retailers have not yet optimized their mobile presence.

Mobile Strategy (Australian online retailers)



Source: The State of Online Retailing 2011: Marketing, Social and Mobile, Forrester Research

Key Mobile Metrics

Mobile investment	\$34,755
Tablet investment	\$14,628
Planned investment in coming year for mobile	\$220,893
Planning investment in coming year for tablets	\$144,054
Traffic from mobile browsers	4%
Tablet traffic (as a percentage of mobile)	21%
Online revenue through mobile	2%

Source: The State of Retailing Online 2011, Forrester Online

Whilst many retailers claim to have a mobile strategy in place, many have simply shoe-horned their existing web site into a mobile friendly site or smart phone application. Almost half (44%) of retailers in a recent survey said there was nothing outstanding about their mobile site.

Investment to date has been relatively modest, averaging \$34,755 per online retailer according to a recent survey. The focus has been on porting an existing online presence onto a mobile platform, without taking account of the additional features and flexibility that Mobile Commerce brings.

Planned investment is forecast to increase substantially (\$220,893 per online retailer), although it is not clear whether this additional investment will be targeting areas such as in-store product availability, store maps and layouts, bar code scanning, in-store navigation, and real time coupons for shoppers already in store.

Online revenue from mobile friendly sites currently accounts for only 2% of sales. However, it is anticipated that this will substantially increase and smart retailers are positioning themselves to capture this new market.

Video... the silent salesperson

Online video is used to inform as well as entertain. 37% of YouTube users are looking for information on a specific topic and “How to...” apparel related searches have increased threefold over the previous 18 months. Video is increasingly a silent salesperson for marketers.

Online video in Australia

10 million

Unique viewers

79%

Percent of internet audience aged 15+

60%

Percent of total population

9.41 million

Total videos

78 million

Total hours

89

Videos per viewer (per annum)

7.5

Hours per viewer (per annum)

“Following in the footsteps of the smartphone evolution, tablets are another device to watch as a potential game changer. The screen size is already attracting a slightly different patten of behavior to that of a smartphone, with a far greater proportion of tablet owners watching online video on their device. Ownership is already at 8% of online Australians, however purchasing intentions are expected to more than triple tablet ownership by the end of 2011.”

Nielson Online

7 Omnichannel retailing

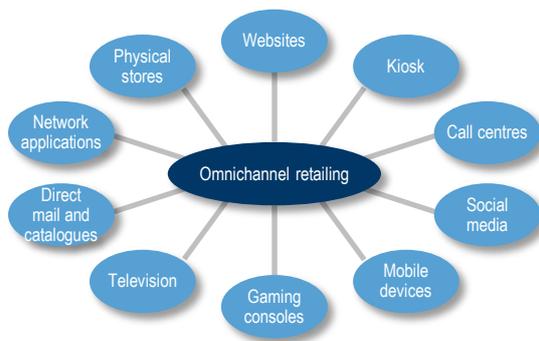
What is online retailing? As the sector develops it will become increasingly hard to define it, let alone measure it.

“Is it an ecommerce sale if the customer goes to a store, finds that the product is out of stock, and uses an in-store terminal to have another location ship it to her home? What if the customer is shopping in one store, uses his smartphone to find a lower price at another, and then orders it electronically for in-store pickup? How about gifts that are ordered from a website but exchanged at a local store” (Harvard Business Review, December 2011)

Omni-channel retailing aims to combine the advantages of online retailing with the advantages of traditional bricks and mortar retailing.

Advantages of online		Advantages of physical stores	
Rich product information	Broadest selection	Edited assortment	Convenient returns
Customer reviews	Fast checkout	Shopping as an experience	Instant access to products
Editorial content and advice	Price comparison and special deals	Ability to test, try on, or experience products	Help with initial setup or ongoing repairs
Social engagement and two-way dialogue	Convenience of anything, anytime, anywhere access	Personal help from sales associates	Instant gratification

Source: Harvard Business Review, December 2011



Forward looking retailers (both pure play online and bricks and mortar) are increasingly recognising that consumers are sales channel agnostic and they must meet consumer demands through a range of channels.

“I don’t see online retailing killing offline; I see offline and online gradually merging in ways that will benefit everyone – manufacturers, retailers and customers alike”.

Daniel Jarosch, co-founder of Styletread

“At the moment, there’s an artificial separation between online and offline retailing, but I believe you have to have a customer-centric view and for the customer, things haven’t changed that much. People still want choice, experience, access and a good price. So customers don’t really care if they are buying online or offline – they want both”.

Daniel Jarosch, co-founder of Styletread

8 A retail renaissance?

Can Australian bricks and mortar retailers successfully manage the transition into the new paradigm of agile commerce?

The shift will be a difficult one and there will likely be some casualties along the way. The biggest impediment is the mindset of the retailers themselves.

As online retailing takes an increasing share of the overall retail pie, the response of most bricks and mortar retailers is automatic – cut labour and reduce costs. But this approach initiates a vicious circle. Reduced labour equates to reduced in-store service, which erodes the differentiation between online and offline retailing. Without this, consumers are left with just price and convenience – areas in which online retailers have an advantage.

Given the changing retail landscape, the right response is actually greater investment in physical retail presence. Rather than being a cost liability, stores need to be seen as an asset. But retailers need to be much more creative about how they leverage their physical presence.

Digital technology can replace lifeless storefront windows with vibrant interactive screens that change with the weather or the time of day and are capable of generating recommendations or taking orders when the store is closed	Tablets can give sales assistants information about customers and can provide customized recommendations based on past order history or body types
Virtual changing room mirrors accelerate and enliven the dressing room experience by connecting customers with friends	Technology can eliminate checkout lines, capture transaction receipts and speed up the returns process

Source: Harvard Business Review, December 2011

The larger Australian retailers have not experienced breakthrough innovation. Their “retail is detail” approach and focus on store metrics such as same-store comparative sales and sales per labour dollar, means they are at risk of not seeing the wood for the trees. The most successful retailers will be those who adopt a “start over” mentality and are willing to reexamine and change all aspects of their retail offering.

“A store has got to be much more than a place to acquire merchandise. It’s got to help people enrich their lives. If the store just fulfills a specific product need, it’s not creating new types of value for that consumer. It’s transaction. Any website can do that...
...But if a store can help shoppers find outfits that make them feel better about themselves, for instance, or introduce them to a new device that can change the way they communicate, the store is adding value beyond simply providing merchandise. The stores that can do that will take the lead”.

Ron Johnson, ex senior VP for Retail, Apple

9 Growth outlook

Despite the recent surge in online purchasing, Australia still has relatively low penetration rates (around 4%) as compared with markets such as the US and UK (around 7-10%). Given the similarities between the US, UK and Australia, the overseas penetration rates provide a guide as to where the local market is heading.

Increased penetration will come from both breadth (attracting new customers) and depth (increasing the value and frequency of purchasing by existing online customers).

Power Shoppers

Some online shoppers spend more than others. A lot more. They place bigger orders, they come back sooner and they buy more frequently. They are “Power Shoppers”.

An analysis of purchases from US online retailers shows 10% of customers account for 40% of sales. Interestingly, the Australia and New Zealand region has a high concentration of Power Shoppers. Whilst accounting for only one third of the overall population of the UK and Ireland, the number of Power Shoppers in Australia and New Zealand is three times higher. Given these metrics, it is not surprising that US online retailers have targeted the Australian market so aggressively.

Retail giants will attempt to craft multichannel retailer experiences

Now they have entered the fray, large retailers will make up for their lack of speed and agility by leveraging their strengths: brand recognition, national scale, financial resources and the ability to serve customers across multiple channels.

Smaller retailers will focus on niches to sustain current growth rates

Having successfully rode the initial growth wave, smaller pure play retailers will need to refine their focus in order to continue to succeed. With little chance of competing directly with the larger retailers, they must refine their offering and exploit niches which the larger retailers are unable to service.

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