Retailers need to adapt to tighter times

By Nicola Mawson, Consumer Industries Correspondent

4 Jul 2008

Retailers will have to undergo a change in "lifestyle" to make it through the tightening economic cycle, commentators say. Cost cuts and risk reviews are in order.

KPMG's director of consumer markets, Daryll Jackson, says retailers will not be able to just ride the wave and come out the other side without basic changes. Retailers need a "lifestyle change, not a crash diet", he says.

South Africans have faced several interest rate hikes since June 2006, taking the prime rate from 11% to 15,5%.

Lullu Krugel, manager of KPMG Financial Services's Financial Risk Management division, says retailers are seeing the effects as consumers spend less on credit.

The rate hikes, coupled with higher fuel and food costs and higher debt levels, have resulted in consumers who recently were able to shop in higher-income outlets moving back down the curve to middle-income outlets.

The same has been seen with consumers downtrading from middle-income outlets to lower income outlets, Krugel says.

Statistics SA's personal insolvency figures, which Krugel says showed an increase of 4,7% in April from a year earlier, are a further sign that consumers are under pressure.

Clothing retailers are expected to see this more than food retailers as consumers avoid credit retailers such as Foschini and Truworths and spend at cash retailers such as Mr Price.

Furniture falls

JD Group chairman David Sussman said the furniture retailer saw a decline in credit sales of 19% and a 10% rise in cash sales in the half-year to February as fuel, food and interest rates were still climbing.

At furniture group Lewis, credit sales in the year to March fell to 67% of sales, from 69%.

While cash and food retailers are expected to feel the pinch, they will not be as hard hit as retailers selling higher value goods on credit, Krugel says.

Clothing retailer Edcon, which owns Edgars and Jet, said credit sales in the year to May slowed, although total sales rose

8,9%. Sales, it said, were affected by rising interest rates, escalating food and fuel prices, and implementation of the National Credit Act.

The group, which has more than 4-million active credit card accounts, says credit sales accounted for 53% of total retail sales during the year, down from 60% in the previous year.

Consumers are likely to avoid becoming further indebted, Krugel says, as they are spending more on debt than they did 10 years ago as a result of higher interest rates and a higher debt-income ratio.

Debt costing consumers more

KPMG has calculated that debt is costing consumers 10% more than it did a decade ago, allowing for inflationary effects on income, and they are spending more on servicing debt than ever before, Jackson says.

Reduced spending in the shops has been felt further back in the chain, with manufacturers cutting back on production, which will push inflation once demand grows again, Krugel says. Another inflationary factor is that wage increases are likely to be settled at about 11,4% on average in the second quarter, she says.

Inflation in staple foods lags the international situation, so wheat and maize will go up again, followed by animal feed and meat prices, Krugel says.

As a result, it will be some time before inflationary pressures ease. However, the effect of several interest rate hikes is starting to be felt, indicating that the end of the tightening cycle is near.

Jackson says retailers will have to respond through a step change in the way they do business, and this will mean long-term changes to their models. This will include reassessing risk and taking any additional costs out of the company.

One way retailers may cut back on exposure is to cut down or sell off their debtors' books, Krugel says. Woolworths has said it will sell a majority stake in its financial services division to Absa for R875m.

Jackson says retailers may also look for other revenue streams to bolster earnings in the longer term.

Source: *Business Day*

Published courtesy of

I-Net Bridge