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Alma Grove Consulting

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The Bricks and Mortar Dilemma. Retailers, Banks and Postal Services in Transition.

Did you hear the one about the shop, the bank and the post office ... ? This may be the joke in business schools in ten years' time – maybe earlier. Executives around the world are grappling with the dilemma of how to maintain networks of retail outlets – that in many instances

development of the new economy. However they have a common issue of what to do with extensive 'bricks and mortar' retail outlets. In particular they all are facing declining patronage (or footfall) and resultant under-utilization of these assets. There is also the added dilemma of

Is it clear that 'bricks and mortar' outlets in a state of decline ? Recent experience in developed economies suggests this is the case.

In the USA, the demise of chains such as Circuit City and Borders point to a terminal decline of large chains of retail outlets in some segments. A recent announcement by GAP Inc. that it will close about 200 stores by 2013 (approximately 21%) also suggests that something more structural is occurring.

For postal services the same issue is manifesting itself. Legacy retail networks - coupled with rapid changes in its business and industry structure – are forcing painful changes in the postal services' operating models.

The US Postal Service has reduced the number of retail outlets from 38,000 to

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Each of the three sectors (retail banking, postal services and retailing) face their own specific challenges from the rapid

what to do with changing demographics and urban development – which has in the past necessitated the opening up of new outlets as new urban areas are opened up. Do I still open new stores or branches ?

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approximately 31,000 in the past decade – with many thousands more expected to close in the next few years. The closures to date have not, however, been sufficient to restore profitability.

Banks are in a slightly better position. Whilst still looking to close retail outlets in many countries, a number of factors have relieved banks of the same level of pressure when compared to postal agencies and retailers. Banks have for many years now been developing operating models – particularly electronic banking platforms – to transition to.

All three need to determine what the future operation models look like and how they manage legacy bricks and mortar assets.

What are the key strategic considerations ?

Key considerations revolve around the nature of the threat to the current operating model, drivers of future customer preferences, and technology and demographic influences.

There are four areas to focus on are:

- Understanding the threat (or challenge) to the current operating model;
- ‘Biting the bullet’ and writing off existing legacy assets;
- Identifying a sustainable operating model to transition to; and

- Seeking out new, high growth segments in the existing business.

These four considerations will focus the planning on assessing the current landscape, identifying weaknesses in the current modus operandi and mapping out a transition path.

Understanding the threat (or challenge) to the current operating model.

In strategic planning there is

Retailers should likewise continue to seek out high growth geographic regions, products and segments. Areas of high population and/or economic growth should continue to be supported as they display similar characteristics as emerging or developing markets overseas.

always a temptation to renew a three or five year business plan with more of the same - and ignore looming threats that are considered still ‘over the horizon’. It is often only businesses that are facing immediate threats and have already seen earnings and market share eroded that make the necessary changes to transition to a new operating model.

Booksellers are one of the best recent examples. It was clear at least five or more years ago that the digital revolution was going to adversely impact booksellers. It was only a question of how quickly it would occur and what

specific form the take up of digital ‘ebooks’ would be. How many booksellers solely relying on bricks and mortar outlets moved with the requisite speed to a new operating model ? The winners and losers are evident today.

It is imperative to understand the nature of the threat, accept it and quickly develop a flexible strategy to adapt to the new environment as well as capitalize on new opportunities. Success

lies in not denying that change is occurring and ‘swimming against the current’.

Music companies also had advance notice that the digital revolution was underway. To their credit they realized that the profits generated from the sale and distribution of recorded music (in compact disc format at the time) were going to substantially diminish - and eventually evaporate. Record companies quickly adapted business strategies, operating models and focused on revenue streams that were not as much ‘at risk’ (digital royalties, tour

revenues, merchandising and related new media revenues).

For financiers, debt investors and equity investors it is likewise important to assess management's response to the changing environment. Are they aware of the changes - or in denial and reluctant to concede change is imminent? Are plans being implemented to adapt to a different - perhaps less profitable - future?

'Biting the bullet' and writing off existing legacy assets

Retailers, banks and postal services have all for a number of years been looking to increase the utilization of existing retail assets. For banks, this has entailed the cross sell of products and services such as financial planning. For some postal agencies this has included the sale of 'retail' products and/or financial services. It is worth however asking if this can be sufficient to create enough sales and margin to offset the decline in foot traffic and/or over the counter sales. I personally doubt that fundamental shifts in consumer behaviour can be arrested with incremental sales of non-core products. Not quickly enough anyway.

It may be inevitable that the whole - or parts - of the existing bricks and mortar networks may be irrevocably impaired. Many countries' accounting standards require an ongoing assessment of

the carrying value of all businesses and assets. The carry value of bricks and mortar networks may however be clouded by lack of clarity on the exact source of earnings and value of the customer franchise. The value may be incorrectly attributed to the retail distribution network. The pressure to write down (or even write off) 'bricks and mortar' assets may therefore not be there. Management should however critically assess the carrying value of what may be increasingly under-utilized and irrelevant retail outlets.

It is also worth reassessing future capital expenditures - including IT projects - that are biased toward supporting an increasingly redundant retail distribution channel.

Consolidation, right sizing or downsizing retail outlets may in the short term be a viable strategy - but will not in itself be sufficient.

Identifying a sustainable operating model to transition to.

Ok. Having identified the problem in the existing operating model - and reached a point of 'karma' about it - what do you do?

The key is working on quickly transitioning to a sustainable, competitive and viable operating model. It is absolutely critical to

be clear on what the future state looks like.

In Australia, the national postal service, Australia Post has been for a number of years transitioning to a freight and logistics business. Whilst still maintaining its retail postal network and universal service obligation, it has been tapping into the rapidly developing parcel business, leveraging off the boom in internet shopping. Whilst it still has to manage a declining volume of letters and documents it has a clear business and operating model to transition to.

Seeking out new, high growth segments in existing market.

It may perhaps not be all doom and gloom. Larger national and international businesses have for many years been seeking new, higher growth markets to offset mature or declining home markets. These markets are usually emerging and developing markets - with all of the usual challenges. For smaller, national businesses that do not have the risk appetite for overseas expansion, it may be possible to maintain higher rates of growth at home.

This can be by identifying 'emerging markets' in your own backyard. Australia Post, referred to earlier, identified the express post and parcel delivery many years ago as its 'emerging market'.

Similarly, telecommunications businesses in many countries around the world have effectively transitioned their retail businesses from simple bill payment outlets to consumer electronics retailers, selling smart phones, laptop computers, home network solutions, and more recently ipads and other tablet computers.

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growth should continue to be supported as they display similar characteristics as emerging or developing markets overseas.

It is important to note that much of the foregoing analysis and comment only applies to mature or developed markets. In emerging markets – be they in Asia, Africa or South America - high population growth and increasing incomes can readily support (and demand) new ‘bricks and mortar’ outlets, even with the parallel adoption of new technologies.

By asking the above questions, an developing strategic plans to be less tied to the existing operating model – and possibly ‘biting the bullet’ on legacy retail networks – will enable an organization to better cope with the competitive landscape in a *newer* economy. The future is clearly less bricks and less mortar. But hopefully one in which the house doesn’t collapse.

Peter Deans

Risk Management in Business

SPOTLIGHT ON: DEBTOR DEFAULT RISK

This month we continue the regular series on the identification, assessment and management of a specific category of risk in the business world.

In this newsletter we focus on a Financial Risk – Debtor Default Risk. This is the risk of loss from a debtor failing to make a payment or payments due. This can be due to an unwillingness or inability to pay for a variety of reasons - but most commonly due to financial distress on the part of the debtor.

Debtor Default Risk for a firm or organization is of course only a material issue if it is a large sum of money (perhaps stating the obvious) or reflective of broader

systemic issues in the granting of trade credit (or subsequent deterioration in a group of debtors). A debtor that defaults owing a small sum of money – whilst an inconvenience (and possibly a loss of a customer) – does not cause any impairment of the business that is owed the money. The amount of money owed and the impact on the creditor are the two critical issues.

Key steps to ensuring that a firm identifies, quantifies and effectively manages Debtor Default Risk will include:

- Establishment of rigorous processes to establish credit limits for all new and existing debtors, to ensure reporting and monitoring of amounts owed

against these limits and to ensure management and recovery of delinquent debtors.

- Undertaking a business and financial assessment of all existing and prospective debtors. This should entail some form of due diligence on the ownership/management of the customer, credit rating/ reference agency assessment and/or a review of the customers’ financial position (particularly if significant amounts of trade credit are sought / being extended).

- Exploring avenues for extending trade credit with the counterparty – even if credit weaknesses are identified. This may include the upfront

provision of security or credit enhancement (parent or directors' guarantees, bank guarantees or trade credit insurance).

- Ensuring that signs of financial distress are identified early and acted upon. Action taken can include cessation of trade credit, amendment (shortening) of trade terms, and the taking of formal security for new debts created.

From a macro (or portfolio) perspective the key is to ensure that a business has a well-diversified portfolio of trade debtors. As with the previous risk categories covered, identification, quantification and regular reporting of the potential risk is the first step.

Next Month in the *Risk Management in Business Series*:

SPOTLIGHT ON: REPUTATION RISK

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