

## Australia Retail: Evolving in an E-commerce Era

- Amazon's entry has spurred online sales, but overall penetration rate remains low
- Retail mall prospects supported by brisk population growth and tightening supply
- Key for retail malls to position themselves as lifestyle destinations to stay relevant

### Introduction

In this follow-up to our previous paper "[Retail Real Estate: Brick-and-Mortar's Silver Linings](#)", we take a closer look at how online retail has impacted Australia's retail market since Amazon's entry. We then discuss why brick-and-mortar retail is still relevant in Australia despite the advent of e-commerce and how landlords can work with tenants to attract shoppers to malls.

### Faster growth in online retail sales

Australia's retail sector is supported by favourable macroeconomic conditions such as a strong labour market, growing population and an increase in tourist arrivals. Retail sales in Australia expanded by a compound annual growth rate (CAGR) of 3.0% between 2015 and 2018 to reach AUD321 billion.

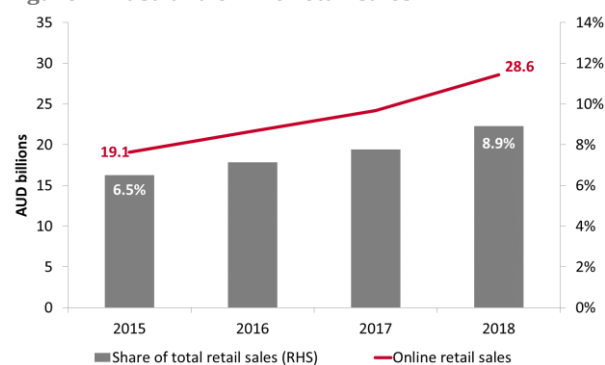
Partly due to a low base, online retail sales rose by a much faster pace of 14.4% to reach AUD28.6 billion in 2018<sup>1</sup> (Figure 1), with the share of online retail sales increasing from 6.5% in 2015 to almost 9.0% in 2018. The strong growth in online retail sales was driven in part by Amazon, which has expanded its own product line and network of third-party sellers since it entered the Australian market in December 2017.

Online retail sales were also lifted by the following:

- Brick-and-mortar retailers strengthening their online capabilities;

- Improvements in the supporting infrastructure. For example, the development of new logistics facilities such as Toll's and Amazon's fulfilment centres in Sydney has resulted in shorter delivery times and lower cart abandonment rate; and
- An increase in the number of "buy now, pay later" services providers (e.g. AfterPay) and partner merchants, which has helped to reduce the upfront cost of purchases.

Figure 1: Australia online retail sales



Source: ABS, NAB, KepCap Research

### Fears of "retail apocalypse" overblown

Despite the strong growth in online retail sales, we think the fears of Amazon triggering a "retail apocalypse" in Australia have been overblown. Certain retail categories such as food retailing and cafes, restaurants and takeaway food services, which together account for 55% of total retail sales in Australia, have been less impacted by e-commerce.

<sup>1</sup> NAB Online Retail Sales

Food retailing, the largest retail segment in Australia, recorded the lowest online penetration rate of 3.5% in 2018 (2017: 3.2%), indicating that the growth of online food retailers has been limited (Figure 2). We expect this trend to continue going forward, as studies have shown that a large majority of consumers globally still prefer to shop for fresh / perishable groceries in-store where they can see and feel the products.

Similarly, the online penetration rate of takeaway food services has only risen marginally in 2018. Food delivery operators are struggling to expand their coverage beyond metropolitan areas, where a lower housing density and limited number of physical food outlets make it challenging for food to be delivered hot and on time.

Figure 2: Retail sales growth by category



Source: ABS, NAB, KepCap Research

Non-perishable products that target consumer convenience saw a higher online penetration rate. For instance, media and recreational goods had the highest online to in-store sales ratio of 74.7% in 2018, up from 61.2% in 2017. Growth was mainly supported by digital distribution platforms (e.g. Amazon Video, Kindle, Netflix, Spotify) which allow consumers to purchase and access various audio, print and video media from their electronic devices without having to visit a physical store.

## Logistical challenges limit future online retail sales growth

Further growth in online retail can be expected as Amazon and traditional retailers alike continue to

bolster their presence in the e-commerce space. The online penetration rate in Australia is expected to reach 14% by 2023<sup>2</sup>, from ~9% in 2018. This is still low compared to the current level of e-commerce penetration in other Asia Pacific countries such as China and South Korea (Figure 3).

Figure 3: Retail e-commerce by market share

	E-commerce as % of total retail sales
China*	18.4%
South Korea	13.9%
Global	11.9%
US**	9.6%
Japan	9.0%
Australia***	8.9%

Sources: NBS\*(2018), US Census Bureau\*\*(2018), NAB\*\*\*(2018), Statista (2018)

However, the current pace of online retail sales growth may not be sustained over the medium and long term, in part due to logistical challenges. Australia's low population density is and continues to be a major hurdle for pure-play online retailers such as Amazon, which are struggling to provide speedy deliveries to customers residing in non-metropolitan areas. This challenge is especially apparent in groceries and takeaway food services, which are more time-sensitive in terms of delivery needs.

The cost of setting up additional fulfilment centres to improve last-mile delivery could also be prohibitively expensive for online retailers, as Australia has one of the highest minimum wages in the world<sup>3</sup>. Indeed, Australia's online retail sales might already be displaying signs of fatigue, as growth eased to 4.4% yoy in 2M2019<sup>4</sup>.

## Fundamentals of brick-and-mortar retail remain positive

Notwithstanding the growth in online retail, we think that the underlying fundamentals for brick-and-mortar retail remain positive.

### Household consumption holding up

In the near term, positive consumer sentiment will help support retail sales and correspondingly the

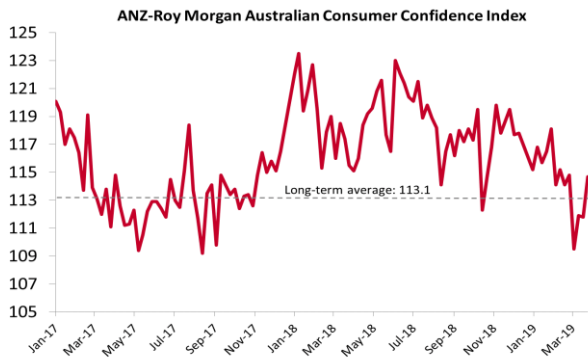
<sup>2</sup> UBS

<sup>3</sup> Institute of Economic and Social Research, Minimum Wage Database, Jan 2018

<sup>4</sup> NAB Online Retail Sales

retail property market. Consumer confidence was positive in 1Q2019, hovering above its long-run average, boosted by a combination of a strengthening labour market and expectations of additional income tax cuts under the FY 2019-20 Federal Budget (Figure 4). Total retail sales rose 3.0% yoy in 2M2019, matching the pace of expansion in 2018, with growth primarily supported by food retailing (+4.6% yoy).

Figure 4: Consumer confidence has largely remained above the long-run level in 1Q2019

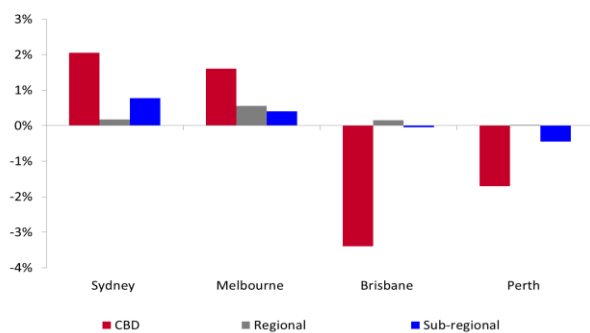


Source: ANZ-Roy Morgan, KepCap Research

**Demand-supply imbalance to diminish**

Despite the strong growth in online retail sales, retail rents were relatively steady in 2018, with regional and sub-regional shopping centres performing better than CBD rents (Figure 5). Rental growth going forward could recover further as the demand-supply dynamics improve.

Figure 5: 2018 retail rents, % yoy change



Source: JLL

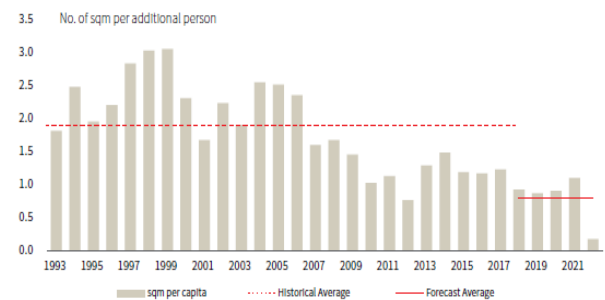
On the demand side, while some brick-and-mortar retailers have inevitably rationalised their physical

footprint or exited the Australian market entirely, the number of store closures in 2018 is still only less than 1% of Australia’s total store count<sup>5</sup>.

Landlords have actively backfilled the vacated space with tenants that are more resilient to e-commerce (e.g. supermarkets). The entry and expansion of international brands such as Lotte Shopping, Aldi and JD Sports Fashion have also helped to absorb the void in retail space. Correspondingly, Australia’s overall shopping centre vacancy rate rose only marginally from 2.9% in December 2017 to 3.2%<sup>6</sup> in December 2018, broadly on par with the historical 10-year average.

Pipeline supply is also limited. The rate of new retail supply will slow to 0.8 sq m per additional person from 2019 to 2022, less than half the historical long-term average of 1.9 sq m per capita<sup>7</sup> (Figure 5).

Figure 5: Growth in retail supply per capita to taper over the next four years



Source: Deloitte Access Economics, JLL Research

The growth in new retail supply per capita may be even lower in Melbourne and Sydney, where populations are projected to expand by a faster pace of 2.2% and 1.8% p.a. (compared to nationwide population growth) respectively over the next 10 years on the back of overseas migration. Interstate migration could also boost population growth in Brisbane and Perth and further reduce the level of new retail supply per capita in these two cities as well.

As the demand-supply imbalance diminishes, retail rental growth could recover. Growth will be led by Sydney, Melbourne and Brisbane, which continue to be appealing destinations for international retailers

<sup>5</sup> JLL

<sup>6</sup> JLL

<sup>7</sup> JLL, Australian Shopping Centre Investment Review 2019, Mar 2019

given their booming urban populations and tourist markets.

### Brisk population and tourism growth

Over the longer term, the biggest driving factor supporting Australia's retail sector is the country's population, which is projected to expand by a CAGR of 1.5% from 2018 to 2028<sup>8</sup>. This is nearly four times the 0.4% growth projected for other high-income countries<sup>9</sup>. Australia's population growth will be led by the 35-44 age cohort, which is forecasted to increase by 800,000 p.a. (2.2% CAGR) over the next 10 years. This would have a positive bearing on retail sales in view that household consumption peaks between the ages of 45 to 54<sup>10</sup>.

Australia's retail sales would also get a boost from a sustained rise in both tourist arrivals and spending, which are projected to expand by 5.8% and 6.7% p.a. respectively over the next 10 years<sup>11</sup>. Growth will be led by Asian markets such as China and India, with the rapid growth in their middle-class populations.

### Imperatives for retail mall owners

While the medium and long-term fundamentals for the retail sector remain positive, amid the changing retail landscape, landlords need to undertake more proactive asset management measures to reposition and revitalise their malls. The immediate priority would be to shift the tenant mix towards non-discretionary sectors least disrupted by e-commerce such as supermarkets to navigate through any potential slowdown in retail sales. The resilience of Australia's grocery sector is certainly not lost on foreign retailers, with German supermarket giant Kaufland announcing plans to open 32 stores in Australia by 2023<sup>12</sup>.

To increase the appeal and relevance of shopping malls over the longer term, landlords need to work closely with tenants and the broader community to position their shopping malls as not just a place for retail, but as one-stop destinations where consumers can socialise, experience new food and entertainment concepts and receive personalised

services. Indeed, a majority of respondents surveyed by Monash Business School (65%), Mood Media (79%) and UBS (82%) indicated that there is still a place for brick-and-mortar stalls despite the growing prevalence of e-commerce. Key reasons cited included the need to touch and feel the product as well as relishing the experience of shopping in-store. Correspondingly, landlords should capitalise on this by adopting the following initiatives:

#### 1) Community and cultural events

Regional malls can make use of common areas or unutilised surface parking space to host community and cultural activities, which would enable them to forge a closer bond with the local community. For instance, Southgate Melbourne's partnership with German restaurant Hophaus to host a series of Oktoberfest activities resulted in a 45% increase in average Saturday footfall in September 2018<sup>13</sup>.

#### 2) Explore mixed-use opportunities

Retail mall owners can extract additional value from their sites by adding residential, office or hotel above or next to the centre. Capitalising on Melbourne's status as Australia's tourism capital, Vicinity is developing a luxury hotel which will be situated next to its newly refurbished Chadstone shopping centre. The benefits are complementary, with guests from the hotel generating additional footfall for the mall while the latter provides tourists with convenient access to a wide range of large-format international flagship stores and entertainment options that could increase their length of stay.

#### 3) Diversify floor space towards consumer services tenants

Consumer services tenants (e.g. children's entertainment, finance and insurance, gym) are less affected by e-commerce. With traditional and discount department stores expected to reduce their footprint in the near term, there lies opportunities for landlords to backfill the space with such tenants. This is an important consideration for sub-regional malls, which on average lease out a quarter of their floor space to discount department stores<sup>14</sup>.

<sup>8</sup> ABS

<sup>9</sup> United Nations Population Division. High-income countries include Canada, Germany, Hong Kong, Japan, Singapore and US

<sup>10</sup> RBA, The Distribution of Household Spending in Australia, Mar 2014

<sup>11</sup> Tourism Research Australia, Tourism Forecast Aug 2017

<sup>12</sup> [www.insideretail.com.au](http://www.insideretail.com.au)

<sup>13</sup> [www.shoppingcentrenews.com.au](http://www.shoppingcentrenews.com.au)

<sup>14</sup> CBRE, Sub-regional Shopping Centres – A Case of Middle Child Syndrome', Nov 2018

Landlords will also be able to improve customer engagement and dwell time by attracting consumer services tenants that cater to the profile of shoppers in the surrounding community. For instance, Australian Seniors Insurance Agency opened its first physical store in Castle Towers Shopping Centre, located within the New South Wales suburb of Castle Hill. The insurer had noted that Castle Hill featured a higher proportion of persons aged 60 and above who prefer to visit a physical store to get a quote or purchase an insurance.

## Conclusion

Despite the advent of e-commerce, surveys have shown that consumers will continue to shop at brick-and-mortar shops. As highlighted earlier, certain categories of online retailers are unable to compete effectively with their in-store counterparts due to logistical challenges. In addition, there are non-price, intangible benefits of shopping at a physical mall which cannot be replicated online, such as getting personalised services and being able to socialise with other like-minded shoppers. Landlords can capitalise on this by repositioning their malls as lifestyle destinations offering a variety of retail, entertainment and consumer services that are tailored to the profile of the surrounding community. Retail malls that manage to evolve will thrive better in today's digital landscape.

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