

Interchange alert



Retail: more consolidation to come

Rigorous and disciplined restructuring tactics that focus on significant cost controls have strengthened many retailers' balance sheets in the past two years – allowing them to survive and in some cases even thrive in this protracted recession. That's no small feat in an environment of continuing economic uncertainty, weak demand, margin erosion and ongoing scarcity of capital. In fact, some cash-generating retailers are beginning to build up war chests that will likely be used to make small, targeted strategic acquisitions.

Their prey will be those retailers that either have not kept up with consumer trends or have not established a strong online presence. Many industry watchers expected more of a shakeout this past year and foresee continued consolidation over the next six to 12 months.

Cost cutters

The emerging alpha retailers draw their strength from stringent cost-control and cash management actions they have taken – and continue to take – to optimize and preserve liquidity. These businesses are keeping an extremely tight leash on inventory. By buying 5% to 20% less inventory than last year, they won't need to deeply discount merchandise to move it out of the stores. They are also continuing to hold back on all capital expenditures, delaying store openings and remodeling, as well as updating information technology and closing underperforming stores.

In addition, these retailers are keeping advertising, marketing and store payroll costs down. Finally, they are continuing to improve the sourcing of product through private label sales which helps to control margin erosion. Overall, the last 18 months has seen the well-positioned retailers create the necessary flexibility to monitor risk, streamline their businesses and become much more focused on the execution of their operations.

Still not out of the woods are the high-end retailers and consumer product apparel companies. While they have also benefitted from cost-cutting measures, consumers have yet to return to luxury brands in the numbers that would signal a bottoming of their business cycle.

Building war chests

Though credit is still scarce, the surviving mass merchandisers, mid-tier and specialty retailers are building significant cash war chests. How? Through the prudent positioning and reshaping of their businesses to align with an extended downturn, fragile recovery and what looks to be a long-term shift in consumer demand.

As value-conscious consumers purchase the higher-margin private label store brands, it is these retailers that are generating cash. What's more, when competitors filed for bankruptcy last year, their sales and market share were picked up by the survivors. These trends are pushing up some store sales by a modest 1% to 3% increase over last year.

With their balance sheets shored up, such businesses are in a position to make growth buys as the economy slowly improves. Rather than purchase the larger chains facing bankruptcy, they are likely to focus on their core strategies, adding complimentary brands that expand their footprint and support existing business.

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Other trends

Other players that may take advantage of continuing flux in this sector are the private equity (PE) funds. Some PE firms are acquiring select small retailers and "orphaned" models such as the catalog business. PEs also are quietly beginning to shop their retail holdings in an effort to monetize them.

Another area of growth is the trend for retailers to enhance their web presence. Those retailers with strong web distribution channel are doing better and will continue to see strong growth as consumers increasingly migrate online.

To be sure, as retailers adapt to the "new normal," they need to continue to manage their capital agenda and keep operations nimble and flexible in order to maintain their competitive advantage as the economy recovers.

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