

Amazon's Expansion into Australia

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After a great deal of speculation, on April 20 2017, Amazon.com (Amazon) announced that it will be extending its range of retail services in Australia over coming years.

“Amazon Web Services launched an Australian region in 2012, we launched a Kindle Store on Amazon.com.au in 2013, and we now have almost 1,000 employees in the country. The next step is to bring a retail offering to Australia, and we are making those plans now. We are excited to bring thousands of new jobs to Australia, millions of dollars in additional investment, and to empower small Australian businesses through Amazon Marketplace. We are optimistic that by focusing on the things we believe customers value most – low prices, vast selection, and fast delivery – over time we’ll earn the business of Australian customers.” (Jeff Bezos, Amazon CEO)

What is Amazon?

Amazon is an American e-commerce company that was founded in 1994. The company started as an online bookstore, however, later diversified to sell a full range of products via a multi-level e-commerce platform. According to the company's financial results, as at 31 December 2016, Amazon employed approximately 341,400 full-time and part-time persons globally. During 2016, Amazon recorded net sales of \$136 billion, having grown by 28% from 2015 (excluding the effect of foreign exchange rates). The company currently employs more than 1,000 persons in Australia.

The company's first line of business is selling products directly to consumers through its web services. In addition to this, Amazon owns and operates **Amazon Marketplace**, numerous e-commerce platforms that allow third-party sellers to sell new and used products. Businesses and sole traders are able to list their products on the marketplace free of charge, paying a percentage of revenue from their sales to Amazon. There are currently 11 marketplaces across North America, Europe and Asia. According to the CEO of Amazon (Jeff Bezos), close to 50% of all items sold on Amazon websites globally are through Amazon Marketplaces. While Amazon Marketplace does not currently operate in Australia, it is reported that more than 1,000 Australian businesses currently sell their products on existing overseas Marketplaces. Amazon offers third-party sellers on its Marketplaces a '**Fulfilment by Amazon**' (FBA) service in which goods can be stored, picked, packed and dispatched on behalf of the seller. According to the company's financial results, the number of active sellers using this service grew by 70% from 2015 to 2016.

Amazon also operates its **AmazonFresh** business, a grocery delivery service currently operating across the US, London and Tokyo. Amazon charges customers a monthly fee to use the service with items delivered to the customer on the same or next day. The company is currently trialling a pickup service in which customers reserve a time to pick up the groceries and have them loaded into their car for them. The **Amazon Prime Pantry** service is available for Amazon Prime members, which involves the delivery of everyday (non-bulk), non-perishable grocery items into a single box for a flat fee.

The **Amazon Prime** membership, is an annual membership, which, amongst other services and offerings, gives customers free express shipping on over 50 million items for an annual fee. **PrimeNow** is available in selected locations, and offers free two-hour delivery or one-hour delivery for a cost of US\$7.99. While the number of Prime members is undisclosed, membership has grown considerably during recent years. According to the company's financial results, “tens of millions of new paid members joined the program” in 2016. Amazon is also currently trialling its **Prime Air Delivery** service in the UK, a delivery system using drones to deliver goods within 30 minutes.

In late 2016, Amazon announced that it would open its circa-170 square metre **Amazon Go** grocery store in Seattle during 2017. The store allows Amazon customers who have a supported smartphone to enter the store, take the products they want to purchase and leave without going to a checkout. In-store technology detects when products are taken or returned to shelves and after finishing shopping, the customer's Amazon account is charged.

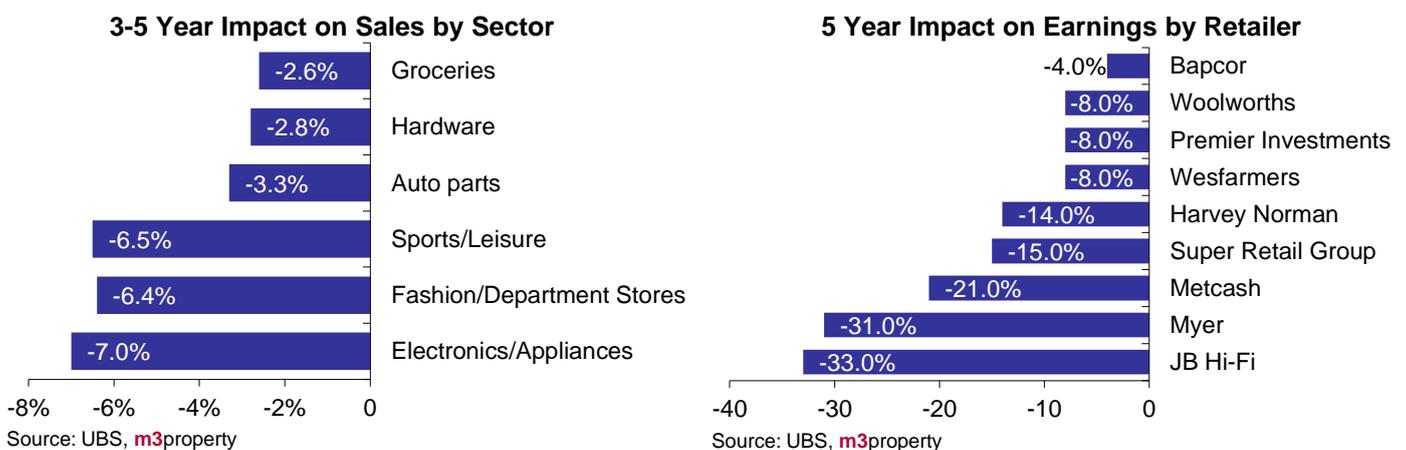
Online Retailing in Australia

In the 12 months to March 2017, Australians spent \$22.23 billion online, representing 7.3% of what was spent in bricks and mortar shops (NAB, March 2017). According to NAB, approximately 80% of money spent online is through domestic retailers. Compared with the US and UK, the online retailing market is considered to be relatively immature in Australia. It has, however, grown considerably during recent years, with year-on-year growth of 9.0% recorded from March 2016 to March 2017. Homewares (19.9%), Media (17.3%), Groceries (16.7%) and Fashion (15.7%) account for the largest proportions of online retail spending by Australians. Online retailing is expected to continue to grow alongside Amazon's expansion into the Australian market. According to Hitwise website profiling, monthly searches for Amazon have increased 93% since July 2016. According to Nielsen Australia, Amazon currently converts 49% of Australian visitors to its US site into sales.

Potential Effects on Retailers

Nielsen's study found that 75% of Australians aged 18 and over were interested in Amazon Australia. 56% of those surveyed said they were likely to purchase from the Amazon Australia site and 45% said they would pay to become an Amazon Prime member. Electronic goods (67%), books (61%), clothing (59%) and footwear (42%) were the products listed by those surveyed as the likely items they would purchase. According to Hitwise, 55.2% of JB Hi-Fi's, 54.1% of Harvey Norman's, 65.8% of Dymocks', 55.7% of Myer's and 57.7% of David Jones' online shoppers also searched Amazon.com. The Nielsen survey found that there were low levels of interest in buying fresh vegetables (9%) and fresh meat (7%) from AmazonFresh.

According to UBS, the impact of Amazon's expansion into the Australian market will be material. The Electronics/Appliances, Fashion/Department Stores and Sports/Leisure sectors were the sectors forecast to experience the strongest sales and margin pressure.



The survey consensus was that electronics retailer JB Hi-Fi would be the most affected retailer, with earnings (before interest and tax) estimated to fall 33% over the five years to June 2022. Harvey Norman is forecast to see earnings fall 14%. Department store Myer is forecast to see earnings fall 31% and listed retailer Premier Investments (Portmans, Peter Alexander, Jay Jays, Dotti, JacquieE and Just Jeans) is forecast to see an 8% fall in earnings.

Leisure retailers are also expected to come under significant pressure. Super Retail Group (Amart Sports, BCF, Goldcross Cycles, Rays, rebel and Supercheap Auto) is forecast to see earnings decline 15%. Other market sources have also noted that book retailers (such as Dymocks) will come under pressure, although this is expected to be minimal given Amazon.com.au already offers books in Australia via Kindle.

The decline in grocery retailer sales is also not expected to be as significant as the other retail sectors, with consumers currently displaying a low interest in purchasing groceries from Amazon. The UBS survey forecast Metcash's earnings to fall 21% and Wesfarmers' and Woolworths' earnings to fall 8%. Metcash is expected to be harder hit than Coles and Woolworths due to its current lack of an online store.

How can Australian Retailers Compete?

According to the Commonwealth Bank of Australia (Retail Insights, Edition 4), 41% of the retailers see Amazon Australia as a threat to their business and only 5% of retailers have a plan in place to compete with Amazon. While the risk that Amazon poses to Australian retailers may be significant, results of the survey conducted by CBA suggest that many retailers are unprepared for Amazon's expansion into Australia.

The two selling points of Amazon are its competitive prices and its ability to deliver purchases rapidly. Retailers who invest into their 'last mile' strategies (the last step before a delivery reaches the customer) are therefore expected to be better positioned to compete with Amazon. During recent years, customer expectations of delivery times have changed considerably. According to Deloitte, in 2015, 63% of online customers surveyed viewed delivery within three to four days as 'fast shipping'. The same survey conducted in 2016 found that this proportion had dropped to 43% and that the majority of online customers (89%) saw fast shipping as being delivery within two days.

Amazon has placed a large deal of focus on the last mile of delivery in its overseas markets. Having recognised its importance, the company insourced its supply chain and delivery process. In order to compete with Amazon, Australian retailers will therefore need to invest in their last mile offering. Currently, some retailers use companies such as Zoom2U and UberRUSH for last mile delivery, however on a whole, Australian retailers have typically been slow to offer same-day and shorter delivery options.

In terms of pricing, some retailers have noted that they will 'match or beat' prices offered by Amazon. Harvey Norman's Gerry Harvey has made reference to US electronics company Best Buy, who, despite being in competition with Amazon, have improved sales through reduced prices, an updated website, improvements to the online checkout process and the provision of fast and reliable shipping. Harvey has also questioned the ability of Amazon to cut the costs of electronics and whitegoods in Australia to the extent that they have overseas due to Australia's competition and consumer laws.

For some retailers, Amazon's expansion into Australia may involve them choosing to sell their products on the Australian Amazon Marketplace site to a global audience, a positive for retailers who choose this avenue. On the other hand, retailers who sell a generic-branded product are likely to be in direct competition with Amazon in terms of delivery times and pricing. Furthermore, Amazon have previously proven that they are willing to operate on small profit margins or at a loss for periods of time in order to establish market share.

The success of Amazon internationally shows the importance of innovation in the retail sector. A recent CBA report noted that 49% of Australian retailers are 'innovation active'. The research found that retailers predominantly cited revenue growth as the primary expected output of innovation (74%) and only 47% expected it to enhance service and the customer experience. However, the global success of Amazon shows the importance for retailers to be innovative for both revenue growth and in order to grow and maintain market share through service and the customer experience. On this note, with consumers spending more of their time purchasing and undertaking product research on their phones, retailers will need to continue to adopt and develop mobile e-commerce platforms.

There are a number of challenges that Amazon will face when it enters the Australian market, including consumer habits, market size and the distribution of goods. Many Australian consumers still avoid online shopping (with concerns over credit card fraud, returning goods and delivery times and costs the key reasons) and in the online grocery shopping sector, the market is fairly well-served by Coles, Woolworths and other pure-play online food retailers. Furthermore, a key competitive strategy of Amazon is its free and fast delivery for Prime members, which in Australia, will be more difficult to achieve than it is in the US and UK which have more concentrated populations, and this will be a challenge for the company's distribution network. In addition, the Executive Director of the Australian Retail Association has noted that Amazon will have to adapt to higher staff wages and operating costs in Australia than what exist in the US.

Potential Effects on the Commercial Property Market

While Amazon's expansion into Australia will undoubtedly have an effect on the commercial property market, it is difficult to gauge the extent of the effect. In the US and UK, the number and size of bricks and mortar stores has declined during recent years, partly attributable to growth in the more mature online retailing sector in these countries (Jones and Livingstone, 2015). As a result, retailers have become more competitive and are offering a wider range of pickup and delivery options. In the US, retail construction has been extremely subdued since the mid-2000s, with retail expansion currently being driven by services that typically do not compete with online retailers (such as food and services-related retail) (Jones and Livingstone, 2015). However, because online retail penetration is lower in Australia than it is in the US and UK, there have been some reports suggesting that Amazon's impact on the retail sector here may be not as significant as seen overseas.

Due to the common inclusion of percentage rents in retail leases, shopping centre owners could see rental income come under pressure if they are heavily exposed to those retailers that are forecast to see reductions in sales.

In terms of its warehousing and logistics requirements, Amazon has confirmed that it is actively looking for a distribution and fulfilment centre in Australia. Amazon currently operates distribution and fulfilment centres of varying sizes in its overseas markets. In its most established market (the US), the company has various types of fulfilment (to store items from third-party sellers) and sortation warehouses. The company also has separate warehouses for perishable and frozen merchandise and pantry/dry groceries. Amazon's larger warehouses are typically its regional sortation centres which are used to sort packages according to geographical region or by delivery stations for the last mile delivery. During recent years, the company has rapidly expanded its delivery station distribution network to include smaller facilities to sort packages for last mile delivery. These warehouses are typically 5,000 square metres to 10,000 square metres in size and are located close to large metropolitan cities and often near airports. The company also expanded its distribution network across high-population cities to include PrimeNow Hubs which stock limited lines of high-demand items that can be delivered within one to two hours of being ordered.

While details on the size and location requirements of Amazon's distribution and fulfilment centre in Australia are unconfirmed, it will be located in Melbourne, Sydney, or Brisbane and will most likely be purpose-built. It is rumoured that Amazon will be pre-committing to a purpose-built fulfilment centre in Oakdale Industrial Estate in Eastern Creek, Sydney, which is owned by Goodman (who are Amazon's main landlord globally). DHL is also located at Oakdale Industrial Estate and are likely to assist in delivery of Amazon's products. However, it has also been suggested that the company is considering existing warehouses and may need multiple distribution/fulfilment centres. While at present, Amazon's expansion into Australia will not see a substantial increase in demand for industrial space (proportionate to the size of Australia's industrial market), it is expected that the number of distribution centres required by the company would increase in-line with the company's growth in Australia.

Key Sources

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