Can U.S. Retailers Profit in the Challenging Canadian Market?

Description

Canada represents a potential profitable market for U.S. retailers. A report by BMO Capital Markets stated that Canadian retail sales are equal to U.S. sales on a per capita basis. However, U.S. retailers must understand the many challenges the Canadian market presents.

1. Lack of commercial space for retail development

Commercial space for retailers isn't as plentiful as in the U.S. Industry Canada's most recent "Consumer Trends Update: Canada's Changing Retail Market" report said that, "Since 1989, only two major enclosed shopping malls have been built in Canada: Vaughan Mills in Toronto and Cross Iron Mills in Calgary." In addition, strip malls in Canada are falling by the wayside.

2. Distribution challenges

Getting products into Canada involves customs issues, border traffic backlogs, and the logistical challenges of getting inventory across a broad geographical landscape with a tenth of the population of the U.S.

Target's (NYSE: TGT) expansion into Canada has been met with complaints from shoppers who don't like empty shelves. In answer to these concerns, Target is working to improve its distribution/replenishment systems. Target has said its operational focus in 2014 would be reducing out-of-stock issues.

3. English/French packaging costs

These costs may not be exorbitant. Nevertheless they are extra costs, which cut into profits. A Canadian report by the Office of the Commissioner of Official Languages stated, "Costs of actual compliance with federal two-language packaging and labelling requirements have been found to be less than one per cent of product revenue, often considerably so… This should not, however, be taken to mean that these costs are negligible."

4. Labour costs

Canada has a higher minimum wage than the U.S. For example, in the Province of Ontario, the current minimum wage is set to increase to $11.00 per hour on June 1, 2014. Neighbouring New York State's minimum wage is $8.00 per hour.

5. Pricing

Nordstrom (NYSE: JWN) won't be entering the Canadian retail market too aggressively just yet. The company planned to introduce its Nordstrom Rack (discount pricing) stores in Canada in 2015. It's delaying this initiative until approximately 2017.

Pricing will be an issue it will have to consider. Target is experiencing backlash from Canadian shoppers who are balking at its prices, which are higher in Canada than in its American stores. Learning from Target's distribution and pricing problems, Nordstrom is looking to take a more measured approach to the Canadian market.

6. Too aggressive expansion

Nordstrom plans to open its first regular store in Calgary, Alberta, in autumn 2014. Nordstrom said it would refrain from opening too many stores too quickly, as Target did in Canada. A full-line Nordstrom store takes 18-24 months to set up properly for business. In contrast, a Nordstrom Rack store takes six to eight months to set up.

7. Increased competition

U.S. retailers should not think that Canada is competition-free. Ask **Best Buy** (NYSE: BBY). This past January, Best Buy Canada announced it would eliminate 950 jobs at its Best Buy and Future Shop stores. The reason? It's facing increased competition in Canada and needs to restructure its store operations to cut costs. Best Buy is combining departments and cutting management in stores.

Foolish bottom line

Potential exists in the Canadian marketplace for U.S. retailers. The key is to understand the nuances of operating in Canada. U.S retailers must align operational philosophies with those of Canadian shoppers and the regulatory environment.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BBY (Best Buy Co., Inc.)
2. NYSE:JWN (Nordstrom)
3. NYSE:TGT (Target Corporation)

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