PROFILE

A GIRL'S BEST FRIEND

The founder of a fashion accessories business tells Mark Fenton-Jones how he plans to succeed in a cut-throat world.

Gloss Cosmetics founder Jeremy King works hard at understanding his customers. Photo Jim Rice

Fashion retailers are facing tough times at the moment. After experiencing the most buoyant retail market in the history of Australian retailing for the past five years, they now have to deal with the credit crunch, rising interest rates, record petrol prices and a decline in consumer spending.

That some leading retailers have fallen over in the past few months should not surprise many people. This month, 26 years after opening, 200-store jewellery and fashion accessories retailer Kleins was placed into voluntary administration after it collapsed owing more than $20 million.

James Stewart, a partner at insolvency practice Ferrier Hodgson who was appointed an administrator of Kleins Franchising, J.D.A. Imports and The Jewellery Chain, said one reason for the collapse was that Kleins failed to reinvent its brand.

"The collapse of Kleins is not about consumer spending or the economy. It is about something much more fundamental to the retail equation: brand reinvention. Most retail businesses need to regularly refresh their product offerings to stay ahead."

Among the host of players who have swarmed into the accessories trade, often taking market share from the likes of Kleins while expanding the sector, is Gloss Cosmetics founder Jeremy King.

He's well aware of the need to move quickly. King, who was interviewed during the week just after signing five-year leases with Westfield for 10 more stores throughout NSW and the ACT, views the relationships his business has with suppliers as critical to his expansion plans.

"The most critical thing is our ties to our suppliers, in keeping our suppliers happy and getting the products on the shelf as fast as you can," King says.

"The $500,000 investment in the custom-built Microsoft RMS stocktaking system when we first opened has been an enormous help. We actually stocktake every two weeks across the store brands, in every store. The number of items in a store can range between 9000 and 12,000. Without this level of inventory control you cannot run cosmetics stores.

"Everyone talks about clothing as fast fashion but cosmetics is fast. Pink nail polish will sell for three days and then it will switch to black almost overnight and you have to be on top of it. And this is where these other companies have just not got on top of it."

Gloss sells fashion accessories and cosmetic brands at 20 stores located in major shopping centres in Western Australia, South Australia and Victoria. The newest is a 120 square metre store in the Marion Centre in Woodville, South Australia, which cost $300,000 to fit out. Ultimately King is looking to have 200 stores estimated to be worth $150 million a year.

A year ago Gloss's turnover was $11 million but is expected to be about $15.5 million this financial year and reach $22 million with the opening of the 10 new stores.

Fitouts typically cost between $190,000 and $250,000 depending on store size, which are normally 100 sq m.

The expansion is totally self-financed, partly from the profits from the sale of King's clothing stores seven years ago and partly from cash flow. "Just about every accountant I've ever met says that I'm crazy. At the same time with the interest rates going up, I don't think it's such a bad idea."

Since the first store opened in 2005, expansion has been slow as the business has built up cash reserves.

"I had to hold myself back. I've been in retail, I've had a fashion group before and you have to hold yourself back just to see what the market is doing," says King, who expects his chain will pick up a share of the market left by Kleins and several other fashion accessory businesses that are either closing stores or withdrawing from cosmetics.

Asked why he should be successful where similar businesses have failed, King replies that 75 per cent of his business is in the lower-priced end of the cosmetics market, the rest from sales of fashion handbags, jewellery, belts and clutches. "Apart from us there is no one in specialty retail doing it. We are the last ones now."

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The stores cater to the under-18 market, which King considered was being neglected by retailers like Myer and David Jones. "[Girls under 18] had to really shop in pharmacies or in discount stores like Big W. When we launched to under 18s – $3 lip glosses up to $19 lip glosses – we had phenomenal success."

Research was undertaken, often in the food courts of shopping centres, where Gloss Cosmetics staff spoke with groups of girls.

"We just found that they literally could not find the make-up in a shop that they loved. They usually went with mum somewhere else and then they didn't like it. So we offered them this funky environment to shop in."

He attributes his chain's longevity to several strategic decisions taken from the outset. First, the business could not depend on one brand – it had to offer a range of products. Brands include Bloom, Chi Chi, Cargo, SugarBaby, Tali and St.Tropez.

"Most Australian girls under 18 love to shop in a store where they have plenty of choice, plenty of range, and they don't want to look at one lip gloss, they want to look at 10 different brands together," King says.

Second, he partnered with local boutique brands like ModelCo, Chi Chi and Be Yourself Cosmetics, which developed products for Gloss, rather than source from overseas manufacturers.

"Foreign imports from China are cheaper but have long lead times and large quantities, and the prices are not stable. They are increasing at 20 per cent a year and I don't see that changing for the next three years."

The business of strategy at tax time

Small businesses might like to consider some legitimate tax strategies as the end of the financial year fast approaches.

The national manager for tax training at Kaplan Professional, Roger Timms, declares that those who are classified as a Small Business Entity have access to a wider range of concessions as well as concessions previously available under the Simplified Tax System. An SBE is a taxpayer who runs a business with an aggregate turnover of less than $2 million. SBE provisions replaced the STS on July 1, 2007.

Prepayments are in his spotlight of immediate tax deductions that SBEs are entitled to. They can usually be claimed if the service period for the prepayment is not more than 12 months.

SBEs are also able to claim a deduction for the cost price of small assets.

For example, if a 12 month business subscription was taken out on June 1, a full deduction would be immediately available. But a non-SBE taxpayer must split the deduction between two income years, claiming a 12th in 2008 and the remainder in 2009.

SBEs are also able to claim an immediate tax deduction for the cost price of small assets, typically less than $1000 an item, rather than having to depreciate the item over its useful life.

Chartered accountants Weston Woodley Robertson advise that when prepaying your interest, the financial institution charges the interest to the loan account rather than simply reducing the loan balance. The firm also notes that as well as the concessions previously available under the STS, SBEs have access to a wider range of concessions, which include the capital gains tax 15-year asset exemption, the CGT 50 per cent active asset reduction and simpler depreciation rules.

As for claiming a deduction for a bad debt, the debt must be written off during the year the deduction is claimed, says Timms.

Business owners should review debtors before year's end to identify debts that could be considered "bad". He warns that the debt must exist at the time of write-off otherwise no deduction will be available.

Mark Fenton-Jones

Q+A

ATO keeping watch on charges between companies

My wife and I are involved in two family companies. They both trade in related business areas. We have been reviewing our management accounts and are trying to complete our end of financial year tax planning. One of our companies has made a significant profit and the other company has made a loss. Both firms have the same shareholders. We want to be able to offset the two positions so that our tax exposure is only for the net position. Is this a problem?

What you are trying to achieve sounds simple enough, but it isn't. In tax, three minus one does not always equal two.

You are not allowed to simply offset the losses of one company against another, even if they have the same shareholders. Some years ago you could do this.

Where you have a number of companies owned through a holding company you can consolidate them for tax purposes. The effect of this is that you only lodge one tax return for the group and all inter-company transactions are ignored. This probably achieves what you are after, plus a bit more. However, from what you have described, your companies are not owned through a holding company, but rather they have the same shareholders. Consolidation will not apply in this situation.

Be careful about trying to solve the problem by simply pushing through management charges to balance out the books. While there is no problem with one company charging the other company for goods or services provided, there needs to be a commercial reason for this. The ATO is looking at these types of transactions. If it does not stack up it will cost you a lot more than the tax saved.

If your companies are owned through a holding company it may be worth considering tax consolidation. This is not a simple process and you need to balance the advantages against the disadvantages. Either way, you need to get some advice on this. But time is not on your side.

Carrying forward significant tax losses in one company while the other is paying tax is not cash-flow effective. You need to look at your options to resolve this position.

Hayes Knight Accountants & Business Advisers

Answers are general and not to be taken as specific advice. Always seek professional advice. Questions to dlynch@afr.com.au or call (02) 9282 1900.