

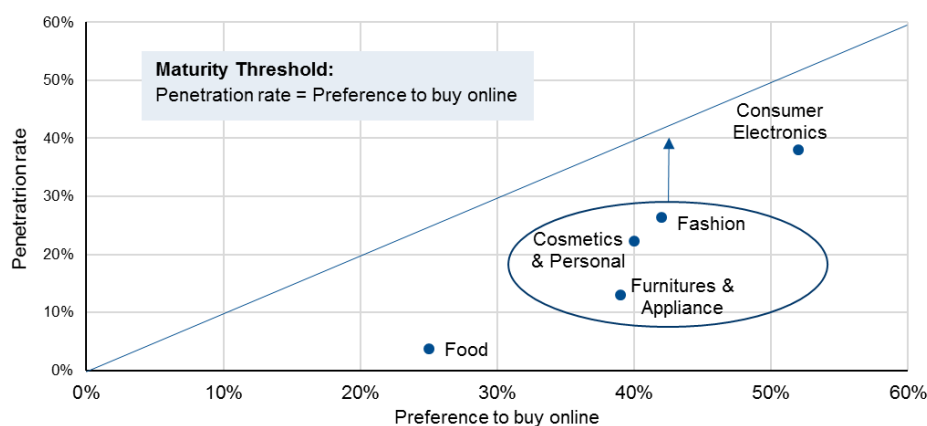
Of tortoises and hares: Retail segments in Europe have divergent online growth prospects



Scope
Ratings

While online retailing has evolved in Europe, e-commerce sub-sectors have grown at different rates, leading to varying degrees of digital penetration for different product categories. To see how much more potential there is for online growth in European retailing, Scope has chosen a sample of five sub-sectors for analysis. In each case, consumers' preference to buy online—a "maturity threshold"—is compared with the extent to which they are already doing so, measured by online-shopping penetration rates. The gap between the two indicates how much development is still possible before the segment reaches the threshold maturity line, represented in the graph by the blue line. In other words, it suggests how much growth potential there is for online sales as well as the downside risk for traditional incumbents relying on in-store sales.

Figure 1: Online maturity threshold per retail segment



Source: Scope Ratings

Europe's e-commerce sector has plenty of potential for growth, but some sub-sectors look set to expand much faster than others. The electronic-goods segment is relatively mature, partly because it is well suited to the digital format. The majority of the other sub-sectors, while in need of some time to adjust their business models, are set to catch up with the front runners in the long run, with only food retailing likely to prove a laggard.

With an estimated 38% penetration rate in 2018, the Consumer Electronic retail subsector is the proverbial hare in the e-commerce race in Europe, as represented in figure 1. Consumers' preference to buy electronic goods online is the highest in our peer group. The penetration rate—the proportion of shopping undertaken online—and the propensity to buy online have increased at the expense of bricks-and-mortar outlets. The online format has a number of advantages for shoppers:

- Websites allow customers to compare the technical specifications and understand the complexity of products in this segment, which comprises devices used for entertainment, communications and home-office.
- Since each consumer-electronic product should be the same in every shop, customers can compare prices online, independently from a physical shop's inventory, and adapt their purchases accordingly.

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[Resisting the e-commerce whirlwind: A comparative study of the US and European retail sectors – May 2018](#)

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Scope expects the penetration rate to continue to grow to reach the threshold at which consumers are in fact doing as much shopping online as they would like. Nevertheless, with already high penetration rates, the consumer-electronics market appears to be relatively mature. The consolidation of the main European actors in the industry offers evidence of this, with the emergence of large pure-players such as CEconomy & Darty/Fnac. The sector's online growth prospects look less bright than for the other sectors presented below.

Fashion¹ comes second in Scope's retail sample, with an indicative penetration rate of 26%. While clothing and apparel shopping appears most suited to traditional in-store formats—the need to see, touch, and try-on the products—specialist online fashion companies such as Asos and Zalando have broken the mould. By bringing the shopping experience to customers' homes, they have forced most of their rivals to follow suit.

The online fashion sector looks set to consolidate due to the emergence of new niche-players (targeting specific customers, possibly by budget, and/or offering dedicated product ranges). Still, Scope doesn't expect the online fashion market to go through significant fundamental change as most of the sector's actors now have a mix of online and offline offers. New competitors and new payment possibilities are expected to modify the market, though already short delivery times and improved shopping experiences should limit how much radical change they bring. In terms of online growth, Scope expects an increase in the short- to medium-term as the online penetration rate is still below the European preference to buy fashion and apparel online.

The Cosmetic & Personal Care² sector is, in Scope's view, at the cross-roads between the in-store and online models. This sub-sector has features similar to the fashion and apparel segment: high brand recognition, fashion risk and relative durability of the product in stock. On the other hand, online sales remain relatively low, with the segment's penetration rate at around 22%. In a similar way to how people shop for fashion goods, cosmetics customers typically go to brick-and-mortar stores to test and choose their products. Scope believes that the sector is ripe for further change, partly because its high profit margins would allow specialist online suppliers to undercut incumbent retailers, offering attractive prices to consumers, and still turn a profit. Scope views the penetration rate and preference to buy online as relatively low in Europe, with no clear market leaders offering distinctive online shopping experiences and a broad portfolio of cosmetics brands. Given consumers' relatively high preference to buy online, the size of the digital market for this sub-sector should increase.

The digitalisation of the Furniture and appliance³ sub-sector, in Scope's view, makes the segment the proverbial tortoise in this e-commerce race. With an indicated penetration rate of 13%, the ratio of this subsector is significantly below average. Nevertheless, changes in purchasing habits might lead the furniture market to increase its online penetration at a rapid pace. German e-tailer Otto has reported a 68% increase in the purchase of furniture online since 2014, accounting for 37% of sales. Wider internet coverage and technological innovation such as augmented reality (Ikea has said it is exploring the potential of a Virtual Reality app) allowing customers to better visualise how purchases fit into a room, could set the stage for omni-channel retail strategies, which could boost online sales and lower costs. Customers tend to compare home products online and then go to a store to examine the goods before buying them and having them

¹ Fashion includes clothes, accessories and shoes but excludes outdoor and sport clothing

² Cosmetics and personal care includes cosmetics and pharmaceutical products but excludes professional medical products

³ Furniture & appliances includes furniture, household goods and home appliances but excludes B2B markets & C2C markets

delivered later. Technological developments could lead, in Scope's view, to significantly enhanced potential for online growth in this category

The laggard in the digitalization process is online food retailing⁴ and it may even be out of the race. The segment, with just a 4% online penetration rate, represents one of the largest and most difficult markets for e-commerce to unlock. Despite expectations that the "weekly grocery run" might come to dominate the market for fast-moving consumer goods, most food shopping is based on impulse buying. If a bricks-and-mortar store can capture that by proposing an immediate purchase, such spontaneity allows the outlet to compete well against an e-commerce rival, given the time it takes to order groceries online and have them delivered. Scope also sees a high investment barrier for new entrants, as an e-tailer has to offer competitive prices while developing a costly delivery system, assuring that products are fresh and maintaining ample stocks. Theoretically this is possible, but the low single-digit margins typically associated with food retailing may prove dissuasive. According to McKinsey, the additional expense of selling groceries online amounts to between EUR 4 and EUR 7 per transaction, largely related to delivery costs.

Is the online food sector fated to remain on the fringes of European e-commerce? Scope considers that it will develop but not uniformly throughout Europe. In the UK, which is the most advanced online grocery market (see "Resisting the e-commerce whirlwind: A comparative study of the US and European retail sectors"), Scope has noticed the emergence of two internet food champions, with Tesco (whose online sales constitute close to 8% of their total) and Ocado (food online pure player). In France, the success of the "click & collect" or "click & drive" options (buy on internet and get the delivery at a specified place and time – without necessarily leaving the car) shows a more cost-effective alternative to home delivery. Nevertheless, the overall currently low preference of consumers to buy online reinforces Scope's view that there is limited potential for near-term growth in this segment without a radical change in the commercial offerings consumers can choose from.

Europe's e-commerce sector has potential for growth, but some sub-sectors look set to grow much faster than others. The electronic-goods segment is mature. Other sub-sectors will need of some time to adjust their business models though they are likely to catch up with the front runners in the long run, with only food retailing likely to prove the sector that lags.

⁴ Food retail includes food and beverage but excludes baby food



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