

Retail Examiner

NOVEMBER | 2009

INTERNET RETAILING: GET ONLINE OR GET LEFT BEHIND!

Internet shopping has been hailed as the “next big thing” in retailing for more than a decade. However, the reality doesn’t seem to have matched up to the vision. The Internet has not spelt the end of high street shopping, as warned by some of its more rabid proponents, and, although it has certainly influenced the way we shop, it has had very little impact on some retail sectors. Internet retailers in New Zealand will reach sales of \$1 billion within 5 years – however, they will have to go head-to-head with the biggest and best online retailers in the world to attract the Kiwi shopping dollar. Will we rise to the challenge?

Then and Now

In 1995, few New Zealanders had Internet access. Most Internet users were male, and were either academics or working in the IT industry.¹ A lot has changed!

The Internet is now a major force in our lives. Modern online shopping requires broadband-level speeds to be attractive for customers, and the latest figures suggest that around half of all homes have broadband. The number of households with broadband will keep increasing, and speeds are getting faster all the time.

Progressive Enterprises (owner of Woolworths, Foodtown and Countdown) has probably offered online shopping longer than any other major New Zealand retailer. Online grocery shopping was launched eleven years ago in November 1998, and is now a profitable part of Progressive’s business.²

Trade Me began in 1999. Ten years on, it is so popular with New Zealanders that it barely needs a description. It was sold to Australian media company Fairfax Holdings in 2006 for \$750 million, and is the giant in our online shopping scene.

Internationally, Amazon is the world’s largest online retailer, selling a huge range of books, music, DVDs and other products. Amazon had sales of \$19 billion USD in 2008. This is more than one thousand times higher than its sales in 1996, of just \$16 million!

In New Zealand, plenty of businesses have launched online shopping websites since the 1990s, but there have been just as many failures as successes. Flying Pig tried to be New Zealand’s answer to Amazon, but never took off, and lasted just two years. Ferrit was a site where consumers could compare prices and features of products from a number of retailers, and then make a purchase. Despite heavy advertising, Ferrit lost millions of dollars, and the plug was pulled at the start of 2009.

Amazon itself made such big losses in its early years that it still hasn’t recouped them fully! The business has been profitable since 2003, but has still made a net loss over its lifetime.

This year, The Warehouse has re-launched online shopping facilities, starting with a limited product range of around 5,000 SKUs.

We have spoken to several major retailers (with collective sales in the hundreds of millions of dollars) who have recently launched online shopping, or are planning to in the next year.

These retailers think that now is the time to get involved with online shopping, and they expect strong growth.

¹ See “Survey – Average World Wide Web User is a Well-Off

Bloke”, The Dominion, 18 December 1995

² “Online Grocery Shopping Turns 10”, Infotech Weekly, 3

November 2008

Where Do New Zealanders Shop Online?

Trade Me is the most popular online shopping site in New Zealand. Trade Me isn't a retailer itself, but a vast amount of goods are sold or resold on it, and it's far too big to ignore when reviewing Internet shopping. It completely dwarfs any of New Zealand's online retailers in terms of Internet traffic (how many people visit it, and how many pages they open on the site), as shown in the following table:

Internet Traffic: Trade Me vs. Other Online Shopping Sites

Website	% of Trade Me Traffic
"Top 100" Sites	
Trade Me	100.00%
Amazon.com	12.82%
Air New Zealand	12.01%
1-Day	7.88%
Dick Smith	3.25%
Other Online Shopping Sites	
The Warehouse	2.71%
Noel Leeming	1.37%
Ascent Computers	1.18%
Torpedo 7	0.90%
Progressive*	0.67%
Ezibuy	0.67%
Bond and Bond	0.61%
Mr Vintage	0.31%
Barkers	0.12%

Source: www.alexa.com, RCG

* Combined traffic for the Woolworths and Foodtown online shopping sites

Trade Me brings a massive population of buyers and sellers together, and as such, it's the largest auction facility we've ever seen in New Zealand. A significant number of sales are "consumer-to-consumer", i.e. from one private individual to another. However, there are hundreds of retailers that sell goods through Trade Me.

In 2005, \$300 to \$400 million of goods were traded through Trade Me auctions,³ and the figure has increased significantly since then. A large number of vehicles sales are "facilitated", if not directly made, through Trade Me.

³ "Telecom Takes On Trade Me", New Zealand Herald, 7 October 2005

The average New Zealander, then, spends at least \$100 a year through Trade Me. Within RCG, everybody seems to have a Trade Me story - selling a \$10 item for \$130, or buying a second-hand Porsche! Trade Me has grown massively in the last few years, and generated EBITDA of almost \$80 million in the past year, nearly half that of The Warehouse Group, our biggest listed retailer!



Online ticket sales make up a very substantial part of Air New Zealand's business. We expect that Air New Zealand online ticket sales make up well over 30% of total ticket sales, and perhaps more than half of domestic ticket sales. The "Grabaseat" website, aimed at price-sensitive customers, seems to be very successful, and allows Air New Zealand's main website to target more affluent customers.



Amazon.com is the second-most visited online shopping website in New Zealand, and the 25th-most visited website overall. We expect that New Zealanders spend tens of millions of dollars through Amazon each year.

Amazon doesn't make any particular efforts to attract New Zealand customers - it doesn't have a NZ website, or even an Australian one. New Zealanders have to work out the exchange rates, but are still attracted by the huge range and often-competitive prices.



The Warehouse recently re-launched Internet shopping on its website, after briefly experimenting with it in the late 1990s. The company predicts that annual sales will reach \$35 - \$50 million within three or four years.⁴ This figure is only 2-3% of sales, and in our view, The Warehouse will be able to do better.

⁴ "Warehouse's high hopes for online store", BusinessDay, 26th June 2009

"There is significant anticipation in the market... Internet shopping in New Zealand will rock, rip and burn" - Major retailer (sales above \$100 million)



New Zealand's second-largest supermarket company has actually been selling groceries online for eleven years, and has grown the business to the stage where it is profitable. We estimate that the online business makes up just 1% of Progressive's sales. However, online sales will grow faster, year-on-year, than physical supermarket sales.



Torpedo7 runs three very successful websites. The Torpedo7 website sells bike gear and other outdoor products, while the 1-Day and 1-Day Tee websites offer a limited selection of products for sale each day, with the selection changing every 24 hours. This model is similar to popular overseas websites (e.g. Woot.com). Every few months 1-Day sells mystery items – labelled as “Bags of Crap” – which have pulled in as much as \$350,000 of sales in 24 hours.

Online Shopping vs. Online Retailing

Having discussed general “online shopping”, let's get specific and consider online retailing. But what is retailing, exactly?

For the most part, retailers are businesses that sell goods to (mainly) private consumers. In New Zealand, some services are counted as part of the retail sector. This includes food and beverage – cafes, restaurants, bars, and takeaways. It also includes services like hairdressers, drycleaners or DVD rental stores.

The travel industry (including flights, travel agencies, rental cars, and accommodation) has been truly revolutionised by the Internet. Travel makes up a big part of Internet shopping sales, especially in New Zealand. However, the travel industry is not part of the retail sector.

Another major part of online shopping is “consumer-to-consumer” sales, which account for a large proportion of sales on sites like Trade Me. There's no retailer involved here – only people selling their goods to other people.

Some products used to be sold as physical goods, but can now be downloaded instead. Examples would be computer games and software, and music. Globally, digital music sales now make up 20% of all worldwide music sales.⁵ Products such as music and software may have gone digital, but they still form part of the retail sector.

How Big Is Online Retailing Overseas?

Overseas, there has been a fair bit of confusion about online sales. Various organisations have claimed that online retailing now makes up 10%, or even more, of the retail sector in countries like the UK or US. However, they're often comparing data incorrectly. They include, for example, online travel sales, or customer-to-customer sales through Trade Me or similar sites. As such, for this Retail Examiner issue, we have chosen to rely on official data only.



Fortunately, there is official data on the online retail sector for some countries.

- In South Korea, online sales make up 6.4% of all retail sales (and around 8.8% of “core” retail sales, which exclude vehicle and petrol sales).⁶
- In Germany, online sales make up 4% of all retail sales.⁷
- In the US, online sales make up 3.5% of all retail sales.⁸
- In the UK, online sales are currently at around 3.5% of all retail sales.⁹

These figures show that online sales only make up a small part of overall retail sales. This doesn't sound very exciting! However, there is more to the picture.

5 <http://www.ifpi.org/content/Library/Recorded-Music-Sales-2008.pdf>

6 Derived by RCG from Korea National Statistical Office figures for the year to June 2009

7 http://www.destatis.de/jetspeed/portal/cms/Sites/destatis/Internet/EN/press/pr/2007/12/PE07__519__52911.psm1

8 United States Census Bureau figures

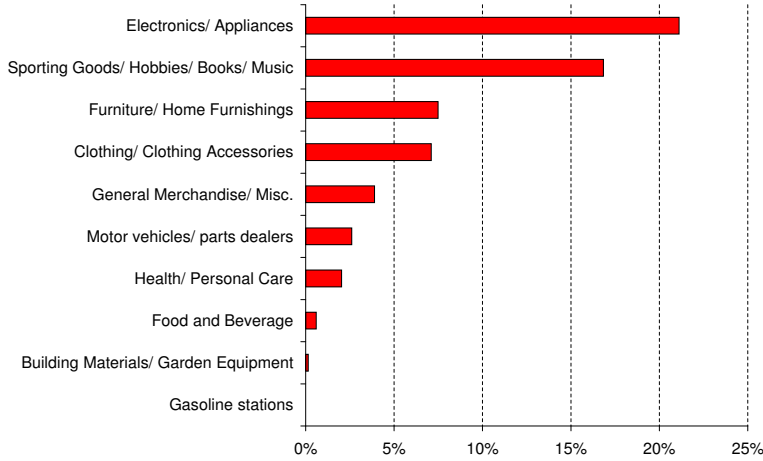
9 Office of National Statistics figures

“Trade Me is absolutely and categorically the biggest mall in the country. It's cheaper than running your own website, it doesn't need to be promoted and we have five times as many hits as we do on our own website.” – Malcolm Bell, Complete Outdoors Director, quoted in New Zealand Retail magazine, issue 666

Firstly, online sales for these countries are still growing rapidly, even though total sales are flat or falling due to the recession.

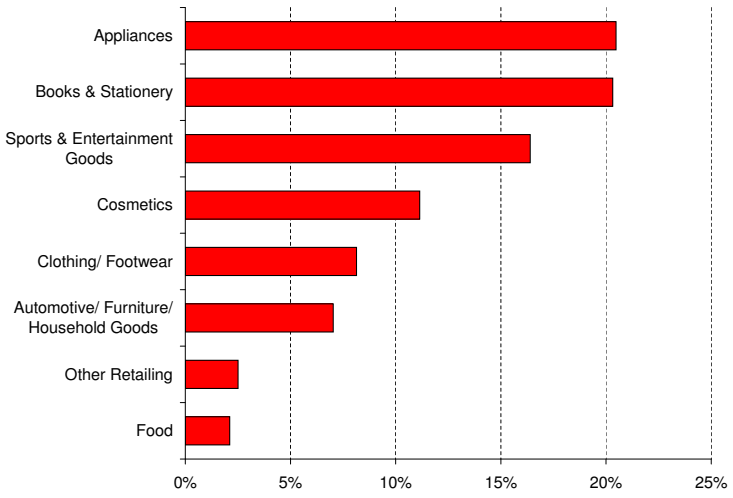
Secondly, when we break sales for Korea and the US down, we can see that online retailing is becoming very important for some store types.

**What Are the Key Categories for Online Retail?
US Internet Sales as % of Total Retail Sales, by Store Type**



Source: US Census Bureau, RCG. Figures are for year ending December 2007.

South Korea Internet Sales as % of Total Retail Sales, by Store Type



Source: Korea National Statistical Office, RCG. Figures are for year ending June 2009.

The figures show that products such as music, movies and software are common online purchases. Books and stationery are also popular online, along with appliances. However, evidence suggests that some appliances are sold via the Internet in large numbers – computer

hardware, cellphones and leisure appliances (e.g. iPods, Playstations) being examples. Other types of appliances, such as fridges or washing machines, are much less likely to be sold online.

Clothing and footwear are popular with Internet shoppers, but the inherent drawback is that shoppers can have difficulty in choosing the right size, or being happy with the style, without being able to try items on.

Online cosmetics retailing is popular in Korea, and we see major growth potential for it here – the products are usually small and easy to ship, and the margins charged in retail stores tend to be high. However, this depends on the willingness of cosmetics companies to supply online retailers with their products – there could be some risk to their brand. The situation for jewellery is similar.

Automotive retailing has been relatively unaffected by online retailing. Clearly, shoppers want to go for a test drive before buying. In New Zealand, Trade Me Motors doesn't directly sell new cars, but it does point prospective buyers in the right direction, allowing them to compare models and prices - and book that test drive!

Online retail sales make up a very small proportion of food sales. This is probably driven by difficulties with the distribution – food purchases usually need to be refrigerated en route to customers, and customers are not prepared to wait days for the food to arrive (unlike, say, a T-shirt). Consumers tend to shop for food regularly - and want it instantly. Online food retail is well catered for in New Zealand, but it will remain a niche business.

For many food and beverage operators, online sales are a bit of an oxymoron. There's no such thing as an online restaurant or bar! However, where the Internet does come into play is for takeaways that deliver prepared food to your door – pizza companies such as Hell, Pizza Hut and Dominos handle a growing proportion of sales through their websites. This figure is probably at least 20%.



(Source: www.thewarehouse.co.nz)

“What it cost us to go online... is less than we would spend on refitting a store, so it's going to deliver a pretty good return on investment... we imagine [the online store] would become our biggest turnover store [within 3 to 4 years]” – Ian Morrice, The Warehouse CEO, quoted in “Warehouse's high hopes for online store”, BusinessDay, 26th June 2009

The stats for the US and South Korea reflect trends that are becoming apparent all over the world. The Internet is becoming a major sales channel for many types of retail goods. However, some types of retail have been relatively unaffected so far.

This isn't surprising, given how Internet shopping works – the major issue is shipping the goods to the customer. As such, goods that are purely digital (e.g. software, music and, increasingly, movies) are the easiest to buy online, followed by small-to-medium sized goods – preferably ones that aren't fragile!

For bulky goods, such as fridges or beds, the Internet is unlikely to become a major sales channel - shoppers find it easier to just head to a store with a trailer! However, consumers will still use the Internet to compare prices on these goods.

What Percentage of New Zealand Retail Sales are Online?



The Retail Trade Survey (RTS), produced by Statistics New Zealand, is the accepted measure of retail sales in New Zealand. According to the RTS, retail sales amounted to \$65 billion for the year to June 2009, or \$48 billion of "core retail" sales, which exclude automotive-related industries (vehicle sales, petrol sales etc).

There is no accurate data on what percentage of New Zealand's retail sales are carried out online. The Nielsen Company's Online Retail Monitor has estimated how much New Zealanders spend online – however, the survey does not differentiate between retail and non-retail spend, or New Zealand and overseas websites.

Our best estimate, based on a range of sources, suggests that there are currently \$300 to \$500 million worth of online sales going to New Zealand retailers. This is less than 1% of total retail sales, and no more than 1% of core retail sales.

A significant chunk of these sales are made through Trade Me, with Progressive and Torpedo7 also making big contributions. We have identified more than 100 other online retailers in New Zealand, but many would sell less than an average "bricks-and-mortar" store.

In the US and Korea, online sales make up at least 10% of total sales for some store types. We don't think any major store types have hit this level in New Zealand. Music sales have probably made it to 10% (counting downloads to cellphones), but this is as much due to the drop of physical music sales as to the rise of online sales.¹⁰ Judging from our discussions with major retailers, we are certainly not there for appliance retailing or books and stationery.

Clearly, and based on overseas evidence, there is significant potential to grow the market! For example, to be on par with South Korea, our online retailers would need \$4 billion of sales a year.

The Future!

In South Korea, the most advanced market for online retailing, Internet sales continue to grow strongly – up 13.5% in the year ended June (while total retail sales grew just 2.2%). Statistics from other countries (UK, Denmark, Sweden, Canada) show that the number of people shopping online is increasing. Research by the Nielsen Company also shows growth for New Zealand. These statistics measure whether people have shopped online in the past year, and do not translate directly into retail sales. Nonetheless, we can be very confident of growth in the market, not just here but around the world.



After 18 months, the Barkers online store now generates "as much revenue as [a physical] store".¹ [1] Barkers expects rapid growth in online sales, and thinks that the website "helps back up" the physical stores, rather than cannibalising store sales. – Zac de Silva, Barkers Managing Director, in "Stitching a Business Together in Cyberspace", New Zealand Herald, 19 February 2009

¹"Stitching a Business Together in Cyberspace", New Zealand Herald, 19 February 2009

¹⁰ According to the RIANZ website, "digital" sales made up 8% of total music retail sales in 2007. We expect the 2008 figures, due out soon, to show an increase.

In the US and Korea, online retail sales have grown by more than 20% a year for the whole of this decade! As such, we expect New Zealand will follow, and the market will grow by around 25% annually for at least five years. We predict that online retail sales in New Zealand will hit \$1 billion in the next five years, and \$2 billion by 2020. Even then, we would be behind where countries like Korea, the US, UK and Germany are now. If anything, these growth rates could end up being conservative.

Of course, as we've seen above, the importance of online shopping is likely to differ between types of store. Trends in New Zealand are likely to mirror those overseas, and retailers selling appliances, DVDs, books or music will be affected the most.

There are a number of factors that will help grow New Zealand's online retail sector in coming years, but there are also challenges to overcome.



Why Will NZ Online Retailing Grow?

Improved Internet access, and more Internet-ready devices – Internet access is becoming faster and cheaper all the time. With more than 1 million broadband subscribers in New Zealand, most people now have Internet access from home, work, or both. Plus, the Internet is becoming available on more devices – an increasing number of people have Internet-capable cellphones.

People using the Internet for more things – Online banking and travel bookings have encouraged people to become more confident about making online transactions. As we use the Internet for more activities, online retailing will grow.

Changing demographics – In New Zealand, people earn their highest incomes when they are in their 40s

and 50s. However, it is the younger age groups that are more familiar with the Internet, and are more likely to shop online. These Internet-savvy consumers will get older and move into higher-earning age groups, and Internet retailing should grow substantially as a result.

More NZ retailers going online – This is a double whammy... it will cut down on the “leakage” of New Zealanders buying from overseas websites, and it will make a wider range of goods available online. We need to see retailers who are prepared to put the money in now, develop their websites, and stay for the long haul. Investment will grow the market for all retailers.

Debit cards – These allow New Zealanders to shop online without having to sign up for a credit card. Westpac was the first bank to offer debit cards, in late 2006, and three years on, most of the other banks have followed.

Targeting overseas customers – Many of the online retailers that we talked to sell more than 20% of their goods to international customers, and this also reflects overseas trends. By comparison, international visitors account for less than 7% of NZ retail sales.¹¹

The success of companies such as All World Shops (see the next page) shows that our Internet retailers can sell to an overseas customer base. After all, New Zealand makes up less than 0.2% of the world's Internet users! The most obvious niche is in products that are strongly associated with New Zealand, but our online retailers have also had success targeting Asia-Pacific customers, ex-pat Kiwis, or overseas customers buying gifts for New Zealand friends and family.



These days, Mr Vintage sells retro-themed T-shirts and other clothes through its own website, but the business had humble beginnings – “selling T-shirts on Trade Me from a bedroom” in 2004. Mr Vintage continues to grow strongly – “around 100% year-on-year growth in 2009”. Marketing efforts focus on “building relationships” through word of mouth and social networking sites like Facebook, rather than traditional advertising. – Discussion with Mr Vintage founder, Rob Ewan

(Source: www.mrvintage.co.nz)

¹¹ SNZ Tourism Satellite Account 2008 and Retail Trade Survey, RCG

What are the Challenges for NZ Online Retailing?

Online “retail leakage” – The Internet makes it very easy for retailers to sell goods to customers in another country. For the present, we seem to be buying more from online retailers overseas than international customers are buying from us. The flow of spending is decidedly one-way! For example, Nielsen estimates that 48% of Kiwis who buy books and magazines online buy them from overseas.¹² Amazon.com is clearly the main attraction in this category.

However, when New Zealanders buy from overseas retailers, local retailers are bypassed completely, and the money goes out of our economy. This is a challenge, but one that can be beaten.

Our NZ online retailers should be able to deliver goods faster than Amazon (which can take weeks), and with cheaper shipping costs. Our retailers may not be able to compete with Amazon on range, but they certainly can on service, and perhaps on price.

Exchange rate fluctuations

Changes in the strength of the New Zealand dollar take a while to filter through to retail prices, and the effect is muted because most of our retailers' costs are in New Zealand (staff costs, rent etc). However, fluctuations instantly affect how attractive it is to shop from overseas websites. This can be a blessing or a curse depending on which way the dollar moves.

Currently, the strength of the New Zealand dollar relative to the greenback makes purchases from US websites very competitive. However, the picture could be very different one year from now, or three years from now, and retailers who are looking to get into selling online should be taking a long-term view anyway.

Economies of scale

In terms of sales, the Internet retailing sector in the US is more than twice as big as the entire retail sector in New Zealand, with sales of \$129 billion (\$US) in the year to June 2009. Many of these US online retailers will enjoy major scale advantages over their NZ counterparts, and are very significant competitors.

New Zealand is, of course, a much smaller market. It's harder for our online retailers to attain critical mass by themselves. Fortunately, Trade Me can be an excellent launching pad for start-up retailers!

¹² Nielsen Online Retail Monitor, Q2 2008

Online Retailers' Perspectives:

Ascent Computers

Ascent has been online since 1997. Policies include top-notch service and “no hidden freight charges... the customer needs to know exactly how much it is going to cost”. Having a physical store in Wellington backs up the online offer – “some customers like to pick up their products in person”.

Motherbase

Motherbase runs the Nappies Direct and Toy Mad websites, with Nappies Direct especially being very popular. “Year-on-year sales growth remains strong, [with little effect] from the recession or Ferrit closing”.

Pharmacy Direct

Pharmacy Direct has offered online shopping since 1997, although the service took some years to become popular. The website has a huge range of products - larger than would be possible in store. Online retailing will get “bigger and better, but there will also be more competition”.

Shop New Zealand

Shop New Zealand, part of All World Shops, only sells locally made goods. This system has proved very successful, and is being licensed overseas. Most sales are to international customers, with popular products including Manuka honey, sheepskins, and natural health products. The site is marketed in several different languages and countries – All World Shops spends \$20,000 a month on Google and Yahoo advertising.¹

Sucklings Shoes

Sucklings Shoes, a Christchurch shoe retailer, launched online shopping last October. In months, the site was “already having a positive impact on sales for the company.”² Even in-store sales have been improved: “Customers [use] the site at home or work to find out if sizes are available and then come into the shop to try them on and make their purchase.”

Anonymous Retailers

“Online promotions are far more effective than offline promotions... we no longer do stand-alone offline promotions.”

“Online retailing in New Zealand is a tricky market, because of our small size and the standards that are set globally. The market will grow, but that doesn't mean it will be easy.”

“The general economy is terrible right now... we are significantly down year-on-year... after experiencing strong growth over the last few years.”

¹ http://www.nzbusiness.co.nz/afa.asp?idWebPage=13579&idAdrenalin_

Articles=684&SID=132728572

² <http://business.scoop.co.nz/2008/12/10/christchurch-success-story-heads-online/>

THE LAST WORD

The Story So Far

The online retail sector in New Zealand is small, but it won't stay this way! We are absolutely confident that there will be major growth in the next few years. New Zealand ranks in the middle of the OECD for broadband connections, and most of us use the Internet regularly. We use it to book flights, accommodation, compare prices on products, or buy from each other through Trade Me – but our retailers are missing out.

Online sales make up less than 1% of total retail sales in New Zealand, which puts us eight to ten years behind the US and South Korea! The overseas evidence shows us that the Internet can account for more than 20% of appliance, music, DVD or book sales – this has to be a wakeup call for these retailers, because we will certainly reach this level, given time.

Hundreds of thousands of us use the Internet regularly and confidently, but have not shopped online, because our wants are not being catered to effectively. There is a big potential market that is not being tapped!

Hundreds of thousands more Kiwis have taken the plunge of buying online, but only plane tickets, or second-hand goods on Trade Me. Retailers need to show them what online retail can offer.

The Effect on Bricks and Mortar (Or, “What’s the Damage?”)

Will online retailing have an impact on bricks and mortar retail stores? We think the process is already beginning. DVD rental stores may expect to have a tougher time of it. Appliance stores have struggled due to the recession and strong competition, and profit margins have been squeezed. In the future, appliance retailers may want smaller, or fewer, stores to reduce overheads and boost profitability. Book shops will also be affected!

Since The Warehouse expects its online store to do better than a physical store in a few years time, could it be that it will close a physical store or two as a result? We think that the effects will be spread out around the country, and over time, so we don't expect any store closures.

And what about the consequences for property investors? Landlords should be very aware that some retail categories are likely to require less space over time, compared to what they currently have.

The Need for Investment

“More retailers need to get involved [with online shopping]. There is minimal investment at the moment” - Major NZ retailer (sales of more than \$100 million)

“There’s going to be an expectation that national chains in particular have an online presence and, if they don’t, they’re going to be penalised accordingly. They need to do it as a measured, strategic activity... sooner rather than later” – John Albertson, New Zealand Retailers’ Association CEO

In the next few years, consumers will increasingly demand online shopping. If our customers can't get it from NZ retailers, they will look offshore, to Amazon or to hundreds of other sites. The result could be the loss of hundreds of millions of dollars in sales, going straight overseas!

We need investment across the retail sector to grow the market. If retailers get online with effective sites, backed up with good customer service, they will reap the benefits. Customers will have a good experience, and become more comfortable with buying online.

Retailers who offer online shopping can boost sales by attracting overseas customers, by getting an edge over their competitors, or by emphasising the links between their website and their physical stores. There are massive opportunities for strong growth, for major retailers and for niche players alike.

Retailers have always needed to innovate to compete. Think of the effect EFTPOS has had! It was introduced in 1984, and once it hit critical mass, EFTPOS use grew at phenomenal rates – around 25% per year from 1994 to 2002, and even today, its share of total transactions is still increasing. Internet retailing is the next frontier – retailers need to get online or get left behind!

Have a look at RCG’s Blog: www.retailexaminer.co.nz

RETAIL CONSULTING AND PLANNING
ARCHITECTURE, INTERIORS, PROPERTY

Retail Examiner is intended for guidance only. RCG Ltd accepts no responsibility for parties acting on the material within, or for any omissions and errors. This Retail Examiner is owned by RCG Ltd, you may not reproduce, publish or transmit this article in any manner without the prior written consent of RCG Ltd.

RCG