Categories Shifting Online

Innovation Stems Cannibalization

More grocery, apparel, prestige beauty, and toy sales are shifting to e-commerce, with new offerings and delivery options. Find out how online sales are growing, and why now.

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By Marie Griffin

In the early years of e-commerce, increased sales of a product category online meant a decrease in the price of the products and a straight-line cannibalization of brick-and-mortar market share. These dynamics are changing as omnipresent retailing becomes pervasive, even among companies born online, and discounting becomes just one of many strategies in the digital commerce toolbox.

The retail marketplace is still in the midst of an ongoing online shift, although the vast migration is tapering off. NPD’s figures show the e-commerce sector increased 7 percent year over year (Y.O.Y.) for the 12 months ending in December 2017, slightly lower than the prior year’s growth rate. Still, even that uptick outpaced overall retail growth as the U.S. retail market was relatively flat for the same period. While brick-and-mortar is still in the lead, consumers regularly move between online and offline shopping.

This whitepaper will drill down into four categories — grocery, apparel, prestige beauty, and toys — that have lower online penetration than most product sectors, as shown by NPD’s consumer data. Logistical challenges and consumer preferences have made these businesses hard to crack for e-commerce, but the obstacles are coming down as e-retailers creatively apply new business models and service solutions. The result for all four categories is higher-than-average online growth and rising overall revenue.

In grocery, the challenges of keeping fresh food fresh and frozen food frozen, as well as the consumer’s desire to gauge food quality with his or her own senses, have until recently been major obstacles to the growth of e-retailing. In apparel, getting the right fit and seeing how the clothes look on the buyer’s own body have been impediments to e-commerce. In prestige beauty, online retail has been hampered by the lack of sensory experience — to smell a fragrance, test a makeup color, or feel a moisturizer. Although e-commerce penetration for toys is not especially low, the category’s online shift follows many of the same dynamics as seen for the other three categories.

As inherently different as these categories are, their online growth paths share certain characteristics, including:

■ **Innovative offerings accessed online**: These are solutions that include products but are not simple transactions. Embedded in the service, usually subscription-based, is a feature that makes the whole greater than the sum of its parts.

  Home meal kits exemplify this trend: The box that comes to the consumer’s home includes recipes for gourmet meals and all the ingredients needed to prepare them. In apparel, a virtual stylist curates clothing and accessories into a personalized package for the subscriber, allowing her to review and keep or return what she wants at no extra charge. In both of these cases, the appeal is not only the products but the perceived expertise of a chef or personal shopper.

■ **Social media creations**: This includes the influencer effect, where a social media star demonstrates or recommends a product and immediately drives huge sales volume. Another angle is the power of demonstration itself. Take “unboxing,” a trend that grew out of videos of people simply taking toys out of packages. Not only have these videos captivated children, undoubtedly leading to sales, but new toys are also being designed so that the play experience starts with the unpacking.
Blurred lines between brands and retailers: It is not a new thing for brands to sell directly to consumers, but brands have traditionally hesitated to compete with their retail customers. Lately, brands have become more adventurous, especially in the online channel, for a variety of reasons: To combat unauthorized online distributors and knockoffs already being sold online, to prevent disruption as key retailers have rolled back store counts or gone out of business, and to expand into new channels, such as subscription offerings. Meanwhile, some brands that launched online and went directly to the consumer from the start have begun distributing to other retailers and/or opening brick-and-mortar stores.

Read on for summaries of how these dynamics are playing out in each of these businesses and for the views of NPD’s industry analysts.

Grocery

Amazon Sparks Competitive Burst In Food E-commerce

The accelerant for a spate of new e-commerce in the grocery vertical was Amazon’s acquisition of Whole Foods, announced in June and completed in September 2017.

By lowering prices on a selection of high-turn, consumable items as soon as it took over, Amazon drove traffic into Whole Foods stores, but the number-one e-retailer simultaneously took Whole Foods to a new level as an online player. As reported in the Wall Street Journal, Amazon racked up $500,000 in revenues in its first week selling Whole Foods’ brands online; in the first month, it amassed $1.6 million.

Having read the signals that Amazon was moving more aggressively into food retailing even before the Whole Foods deal, major supermarket and mass merchandise chains have been extending their e-commerce capabilities. Starting in the fall of 2017, several retailers made announcements about new initiatives in food retailing, including:

- On September 20, near-national supermarket operator Albertsons stepped up to purchase Plated, one of the leaders in the meal-kit delivery market.
- One week later, news broke that Walmart, the nation’s number-one grocery retailer, would launch a premium private-label food line through its online division, Jet.com.
- In early October, Walmart acquired a company called Parcel, which provides last-mile delivery to customers in New York City for both general merchandise and groceries.
- The same week, membership-warehouse-club Costco launched its CostcoGrocery online grocery shopping and delivery service, offering two-day and same-day delivery.
- On December 13, Target announced its purchase of grocery delivery startup Shipt.
- On January 22, Amazon opened Amazon Go, the first convenience store of the future without shopping bags, baskets, or checkout lines.
“You will continue to see e-commerce in retail food accelerate, but it’s a big marketplace,” said NPD’s Vice President and Industry Advisor — Food Sector, David Portalatin. “There’s room for multiple players.”

Food retailers with brick-and-mortar stores still have plenty of advantages. “In this e-commerce discussion, we shouldn’t lose sight of the fact that the consumer is shifting much more toward the experiential,” David added. “In our Virtual Grocery Store Report, based on a consumer study, 44 percent told us they enjoy grocery shopping. So anything retailers can do to enhance that experience — education in the store, sampling, prepared food, culinary demonstrations — can generate retail trips even in an environment where more dollars are shifting online.”

NPD’s National Eating Trends® consumer data showed 7 percent of U.S. households bought groceries online in the three months ending in May 2017. Three-quarters chose delivery to their homes, and the remainder picked up their purchases at the store.

By comparison, less than one year prior, in the three months ending in August 2016, only 5 percent of households purchased groceries online, with a little over half of this group choosing home delivery. These data points truly demonstrate the momentum online grocery delivery has gained in just three quarters.

Consumer adoption of home meal preparation kits also picked up markedly in a short time span; the portion of households subscribing to meal kits climbed from 3 to 5 percent in the three months ending in May 2017 compared to the prior period.

David noted that it took 10 or 15 years for categories like footwear and consumer electronics to get to the point where 25 to 30 percent of sales are purchased through the online channel. “It won’t take that long in food,” he said. “We’ve already reached critical mass with the consumer adoption of this way of shopping. It just happens to be relatively new in food.”

**Apparel**

**The Fight For The Fashion Forefront Is Omnipresent**

Apparel is a big business, with sales above $200 billion a year, and a relatively small — but growing — digital footprint. Although the apparel market decreased 2 percent year over year, apparel e-commerce sales grew 4 percent in the 12 months ending in December 2017.
Some apparel sub-segments are more likely to be sold electronically. Seasonal clothing, by nature, gets significant space on the retail floor at only certain times of the year, prompting consumers to go online if they need these items off-season. As a result, online penetration is higher for categories like swimwear and formal apparel.

NPD’s Chief Industry Advisor — Retail, Marshal Cohen, explained why e-commerce has not made greater inroads into the apparel industry. He highlighted these points:

- **Touch and feel** are more critical in fashion than, say, a category in technology
- **Color** is so much harder to replicate on a screen than in person, and the slight variances can make the simplest online purchases feel like a big mistake
- **Fit** is critical in fashion, a challenge even in-person and more so when clothes are bought sight and fit unseen

Marshal pointed out traditional apparel brands and retailers have not been proactive when it comes to e-commerce. “The fashion industry has been stuck in tradition and sluggish to embrace online as fashion, so little change has occurred to keep pace with the consumer,” he said. “Fashion was once the lead dog in consumption, but it is now chasing almost all other discretionary product spending.”

Indeed, consumers no longer blindly accept the pronouncements from the traditional fashion arbiters, haute designers, and influential editors who once decided the trends, colors, and styles that would trickle down to the masses at the beginning of pre-determined seasons. The web and social media have turned that tradition upside down, contributing to a raft of store closings.

Style influencers arise from the bottom up as images and videos from ordinary people go viral on Instagram, Facebook, Twitter, YouTube, and other social platforms. A new trend can erupt almost out of the blue, leaving retailers without sufficient supply, then fall out of popularity equally fast, saddling retailers with stacks of merchandise that can’t be sold.

Online retailers with agile supply chains and direct-to-consumer fulfillment capabilities have a natural advantage in this volatile marketplace.

New apparel brands born and built online succeed by bringing something new to the market that resonates with some segment of the population. Two examples are Bonobos, which specializes in men’s clothes that have been reengineered to provide a better fit, and ModCloth, which blends a vintage style sensibility with an inclusive approach that is exemplified by its size portfolio — and model sizes — that range from XXS to 4X. Both of these companies were acquired in 2017 by Walmart, joining a growing e-retail division anchored by Jet.com and led by Jet founder Marc Lore.

The key to ringing up higher apparel sales online is addressing the consumer’s need to try on clothes and see how they look. E-retailers have responded with free return shipping and other generous return policies; this is now table stakes in online apparel.
Separately, companies such as Stitch Fix and Trunk Club raised the level of play with stylist-selected arrays of clothing in a box and a business model based on the expectation that the consumer would return some or all of the items while the algorithm learned her preferences. In June of 2017, Amazon joined the “box” game with the launch of Amazon Prime Wardrobe. The apparel marketplace is large and fragmented, and its overall growth is stalled. To win, Marshal Cohen said retailers must adopt an “omnipresent” approach by engaging with consumers before, during, and after transactions. No doubt, Walmart, Amazon, department and specialty store chains, and newer multichannel brands will be fighting for the consumer’s attention and spending for some time to come.

**Prestige Beauty**

**Skincare Leads Category And Online Growth**

Prestige beauty revenues were up 6 percent year over year for the 12 months ending in December 2017, an especially good gain in a flat retail industry. Online sales in the category rose 30 percent in the same period.

As in grocery and apparel, better beauty online sales have been tempered by the consumer’s need for a sensory experience, but that is not the only reason prestige beauty has remained predominantly a brick-and-mortar business. Strong, service-oriented specialty retailers and a few innovative department stores can take credit for keeping consumers in the stores.

NPD divides prestige beauty into three subcategories: fragrance, makeup, and skincare. Each of these segments has different online penetration, varying from fragrance on the low side to skincare on the high side.

Two of the biggest drivers of growth in the prestige beauty business are new products and social media, which are channel neutral. Nonetheless, Executive Director — Beauty Industry Analyst Larissa Jensen said online sales are growing in all three subcategories.

Social media is a huge factor in lifting sales of beauty products. As Larissa pointed out, “Lots of selfies means lots of makeup needs.” And social media isn’t driving just cosmetics. Demonstrations of the application and removal of facial masks, for example, have become hugely popular on Instagram and YouTube.

Skincare, which has the greatest online penetration, is also the fastest-growing subcategory within prestige beauty. Across all channels, skincare growth is coming from a mix of traditional subsegments (like facial moisturizer) and smaller, more innovative, and social subsegments (like masks, cleansers, essences and treatment “boosters”), explained Jennifer Famiano, Manager — Skincare Industry Analyst.

Because performance and ingredients are key factors in skincare product selection, and the results are not immediate, product reviews give e-commerce sites an advantage. “You can feel more comfortable in making a purchase when you know a product has gotten high ratings from other consumers,” Larissa said.

Larissa and Jennifer foresee continued migration of the upscale beauty business to e-commerce, up to a point. “The beauty category as a whole is very experiential and it lends itself well to brick-and-mortar retailing, so we think the category will probably max out at about one-quarter of sales online,” Larissa said.
Toys

The Endless Aisle of Toys Online

The fact that toy revenues are modestly increasing while market share is moving in favor of e-commerce indicates discounting is not the main driver behind the move. Like the other categories featured in this report, a combination of product innovation and new ways of bringing products to consumers is leading to positive results.

The “in-a-box” home delivery trend is piquing consumer interest in the toy business. A range of providers that includes toy manufacturers, giant e-retailers, and entrepreneurs offers unique permutations of toy, craft, STEM, and other subscription boxes through the Cratejoy marketplace.

Social media’s impact on the toy industry has been significant, too. For example, the popularity of “unboxing” videos is inspiring new toy lines. The toy industry, even more than most categories, depends on the fourth-quarter holiday season, when about half of annual sales are registered. Online penetration increases significantly during that critical period, said Juli Lennett, Senior Vice President – Toys Industry Advisor.

At holiday time, shoppers aren’t necessarily going online to find discounts. They are generally looking for specific products to fulfill a child’s list. Brick-and-mortar stores, even big toy specialty chains, have a limited amount of space for toys. But the endless aisle of e-retailing becomes an invaluable asset. “If a child writes a letter to Santa Claus asking for 5 things, the parents are going to try to buy those 5 exact items,” Juli noted.

Winning In An Omnipresent World

U.S. retailing is a zero-sum game. As growth flattens, any channel or entity that increases its market share must take it from another. In general, sales will continue to migrate from brick-and-mortar stores to the digital realm, but this is no longer bad news for the retail sector.

Omnipresent retailing is here.

Consumers are already moving seamlessly between stores, websites, and mobile apps as they shop with any given retail brand. The driver is convenience for the customer, not price. That doesn’t mean price isn’t still important; it means consumers will shop for the best value, as they see it, without regard for the channel they are using at a given time.

The challenge for many retailers is to operate stores and websites in the channel-neutral way their customers are shopping. Their ability to overcome that challenge — and quickly — will determine the winners and losers in tomorrow’s retail arena.

Learn More

This is a snapshot of our e-commerce insights across the food, apparel, beauty, and toys industries. For more retail trends and insights, or to discover how you can measure performance, predict future performance, or improve your marketing and product development, visit our LinkedIn page, contact your NPD account representative, call 866-444-1411, or email contactnpd@npd.com.