

Panorama sectors



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Coface releases a series of economic reports and is pleased to announce the publication of its second Panorama sector report.

Readers will find in it a global sector barometer which analyses the situation in fourteen key economic sectors. The originality of the analysis is that it is based on aggregating the accounts of 6,000 companies in three of the world's major regions: the European Union, North America and Emerging Asia. There is an overview of each sector, with reference to a single indicator measuring its dynamism, financial robustness and Coface's payment experience.

This Panorama also focuses on e-commerce, which is setting the stage for new patterns of global consumption. Within a depressed economic context, this distribution channel has registered double-digit average annual growth since its emergence in the mid-1990s.

We will end with an analysis of the current dynamics of the retail sector in the UK and France. This sector is facing new technological challenges such as e-commerce. The UK is a pioneer with France following, supported by technological soar. The retailers' economic model is accordingly in transition, which gives rise to risks both for traditional and electronic retailers.

The exponential growth in the number of companies suggests an industry consolidation.

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SECTOR BAROMETER

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The gap between the European and North American sectors is widening. Key sectors such as construction and automotives illustrate the growing divergence between the world's main economies.

The credit risk index highlights a still sluggish situation across most European sectors, adding to signs that the recession in the euro zone continues to put pressure on the region's businesses. In contrast, things are improving in North America, especially in the sectors benefiting from the rebound in household consumption like construction and automotives. The risk associated with Asian sectors remains contained, apart from textiles-clothing, mechanical engineering and metallurgy. Aside from these regional disparities, the credit risk has worsened in the metallurgy sector, globally, since the publication of the last barometer in December 2012. Energy and pharmaceuticals continue to post satisfactory performances.

Credit risk index *			
Sectors	Emerging Asia	North America	European Union (to 15)**
Chemical	●	●	●
Pharmaceuticals	●	●	●
Wood-paper	●	●	●
Transportation	●	●	●

Sources: Datastream, Coface

* At the end of March 2013

** See chart of credit risk index page 4

● Moderate risk ● Medium risk ● High risk ● Very high risk

● Chemicals

In emerging Asia, the Chinese chemicals industry remains dependent on the automotives and construction sectors. However, there is insufficient demand to sustain prices and therefore margins. The costs of raw materials are rising, as are wages, reducing the industry's profitability. Moreover, inflation is mounting, which could lead the Central Bank to move to control the money supply, which would affect future growth - a basic variable for a highly pro-cyclical industry.

In North America, the cost structure favours an industry which is benefitting from the recovery of the construction and automotives sectors. Raw materials costs are falling, due, in particular, to an abundance of gas, the prices of which are at historically low levels.

The market in Europe is greatly affected, as is shown by flagging industrial production. Europeans are suffering from excessively high energy costs compared with those of the United States. The only positive point is that exports, which represent 62% of turnover, are sustaining the economy.

● Pharmaceuticals

China and India have emerged as major players in the production of active ingredients for the pharmaceutical industry. Moreover, helped by the development of a middle class in these countries, they have become essential growth hubs for the big pharmaceutical manufacturers.

Fiscal consolidation efforts are affecting the European Union's health spending, particularly through reductions in the reimbursement of healthcare costs in Southern Europe. France is also affected, with the law imposing a slowdown in the rise of healthcare costs. Manufacturers of generic medicines are, however holding their own, positioning themselves as a credible alternative in the context of reimbursement policies, as also producers of over-the-counter medicines, which are not paid for by health insurance.

The American drug approbation agencies are stepping up their rate of approvals of new molecules so that they can be placed on the market, while the Federal health insurance programs (Medicaid and Medicare) still enable the poorest to have access to government healthcare assistance. However, the need to cut the Federal debt and deficit calls for a degree of prudence.

● Paper-wood

This sector is financially healthy with turnover growing by 4% to 16% depending on the geographic region. However, caution should be exercised regarding 2013. The growing power of the existing players as well as the market reentry of other players is leading to volatility in the price of timber. In Europe, the sector is becoming concentrated. In Asia, the recovery of property prices in China is a positive factor in the short term but, in the medium term, restrictive measures could depress the sector's growth. And a slowdown in demand for certain woods is to be noted.

This sector is strong in North America, the United States being the biggest producer of paper (followed by Asia and Canada). However, in the United States, the housing and timber products sectors remain subject to the vicissitudes of economic growth.

● Transportation

The sector is posting positive results (rising turnover in the three regions), essentially because of air transport, which has seen traffic grow, especially for Asian companies, which are benefitting from rising demand. However, American and European companies are experiencing weak growth. Moreover, margins for the whole air transport sector are under strong pressure due to the continuing high price of oil.

Road transport is undergoing a phase of concentration. The sector is subject to strong pressure in terms of logistics and the oil price. Concerning the European Union, the sector is affected by competition from the road haulage companies of Central Europe, which benefit from favourable legislation.

INDEX METHODOLOGY

Credit risk index:

Coface's assessments are based on the financial data published by over 6,000 listed companies in three major geographic regions: Emerging Asia, North America and the EU 15.

Our statistical risk index simultaneously summarises the changes in five indicators: four financial indicators (changes in turnover, in profitability, in the net indebtedness ratio, in cash flow) completed by the claims recorded through the Coface network).

Credit risk index *			
Sectors	Emerging Asia	North America	European Union (to 15)**
Mechanicals	●	●	●
Metals	●	●	●
Automotives	●	●	●
Construction	●	●	●
Energy	●	●	●

Sources: Datastream, Coface

* At the end of March 2013

** See chart of credit risk index page 4

● Moderate risk ● Medium risk ● High risk ● Very high risk

● Mechanicals

Although affected by the contraction of the automotives market, the European mechanical engineering sector has nonetheless managed to avoid sinking into gloom, as reflected by the 4% rise in turnover. This is particularly true for German industrials, which are benefitting from their exposure to high-growth regions.

American manufacturers are benefitting from the recovery of the construction sectors and from the continuous improvement observable on the automotives market (turnover up by 6%).

● Metals

The Chinese steel industry has strengthened its leading world position, securing a market share of 46.3% in 2012. However, the sector is hampered by overcapacity and businesses are experiencing a sharp fall in profits. They need, moreover, to continue their move upmarket.

European metallurgy suffers also from overcapacity while the sector's main customers (construction and automotives) are having a tougher time. Margins are continuing to contract due to weak demand and the high price of iron ore.

In North America, the sector is expected to remain weak with the influx of cheap Chinese steel.

● Automotives

Sales in the European market have collapsed (-9.5% at the end of February 2013) which has led to increased competition and lower prices, thus eroding margins and affecting the weakest manufacturers and sellers. The most resilient European manufacturers are those that benefit from their geographical position close to growth areas and from either their low cost or premium positioning.

China has become the world's leading market ahead of the United States and the European Union, helped by a steady rise in wages and therefore household purchasing power. However, according to the CADA (China Automobile Dealers Association), unsold stocks of new vehicles are rising, as households are apparently shifting to second-hand vehicles (up 15% at the end of February 2013).

Sales in the United States, up by 4% at the end of February 2013, are driven by vehicle fleet renewals and consumer demand. Household confidence seems to have returned, which is boosting the results of local manufacturers and of foreign manufacturers established in the United States (GM published profits for the whole of the year 2012 amounting to \$5 billion). However, tax rises and cuts in social security spending are likely to reduce household purchasing power between now and the end of the year.

● Construction

The sector is a benchmark sector for developed and emerging economies.

Abundant credit in numerous Asian countries has benefitted the property sector, but it can be a source of medium term risk.

Within the European Union, activity in the sector is flagging. Eurostat's construction confidence index was down by 9.1% between January 2012 and 2013. Particularly hard hit, Portugal and France have seen building starts fall. In Europe, the sector is in a situation similar to that observed in 2008-2009.

In North America, the construction indicators are again positive. In the United States turnover growth is up (+6%), with the number of new building starts up by 50% over the last six months; sales of new houses are increasing, as is the confidence index of the players in the sector.

● Energy

After Europe and North America, the Chinese renewable energy sector has been affected in turn by the fall in the price of solar panels. The bankruptcy of the world number one, Suntech, illustrates the difficulties of the sector and its need for restructuring. Moreover, China is also favouring the development of shale gas.

The shale gas revolution in North America serves to supply manufacturers with low cost energy and provide American industry with a competitive advantage, particularly its chemical and steel industries.

Finally, with the oil price still high, corporate credit risk, particularly in North America, for companies operating in the oil sector is weak because of their ability to generate cash flow.

Credit risk index *			
Sectors	Emerging Asia	North America	European Union (to 15)**
Agro-food	●	●	●
Retail	●	●	●
Textile-clothing	●	●	●
Services	●	●	●
Electronics, IT	●	●	●

Sources: Datastream, Coface

* At the end of March 2013

** See chart of credit risk index below

● Moderate risk ● Medium risk ● High risk ● Very high risk

● Agro-food

This sector is dependent on the price of raw materials. World prices are on a downward trend since the start of this year. This could be temporary; prices are volatile as they are dependent on climatic conditions amongst other things. Accordingly, wheat prices are expected to rebound as a result of the drought in the United States. Credit risk remains moderate in all economic regions. In Europe, this key sector is facing new challenges: having to be more transparent and more competitive internationally. The sector has also been hit by the contraction of household consumption in several euro zone countries.

● Retail

The sector presents a moderate risk in Emerging Asia with a double-digit rise in turnover (+12%). The growth of the middle class continues to favour household appliances. However, in Europe and North America, this sector is facing new challenges with turnover growing in these two regions (+4% and 5%), especially thanks to the increase in online sales, favoured in times of crisis by consumers looking for the best price (see p5, focus on world e-commerce).

● Textile-clothing

The sector is undergoing great change with production coming mainly from Asia, where it is still doing well due to the constant growth of businesses' turnover. However the sharp rise in wages in China and Thailand has led to a process of relocation to lower cost countries like Bangladesh and Cambodia. China remains the biggest exporter of textiles and clothing, while the European Union and the United States are the two biggest importers. Although this sector is suffering from a contraction of demand in North America and Europe, the luxury segment is driving up businesses' global turnover. Finally, we note that the cotton industry presents a significant risk: stocks are at an historically high level at 16 million metric tons.

● Services

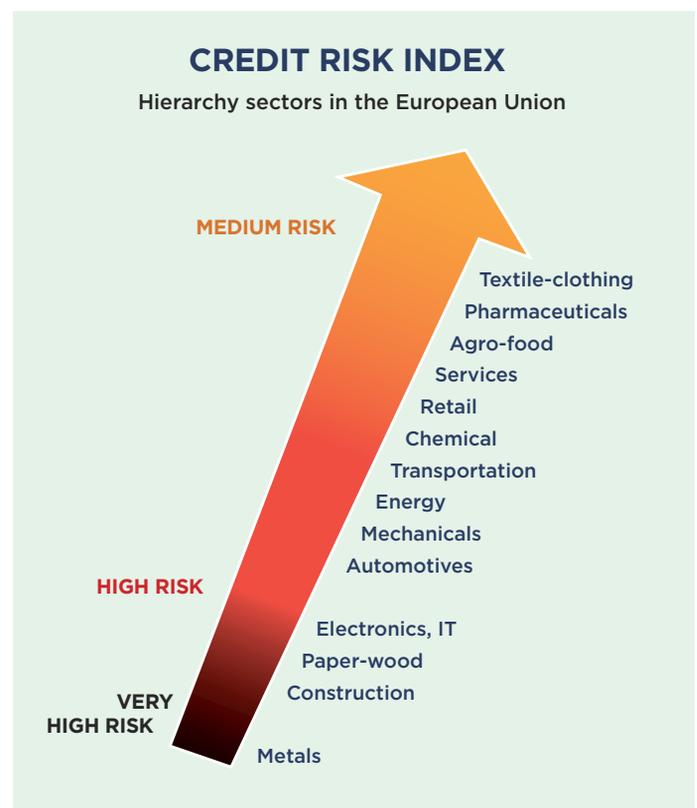
The services sector is seeing an improvement in its risk and its global turnover in emerging Asia (+12%) as well as in North America (+7%) and even in the European Union (+3%). However uncertainties remain regarding services to individuals, which remain dependent on political decisions, particularly in Europe. Services to businesses, particularly in the area of information technology and engineering are now shifting to the emerging countries, where there is a strong demand for this area of skills. Growth in the countries of emerging Asia is a boost for the services sector whose contribution to growth

continues to increase in these economies: the services sector thus represented 45% of Chinese growth in 2012.

● Electronics, IT

PC sales are falling. Players in developing countries are facing new competitors: in 2012 the Chinese group, Lenovo, competed strongly with Hewlett Packard in PC sales, with its market share reaching 15.5% in the last quarter of 2012. The fall in computer sales (-9.6%) is particularly evident in Europe, Middle East and Africa. Competition with tablet sales is intensifying and these are expected to overtake PC sales this year.

Between 2005 and 2013, the share of European manufacturers in investment in the semi-conductor industry dropped from 8% to 2%, according to IC Insights. Only companies with their head office in the United States have increased their global investments (from 29% to 37%). In 2012, Intel and Samsung will concentrate the bulk of their investment in this segment. Their presence in the world top 10 should ensure their long-term survival.



E-commerce around the world

Emmanuelle HIRSCH, economic research group, Coface

E-commerce: an opportunity not to be missed?

TABLE 1:
Key figures,
world

	2007	2011	Evolution 2007/2011
Turnover (€Bn)	357	679	90 %
Internet users (Bn)	1,3	2,4	85 %

Source: IMR

RECENT DEVELOPMENTS

The Internet along with the strong growth of e-commerce has changed the way we do our shopping. However, this is still a niche phenomenon: e-commerce represented, on average, only 8% of world distribution in 2012 (but is expected to rapidly reach 10% or even 15% by 2020). E-commerce represented 11% of distribution in the UK, 9% in Germany and 9% in France in 2012.

E-commerce has not suffered from the crisis. Its expansion has probably even bolstered by the crisis: in 2011, world online turnover rose by over 20% compared with 2010 to reach €680 billion and is likely to remain steady in 2012 at a rate close to 20%. In Europe, it accounted for €305 billion (about half of world turnover), of which 60% is from the UK, France and Germany (Source: Emota).

The United States is by far the largest market for online sales, with a turnover of \$225.5 billion in 2012. The US is ahead of the UK. However sales growth is expected to slow (by between 10% and 15%) in the next few years in more mature markets, like the US, Japan and the UK. Meanwhile, the emerging countries (Latin America, Africa, etc.) will continue their growth momentum. As for China, e-commerce is taking off. Turnover multiplied almost 65-fold between 2007 and 2011 due to the development and democratisation of Internet networks.

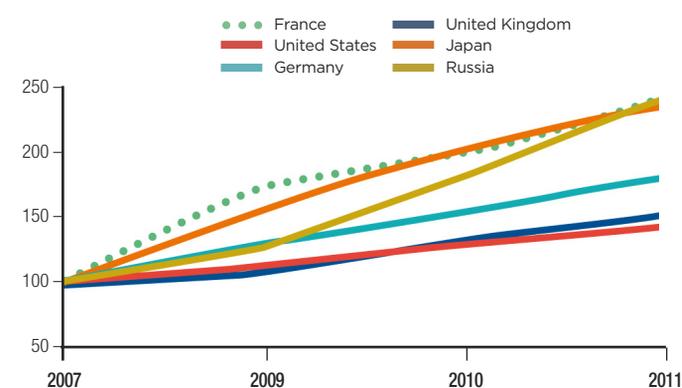
SALES GROWTH CORRELATES WITH EXPLOSION IN NUMBER OF WEB SURFERS

This explosion in sales could not have happened were it not for the very strong rise in the number of web surfers in the world, which increased from 385 million in 2000 to 2.4 billion in 2011. By 2015 there are expected to be 3.5 billion surfers, or half the global population.

China is out in front with 515 million surfers (or 38.3% of the total population). The US is next with 243 million surfers (or 70% of the total population). The rising numbers have been boosted by the development of Internet hardware (miniaturisation, wireless, decreasing prices), which has gone hand-in-hand with lower connection costs.

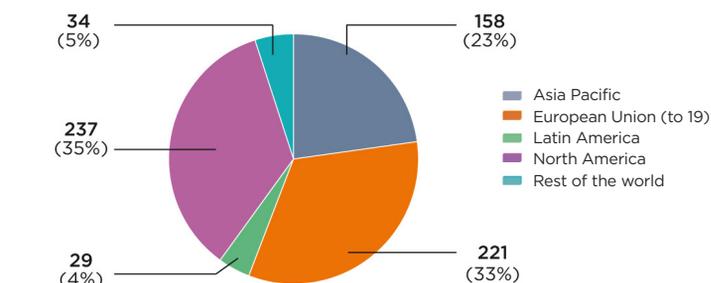
Among the population doing its shopping on the Internet, the difference between men and women is narrowing. Whereas, when the Internet started, online consumers were essentially young and male, now there is quasi parity.

CHART 1:
E-commerce turnover
(base 100 = 2007)



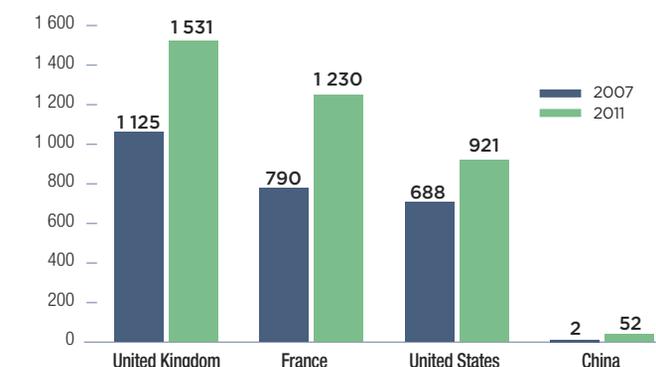
Source: IMR

CHART 2:
E-commerce turnover by geographic breakdown, 2011
(In billions of euros)



Source: IMR

CHART 3:
Average spending of a purchaser (in euros)



Source: IMR, Fevad

TABLE 2:
Ranking actors by
European turnover

European Top 10 in 2011	Company	Country	Online turnover in billion EUR	2010/2011 in %	Market share in world turnover
1	Amazon	USA 	12	38%	1,8%
2	OTTO	Germany 	4,5	25%	0,7%
3	TESCO	UK 	3,9	11%	0,6%
4	STAPLES	USA 	2,6	2%	0,4%
5	PPR Redcats	France 	2,3	21%	0,3%
6	Argos	UK 	2,4	18%	0,4%
7	shop direct group	UK 	1,5	9%	0,2%
8	Apple	USA 	1,3	28%	0,2%
9	Cdiscount	France 	1,3	14%	0,2%
10	3 Suisses	France 	1,3	10%	0,2%

Internet sales growth is steady, regardless of the online consumer's age or place of residence. Between 2007 and 2011, the basket of French online consumers grew by about a third (see chart) although the UK, with average spending of €1,530 in 2011 is the uncontested leader. Internet purchase rates vary considerably by country. In 2012, according to Eurostat, 60% of Europeans aged between 25 and 34 buy online. However, it is the generation aged 16-24 that represents strong potential. Despite having less money, 54% of them made online purchase in 2012. Their online purchases will increase over time as their disposable incomes rise. Longer term, they will contribute to the enhancement of the curve for the older population of online consumers. Geographically, 49% of urbans are online buyers for only 34% of rurals.

WHAT GETS BOUGHT ON THE INTERNET?

Mainly cultural goods (music, films, books), technical equipment (linked to electronics), clothes, travel/holiday rentals. The precise ranking differs by country depending on the make-up of the categories. In France, products linked to tourism are in first place (56% of online purchases, Source: Fevad), while in Germany, clothing represents 22% of online sales turnover du (Sources: Fevad, BVH Info). Growth rates for both these sectors are currently increasing rapidly. In the United States, tourism represents \$94.5 billion, or about 37% of sales carried out online. Meanwhile, textiles and clothing account for about 50% of online sales in China, where the luxury segment is strongly represented.

PRINCIPAL MARKET PLAYERS

With nearly 117,000 e-commerce sites in France and over 300,000 in the UK, the sector is growing rapidly and still not very concentrated. The composition of the sector will change with the arrival of brands, physical shops and the development of m-commerce (mobile shopping).

Three types of player can be distinguished:

- *pure players* that make almost all their turnover on the Internet. Amazon is the world leader in this, but only has 1.8% of market share.
- *click & mortar* companies, i.e. traditional companies (FNAC, SNCF Voyages, Tesco) that have added online business (click) to their traditional business (*mortar*).
- mail order companies whose turnover came from direct selling before their catalogue orders were transferred to the web. E.g. the 3 Suisses, Boden.

These three types of business are fighting it out over who will be in the top 10 European e-commerce businesses (see table 2). As the market matures, the dominance of the pure players will diminish and other players will move in. It should also be noted that online purchases are mainly made by consumers in the same continent, except for those from Amazon, which is the only player present across the whole world. Amazon offers a diverse range of products, and has local offices (in Luxembourg for its administrative and tax affairs and distribution warehouses in the UK and France, among other countries). The second largest European online retailer is OTTO, which operates under German legislation. Confronted with this multiplicity of players, it will be necessary over time to set up a better tax regime and consumer protection legislation.

E-COMMERCE OF THE FUTURE

The Internet along with digital tools will change the role of the traditional shop:

- better consumer information thanks to data gathered online; in-shop interactivity via tablet computers, smartphones and interactive labelling (barcodes, chips), mobile payments. And for the retailer, the provision of further information on the product on the customer profile for different products.
- better product availability: can be bought from anywhere at any time; online purchase from business website and collection in the shop.
- diversified product range through products at competitive prices, niche products (very up-market and high-end design) virtual shops or pop-up shops.
- better customer service through loyalty programmes, personalised offers thanks to better customer identification and understanding of customer location.

This multiplicity of actors affecting all ecommerce players means that only companies which are financially sound (backed by a large group, with substantial equity and contained costs), and able to meet consumer demand (product mix, logistical resources) will be able to continue growing and survive.

To conclude, the potential of e-commerce sites to grow depends on their ability to conquer markets outside their usual catchment area: take Amazon for instance, which has set up logistical platforms in different countries across Europe to satisfy the needs of its customers.

France and the UK: The retail sector faces the technology challenge - what are the consequences for business?

Jennifer FOREST, Economic research, Coface
Guillaume BAQUE, Economic research, Coface

The recent insolvencies of large retailers like Surcouf, HMV, Virgin or Game group point to real difficulties encountered by the sector and the major constraints caused by integrating e-commerce in their business model. The force with which the Internet's impact has been felt across the print media industry presages a far-reaching change to the business fabric. This is driving the move, by the retail sector, towards a single economic model converging bricks and mortar and digital commerce. However, this transition is a source of risk: a technological shock of this kind forces businesses to transform themselves or to suffer the consequences of natural selection. In this paper we first concern ourselves with the characteristics of retail and e-commerce in France and the UK and then go on to analyse the risks associated with the sector. Finally, we ask what new model the retail sector is moving towards.

RETAIL SECTOR: CURRENT STATE OF PLAY

Emerging less than two decades ago, e-commerce has gradually become firmly established in patterns of consumption and information research. While the UK acted as a precursor, France lagged behind and as it catches up, pressure on businesses is expected to increase.

E-commerce represents 8 to 11% of retail

As the backbone of developed economies, the retail sector (excluding foodstuffs) represents 18.6% of French GDP compared to 16.7% in the UK. Despite its size, the sector posted weak, even negative, growth in 2012 (table 1).

The retail trade confidence indicator⁽¹⁾ worsened in France (-15.9 in February 2013), as well as in the eurozone. Only in the United Kingdom has this indicator improved (+7.2) since the end of 2011, showing a result well above the average for 2000-2013. In addition, UK (-15.8) and French (-28.5) consumer confidence remains strongly negative, although there has been a slight improvement on the UK side.

The insolvency rate remained high for both countries in 2012, with a slight drop in the UK, and is likely to remain so in 2013 with a new wave of major bankruptcies expected in the first quarter.

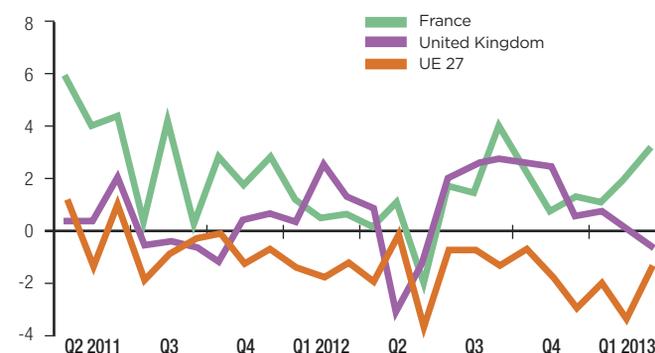
TABLE 1:
Key figures: retail and e-commerce

	France 	United Kingdom 
Retail (excluding food)		
Turnover (2012)	479 Mds €	406 Mds €
Change (2011/2012)	1,3 %	-0,5 %
Bankruptcy rate 2012*	1,61 %	1,16 %
E-commerce		
Turnover (2012)	45 Mds €	90 Mds €
Change (2011/2012)	19 %	14 %
Spending / purchaser	1 400 €	1 830 €
Number of sites	117 000	300 000
Turnover / GDP	1,7 %	3,7 %
Share of e-commerce / retail	8,8 %	10,8 %
Growth of m-commerce	260 %	300 %

* Number of bankruptcy / Number of company
Sources: Insee, Fevad, IMR, ONS, Coface UK, Coface

French and UK retail sales figures diverge from each other from the first half of 2012 (chart 1). While sales are up in France, they are down in the UK. Moreover, one can observe a higher insolvency rate in France of 1.6%. As for e-commerce sales, these continue to rise, representing in 2012 8.8% of retail in France and 10.8% in the UK.

CHART 1:
Retail sales trends (year on year)



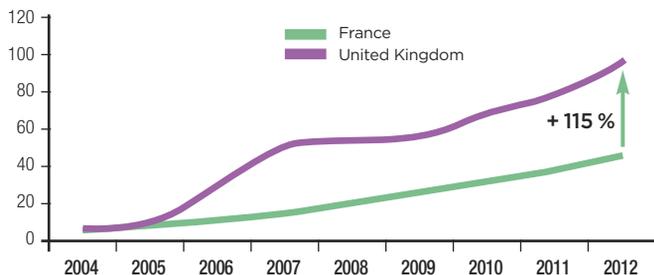
Sources: ONS, Eurostat

Let us recall that the retail sector is characterised by aggressive competition, especially in the UK. The rise of e-commerce has exacerbated the situation with significant growth in the number of players, an average of +30% a year in France over the past five years (according to FEVAD (Federation of Distance Selling Businesses)). Until 2005, e-commerce represented less than €10 billion in turnover in both countries (chart 2) and was almost exclusively made up of *pure players*⁽²⁾. The pace of growth has accelerated strongly in the UK, enabling it to become Europe's leading market accounting for 12% of world turnover, i.e. €90 billion in 2012. The UK market was ahead of the market in France, which started later. Lack of confidence in this new retail channel may partly explain this French « delay », even though e-commerce is now at last established in the economic landscape.

(1) « Business and consumer survey results », European Commission, February 2013

(2) A business that started and operates with a single retail channel

CHART 2:
E-commerce turnover (euro billions)



Sources: Fevad, IMR

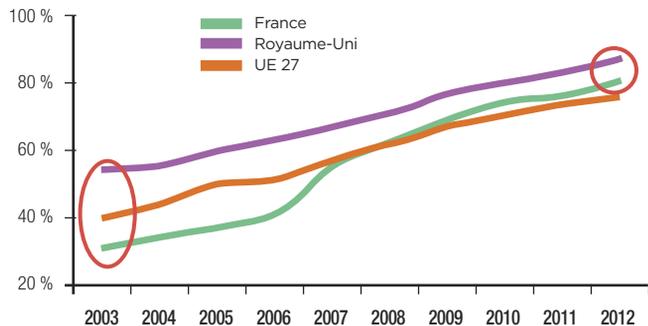
**E-COMMERCE:
AN OPPORTUNITY FOR RETAILERS...**

The sector benefits from particularly favourable structural and economic characteristics. An acceleration in the coverage rate, greater security of transactions and low costs for accessing the Internet are among the many factors driving businesses to move more quickly to digital so as to meet new consumer demand. And the gloomy economic environment has been an opportunity for e-commerce with household purchasing power under pressure. On the hunt for bargains, households have increasingly turned to online shops.

In France, Internet connection rates are converging with UK standards...

The expansion of the Internet network and of e-commerce go hand-in-hand. Since 2007, the Internet connection rate for French households has increased significantly and now exceeds the European average and is nearing Nordic country standards (chart 3). According to Eurostat, 80% of French households now have Internet access at home, of which 96% have broadband. The growth of Internet usage in the UK has been more gradual than in France. With early demand from consumers, the economic fabric in these countries has adjusted more rapidly.

CHART 3:
Proportion of households with Internet access at home

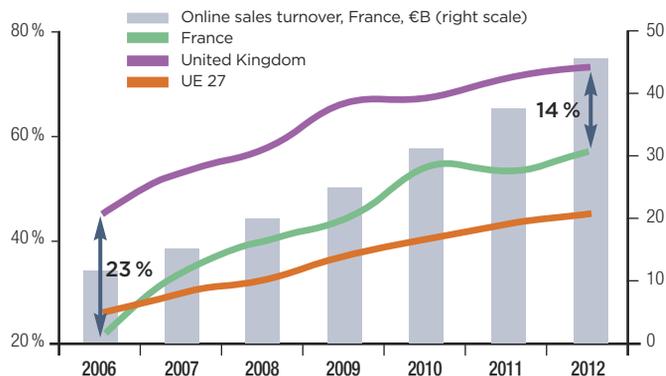


Source: Eurostat

... but consumer behaviour is still lagging behind

French consumers are increasingly turning to online shopping. Almost 8 out of 10 Internet users made an online purchase in 2012 compared with 6 out of 10 four years previously (chart 4). Nonetheless, the pace of growth has declined since the start of the decade because of doubts over the security of online payments and the risks associated with the disclosure of personal information. According to Eurostat, nearly 14% of UK Internet users say they have not bought online during the year for reasons associated with security issues compared with 23% in France. However the scope for growth is still significant considering that the gap between an average annual basket in France and the UK amounted to €400 in 2012 (table 1).

CHART 4:
Proportion of individuals who have ordered online in the past 12 months and online sales in France

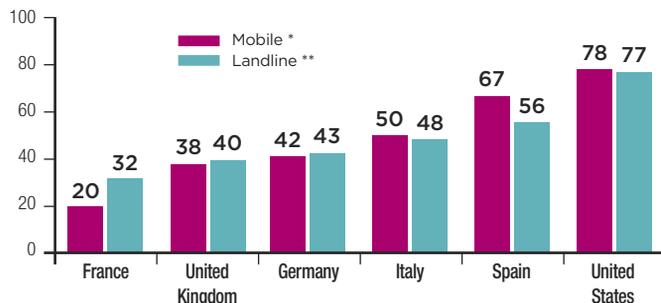


Sources: Eurostat, Fevad

Aggressive offers by French Internet service providers has triggered expansion of e-commerce

The substantial and lasting growth of the sector is fostered by a favourable competitive environment for Internet service providers. Consumer exposure to the Internet is therefore intensified, highlighting the prospects for e-commerce. The service provider Free alone symbolises the sector's dynamism. Its *triple-play*⁽³⁾ offer, launched in December 2003, followed by its mobile telephony offer in January 2012, has allowed it to keep prices low and democratise the Internet by driving up household connection rates. France's fixed and mobile Internet packages are now among the cheapest in the world (chart 5), which has led to a fall in consumer prices for communications networks⁽⁴⁾ (chart 6).

CHART 5:
Comparison of monthly prices for telecoms services (in euros)

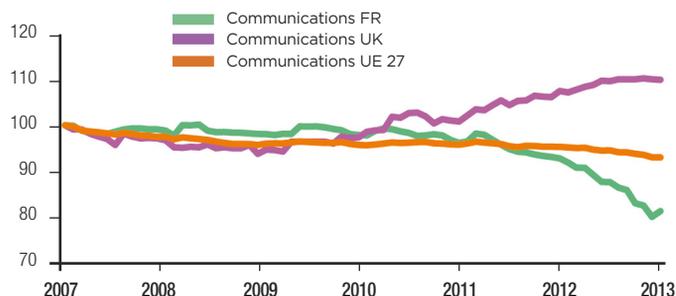


* Comparable packages, October 2012: unlimited calls, sms and mms, Internet (1 to 3 GB), without mobile, pay as you go

** Comparable packages, October 2012: national calls, unlimited TV and Internet broadband

Source: Arthur D. Little

CHART 6:
Harmonised consumer prices index (base 100 = 2007)



Source: Eurostat

(3) Unlimited landline telephone calls, Internet and TV

(4) Landline, Internet and router services and connection hardware)

Moreover, mobile telephony is encouraging Internet usage in our everyday lives. At the current pace of smartphone sales in France, which has now overtaken sales of traditional mobile phones, the whole mobile telephony market is expected to be connected to the Internet by 2015. Coupled with falling prices, this underlying trend points to increasing take-up by consumers. In this context, m-commerce saw three-digit growth in France (+260%) and in the UK (+300%) in 2012.

... BUT ALSO A SHOCK GIVING RISE TO MULTIPLE RISKS

There are two types of businesses at risk: both traditional retail businesses which do not have an internet presence and also a host of small businesses which are present only on the Internet and whose number has tripled in only five years to reach over 117 000 companies in France and 300 000 in the UK. The number of online merchants is such that the big e-commerce players have opened market places aggregating the offer of these thousands of small retailers.

In the UK, early arrival has meant premature collapse of traditional businesses

This risk became apparent primarily in the UK, where the sector had to contend with e-commerce very early on. Since the collapse of Woolworths in November 2008, several leading stores across the UK, such as Comet (former subsidiary of Darty), HMV, Clinton Cards and Game Group, have been toppled by the rise in the power of e-commerce. They were unable to integrate into their business model. According to a survey by PwC⁽⁵⁾, there are now a greater number of retailers closing their doors than opening them, especially in the areas of IT and toys. Retailers need to rationalise their points of sale in order to curtail the fixed costs squeezing their margins. In France, big names in the retail sector have also been hit by the arrival of these technologies, even though this has been somewhat later than in the UK. Insolvencies have also hit big name-retailers like Virgin, Surcouf or Game France.

A risk also for online distributors

Apart from these traditional businesses, those specifically focused on online sales are also at risk. These insolvent businesses are mostly small in scale, with few employees and low equity. In France, in 2012, 305 company insolvencies were recorded among specialised e-commerce and distance selling businesses, representing an increase of 3.4% compared to 2011. Among the most significant insolvencies, we can mention *comerceequitable.com*, which, after 12 years of business, was wound up in December 2012, notably because of substantial debts. Likewise, *pieces-auto-moto.com*, which had a turnover of approximately €500 000, collapsed in January 2012.

This situation is likely to persist in 2013, with further concentration of virtual retailers to come and bricks and mortar retailers optimising their points of sale and strategy.

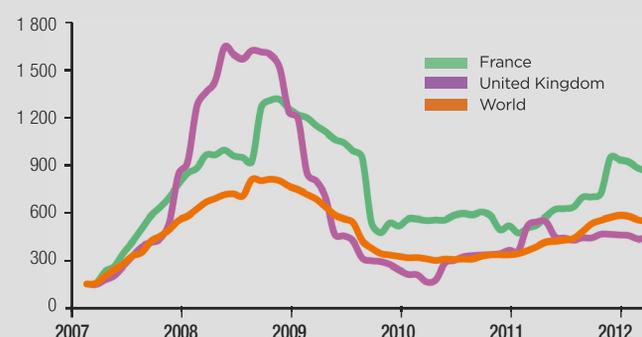
3 questions for Fabrice Rocchi,

Head of Retail,
underwriting department, Coface

• Have you seen an increase recently in payment incidents in the retail sector in France and the UK?

Following the sharp rise in payment incidents in 2008, marked by the collapse of Woolworths, the situation is under control. Admittedly there was a small wave of bankruptcies in 2011, which led to financial difficulties for retailers when their quarterly rent payments were due. The payment arrears curve has now stabilised at a level which nonetheless still requires vigilance. In France, the sector was still greatly at risk in 2009 and since 2011 there has been a worrying upward trend.

Coface payment incidents in the retail sector
(base 100 = 2007)



Source: Coface

• Do you think the risk is higher for traditional distributors or for e-retailers?

In the current crisis and with consumption contracting, the traditional model of bricks and mortar shops is under particular pressure. Fixed costs, limited choice, stocks to manage, opening times and retail prices – these are the parameters which constrain this method of selling. E-commerce does not have these disadvantages but this also has its drawbacks for the customer (unreliable deliveries, risks linked to bank transactions...), as well as for those businesses which are engaged in increasingly fierce competition on price, which reduces their margins and pushes up credit risk. It seems that there will have to be some changes in order to limit this risk. Traditional retailers will have to put in place a multi-channel system. And, for their part, e-retailers will have to get backing from financially solid groups insofar as most of them operate from a narrow financial base.

• How do you see credit risk for this sector in 2013?

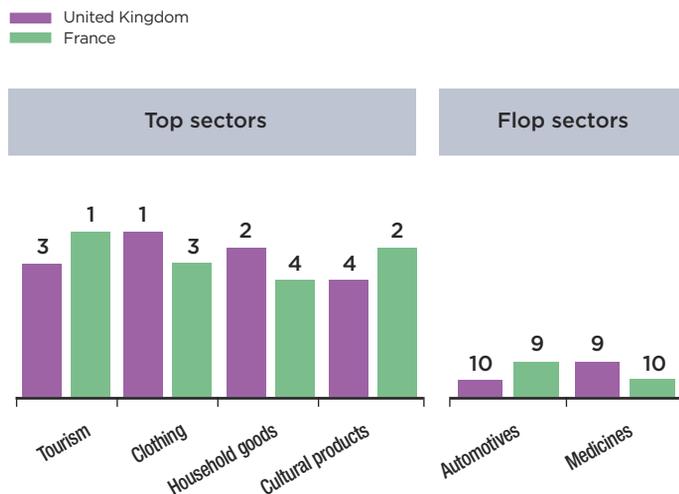
As I said before, e-commerce is now essential if businesses are to develop. But the sector is still in a period of transition, and the hunt for a new sales model that is stable and effective will be a matter of trial and error. This makes risk underwriting for the sector more complex. We will need to closely monitor the changes and pay great attention to the risks presented by the websites of retailers that are not associated with known, financially solid groups. Vigilance is also needed regarding traditional retail if it does not change its economic model to integrate digital retail. Otherwise it will not survive the tidal wave of this new method of consumption.

(5) Price Waterhouse Coopers, publication du 18 octobre 2012

Risk also differentiated by sector

Within the sectors, e-commerce is growing strongly but unevenly and seems to be dependent on the nature of the products. There are no marked differences between France and the UK (chart 7). Tourism therefore occupies an important position in total turnover terms. The British led the way with the launch, in 1995, of Thomas Cook's website. France followed in 2000 with SNCF.

CHART 7:
Classification of sectors by turnover 2011



Sources: ONS, Fevad

Tourism is undergoing restructuring due to the omnipresence of the web in consumption patterns. In financial difficulty, Thomas Cook announced at the start of 2013 that it was going to focus on its Internet channel at the expense of its bricks and mortar outlets, one hundred of which will close. Cultural assets (books, music, tickets) are also selling well. The digitisation of music and changes in how it is consumed are contributing to dynamic growth in music sales. Meanwhile, mail order companies already had the attributes for maintaining their market share on the Internet. In France, 3 Suisses has put its entire catalogue online as early as 1998. However, the company has found themselves in direct competition with the *pure players*, who offered more attractive prices and fuller and more specialised catalogues. Without a comparative advantage, some brands failed, like Camif in 2008.

In contrast, certain sectors have resisted the trend due to legal restrictions (medicines) or stubborn consumer habits linked to the importance of physically buying something (property, cars, loans, food products). Nevertheless, they are now on the web and should experience a favourable evolution in the next year.

(6) Institute for Fiscal Studies, Rowena Crawford, Carl Emmerson and Gemma Tetlow, 2012
(7) Institute for Fiscal Studies, Jonathan Cribb, Robert Joyce, David Phillip: Living Standards, poverty and inequality in the UK, 2012

(8) The Guardian, UK inflation basket: ebooks in, champagne out, 13 March 2013

Bargain hunting: the UK consumer is ahead of the French Consumer

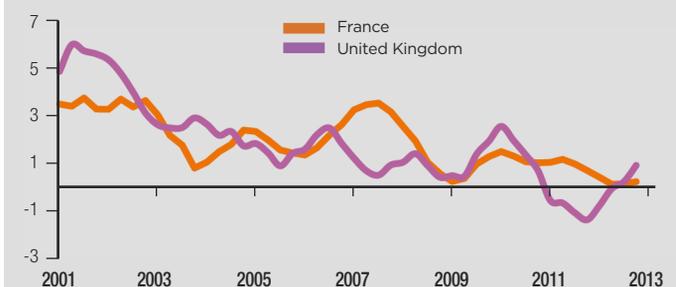
Christine Altuzarra,

Economist, Advanced Countries, Coface

In 2013, the UK consumer will still be hunting for the best price so e-commerce is likely to remain lively in the UK. According to Coface, activity will remain limited over the coming months (expected growth of 0.4% in 2013) as households continue to be stretched by the austerity measures introduced in 2010. Inflation (2.8% in February 2013) is eating into the purchasing power of households, which are unable to rely on wage rises to offset this cut in disposable income. Only 12% of the planned drastic cuts in total public spending will have been achieved by the end of 2012⁽⁶⁾.

The hardest times are therefore yet to come. It is in this context that UK households are expected to continue to repay their debts, bearing in mind that household debt levels represented 145% of disposable income at the end of 2012. Nonetheless, with household savings levels improving (nearly 8% of disposable income), they should be able to afford essential durable items. According to the Office for Budget Responsibility, the drop in the standard of living will extend beyond 2013. The trend in real disposable household income (see chart below) is unlikely to change direction significantly in 2013, prolonging the decline observed since 2001, marked by a sharp fall of 3.1% in median income in 2010-2011⁽⁷⁾. This slow erosion, running parallel to rising e-commerce performances, could be one explanation for the considerable surge in this mode of retail in the country. Moreover, a recent decision by the Office for National Statistics has given the stamp of approval to the phenomenon represented by e-commerce by including e-books in the consumer goods basket (used to measure inflation)⁽⁸⁾. As a result, new consumer patterns are already being taken into account.

Trend for real household disposable income
(year on year)



Source: Datastream

For its part, French household disposable income has not fallen as steadily as in the UK over the past ten years (see chart above). It grew by an annual average of over 2% due to labour market rigidity, which protects salary levels during a crisis and to automatic stabilisers, namely better unemployment protection, while inflation remained contained. However, in 2012 government measures and the gloomy economic context curbed private spending, which stagnated and is expected, for the first time since 1993, to contract (-0.1% in 2013). As a result, households are expected to continue to be very cautious, at least during the first part of the year, as unemployment rises, taxes go up and salaries fail to keep pace. However, thanks to high savings levels (around 16%), French households will be able to limit the contraction in their consumption. They will, though, remain watchful of prices and like UK consumers in previous years, make greater use of retailers' websites. The crisis is therefore likely to foster the development of these new buying patterns, but also to sharpen competition between them in the medium term.

BUSINESSES MOVING TO A SINGLE MODEL

The Internet needs to be seen as a social catalyst and as complementary to bricks and mortar shops. The transition can be observed and is expected to accelerate in France. But risks persist.

The Internet is still going to shake up businesses

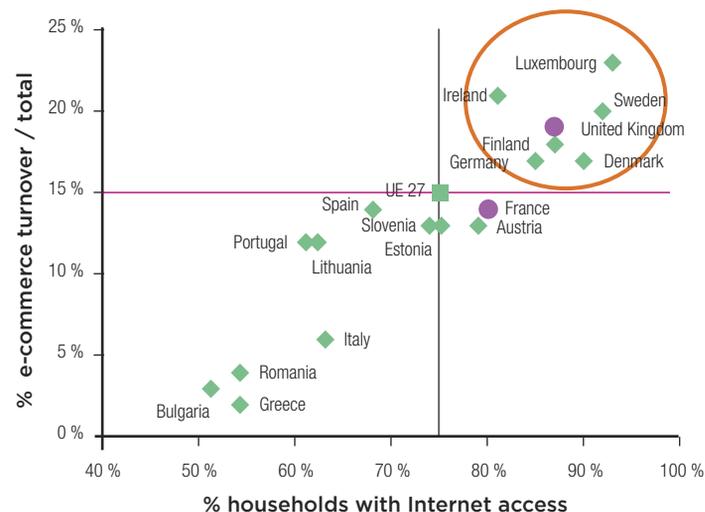
As well as being a new retail channel, Internet use adds another dimension to the link with the consumer. Using the Internet encourages trade and loyalty but also cuts the cost of client acquisition, as it is easier to identify their expectations. However, this prospect will be accompanied by a natural loss of market share by bricks and mortar shops, unless they change their model to adapt to new consumer habits.

Technological cycles: an old story

Over the decades, technological advances have brought far-reaching changes to consumption patterns and prompted businesses to adapt to new consumer demands. In this way, company business models are constantly tested by major technological developments. One example is the rise of the motor car in the early 20th century, which ultimately led to the development of shopping centres. Another is how the democratisation of fixed telephone lines in the 1950s necessitated the introduction of new after-sales services and resulted in the emergence of mail-order companies. Finally, the advances made in terms of food conservation (spread of the refrigerator to individuals and refrigerated lorries for transportation) in the 1960s enabled the rise of large-scale retail. So now we find ourselves in a new cycle which started in the 1990s, symbolised by pure e-commerce players (notably Amazon in 1995). Starting with a bang, this cycle will have focused expectations. Ten years has been long enough to create a bubble around these players, leading to half of them being crowded out in the early 2000s. Today, the Internet seems firmly embedded in the global economic fabric and has an increasingly important share of the retail market. Increasing bandwidths and multiple access platforms are accompanying its development. Over time, these changes will turn out to be indispensable if businesses are to remain connected to consumers and their radically changing habits.

The transition that has begun is likely to accelerate. At the end of the decade, the value of online sales is expected to have overtaken traditional sales. According to a survey conducted by Eurostat, UK companies appear to have a stronger global web presence, which corroborates our theory that this is influenced by early Internet access conditions. In France, the rise of e-commerce would seem obviously to be due to evolutions in Internet access conditions (chart 8).

CHART 8:
Web turnover in relation to total turnover (non-financial businesses with over 10 employees) vs. households with access to the Internet at home



Source: Eurostat

The single model

The trend is clear; already half of physical sales will be influenced by information found on the Internet. Consumers are savvy: they make use of price comparisons, analyse tests, find bargains and take control of their buying experience. There is still room for e-commerce and traditional businesses but they need to understand the synergies and how they can complement each other. Distinguishing between the different channels now seems risky, because of their interdependence. On the one hand, the e-commerce brands will have to shore up their special relationship with consumers, in the face of growing competition; and on the other hand, traditional distributors will need to adapt how they manage their sales area (greater emphasis on 'scene setting'), optimise their stock management (meet the logistical needs of web surfers) and create an interactive relationship with customers thanks to specialist HR resources (community managers).

Accordingly, we will arrive at a single model which merges e-commerce and traditional retail. Physical shops will need to integrate online sales. Large companies like L'Oréal or H&M are already developing this sales channel. For their part, e-tailers will also need a physical presence to target more traditional customers and establish a relationship of trust. Like the Nespresso concept stores and more recently those of the Internet giant Google, which is now opening its own sales outlets. Likewise Amazon in the UK, which is establishing collection points in shopping centres to make it easier for people to pick up their goods.

France will catch up but the growing number of players points to worsening risk. The UK offers a striking example, both as an e-commerce pioneer and in the materialisation of risk.

No, the physical model is not dead. It has the advantage of providing a unique closeness to the consumer. Nevertheless, a risk persist for companies due to the cost of adaptation. These new consumption patterns could undermine customer loyalty and cause loss of market share.

Time is short, the single model takes shape.