Lever VC Insights

European Union Food and Beverage Trends

July 2023

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EU Food and Beverage Introduction

Reflecting on European culture, Food and Beverage (F&B) expenditures remain a notable part of household budgets. However, the share of food expenditure for consumers has decreased significantly in Europe, and in 2021 accounted for around 15% in most European countries. For context, the share of expenditure on food in most Asian countries ranges from 20-50% of total consumer expenditure.[1]

F&B sales in Europe show diversity across multiple food categories, with meat products (20%), various food products (16%), dairy products (14%), drinks (14%), bakery and farinaceous products (11%), the leading categories.[2]

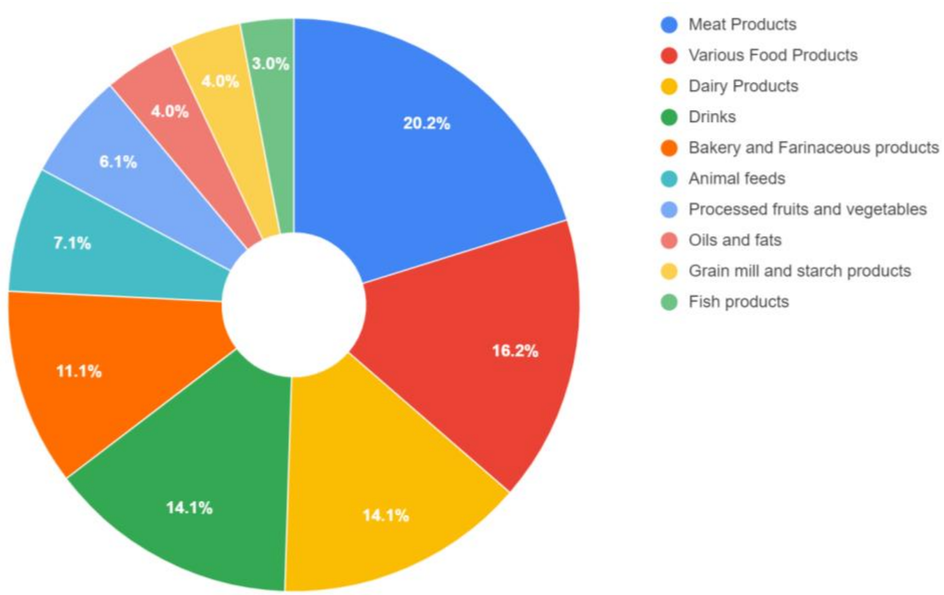


Figure 1: *EU F&B Sales by Product Category, 2019*

France, Germany, Italy, and Spain remain the key driving forces of the EU F&B industry. The vast €1.1 trillion EU F&B industry has recently been characterized by unprecedented inflation, increasing consumer price sensitivity, and automation & sustainability trends.[2] Through the second half of 2023, the sector should experience a progressive normalization of price and volume, although margin and cost pressures will remain.

Overall growth in the sector will be driven by increasing prices, with volumes still under pressure, likely extending on the 3.6% volume decrease of 2022.

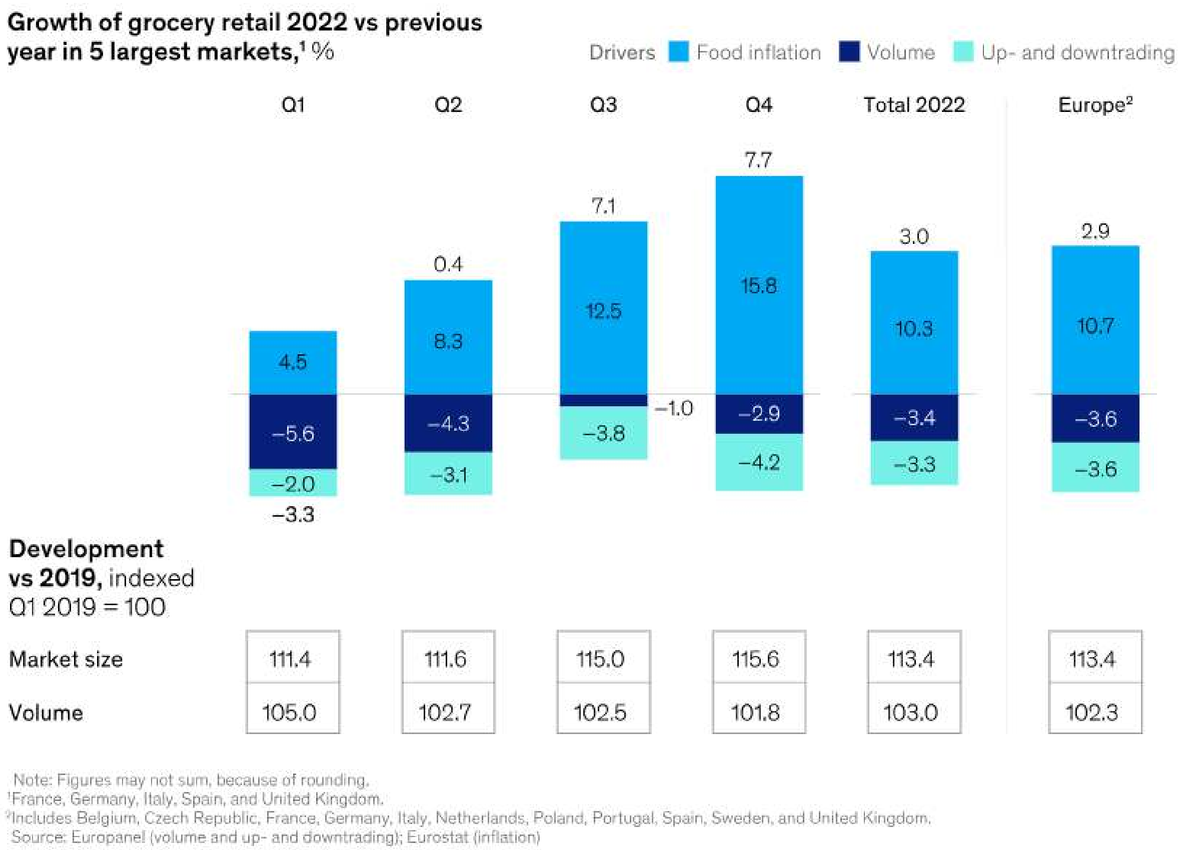


Figure 2: European Grocery Retail Growth 2022

The last 18 months have been characterized by a retrenchment to core brands among major players. CPG companies are adopting retrenchment strategies to reduce costs and concentrate efforts on successful core brands, especially in response to economic conditions and cost-conscious consumers. This shift is heavily influenced by the transition to e-commerce and digital marketing as more effective means to target consumers. This has resulted in the shuttering of several smaller brands targeting more niche categories.

The European Commission's Farm to Fork Strategy underscores the need for transformation within this industry. By 2035, it aims to reduce plastic packaging waste by 10% and encourage the sale of fresh produce without plastic packaging.[3] According to Wrap, supermarkets should aim to sell at least 30% of fresh produce without packaging by 2025.[4] Leading retailers are already pioneering these efforts, with REWE planning to eliminate plastic from select fruits and vegetables, Waitrose pledging to go entirely plastic-free by 2025, Asda trialing loose produce lines to reduce packaging by 50% by 2030, and Carrefour setting a goal to sell 30% of its fresh produce without packaging by 2023.[4]–[8]

As the F&B industry charts its course forward, it must grapple with the evolving dynamics brought about by the COVID-19 pandemic. While consumer spending in the foodservice sector rebounded to pre-pandemic levels by November 2022, total foodservice spending in 2022 saw a 6% decline compared to 2019.[9], [10] This era also witnessed a surge in prepared foods from restaurants consumed at home, marking a 50% increase over 2019 levels.[11] The prominence of click-and-collect orders skyrocketed, reaching €9 billion in 2022, up from €3 billion in 2019, while food delivery sales, although remaining robust, saw a slowdown, with 36% of consumers planning to curtail their foodservice expenditures in 2023.[10]

The COVID-19 pandemic also prompted a significant transition to online grocery delivery services over in-store shopping. These trends have continued to grow in many sectors but are also facing a post-pandemic stagnation period due to high inflation and the relaxation of pandemic-related restrictions. Furthermore, the F&B landscape reflects the nuanced transformations in consumer behavior, with quick-service restaurants (QSRs) experiencing an 8% rise above pre-pandemic levels through May 2023. Full-service restaurants (FSRs) continue their recovery, whereas workplace and student canteens grapple with double-digit losses, indicating a lasting impact of new working patterns even as many return to physical offices.[11]

Online F&B Trends in the EU

The COVID-19 pandemic prompted a transition from traditional in-store shopping to online retail in Europe's most prominent economies, with this most prevalent in the UK. The online share of Britain's total food grocery market was 5-6% before COVID-19. It peaked at about 12% during the pandemic but has since dropped off as shoppers have increasingly returned to stores. This June (2023), online food sales were <9% of the total UK food market, and in-store sales were up by 13%. The increase in in-store spending was largely attributable to the heat wave and the increase in spending on drinks and refreshments.[12]

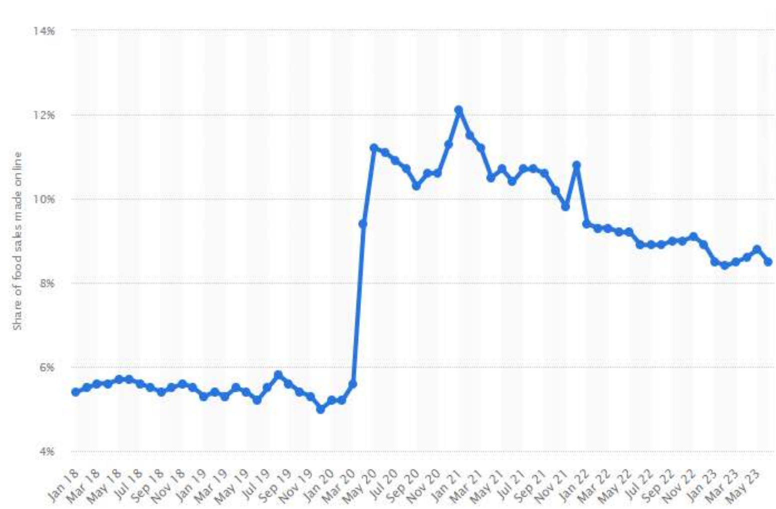
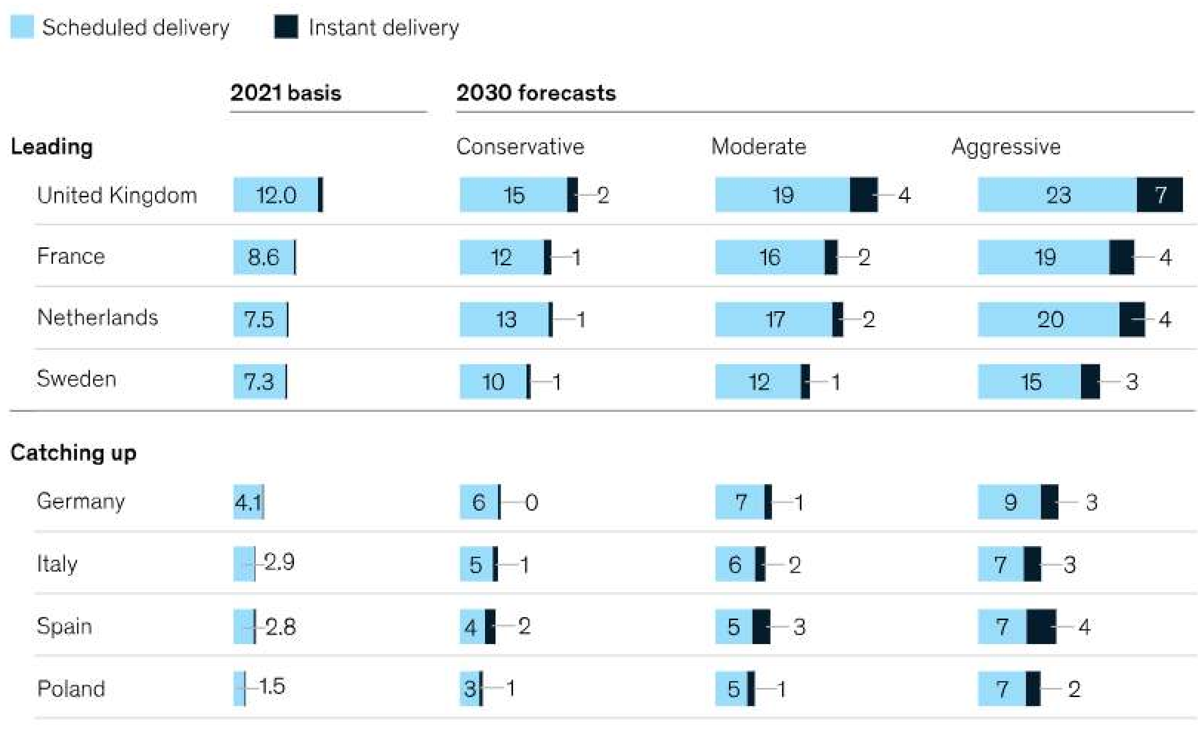


Figure 3: Share of Food Retail Sales Online in Great Britain, Jan-18 to Jun-23

Online shopping remains popular among the younger populations, who use it as a default and will likely continue to do so. However, many older people have returned to in-store purchases.[13] Some of the challenges that need to be addressed by online grocers are the cost of delivering to individual households, which increases labor, fuel, maintenance costs, and logistical complexity. Meanwhile, consumers are getting more accustomed to same-day and two-hour delivery windows, demanding flexibility in delivery times and wide product offerings. Consumers are much less willing to wait – a plurality of customers today report that three-day shipping is the slowest they'll tolerate before looking to other retailers.

As product offerings expand, efficient picking and packing processes will be required and can benefit from increased automation and warehouse layout optimization. After a period of post-pandemic stagnation, e-grocery is expected to return to moderate growth, with players maintaining a strong focus on profitability. Online grocery sales are expected to take an increasing share across the major EU markets. Most of this growth is expected to be in scheduled delivery, which has a lower cost base and will be applicable to a larger share of consumer needs.



Source: McKinsey analysis based on Euromonitor, Europanel, IGD, and own estimates

Figure 4: Share of Online Grocery in the Food-at-Home Market, % by country

Instant delivery, which offers convenience and can aid in top-up shopping, has been expanding but has a smaller selection of key products (e.g. Getir, Gorillas, etc.). They can build their warehouse and delivery logistics in the most effective manner to accommodate new offerings such as produce or warm meals. In the long run, there is a market opportunity for instant grocery delivery in Europe, but this will need to be at higher price points than mainstream online supermarkets. It will cater to a smaller share of shopping occasions and is expected to represent a smaller share of the total online market by 2030.

The meal delivery market also exhibited promising growth, outpacing the expansion of e-grocery. If this growth trend persists, meal delivery is poised to surpass e-grocery in market size within the next two to three years, presenting an appealing opportunity due to its higher profit margins. Moreover, Europe saw a significant jump in meal delivery revenues in 2020 and 2021, particularly on the platform-to-consumer side. [14]

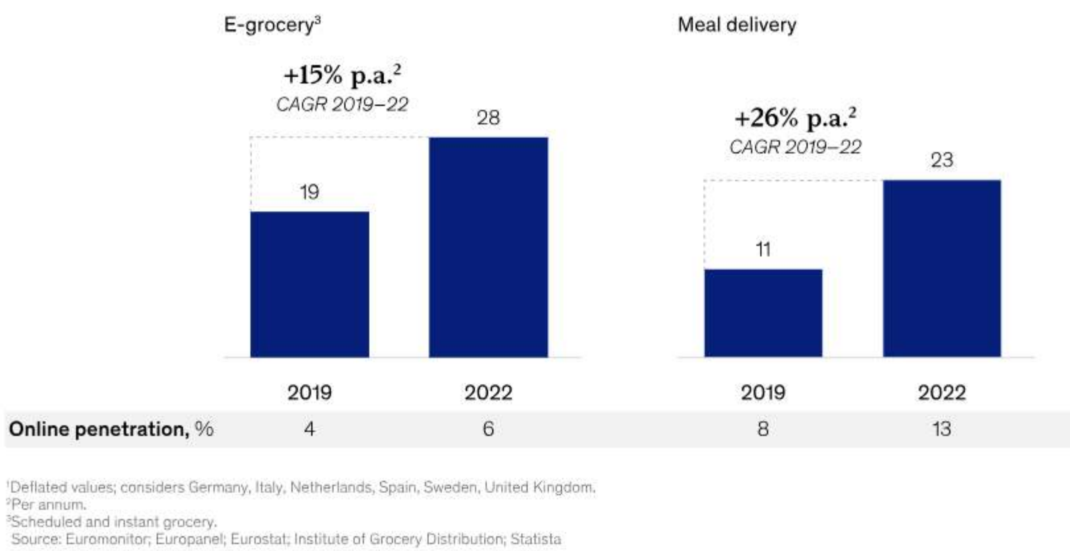


Figure 5: Market Size for e-grocery and Meal Delivery, 2019-22 deflated values, € billion

Increasingly, consumers consider online and offline as independent channels with different value propositions. However, several propositions in the online market will mirror the existing offline markets, including full-basket offerings, which provide same-day or next-day delivery and can offer a wide range of products with more competitive pricing (e.g., Ocado, Tesco, etc.). This may be supplemented further by farm-to-table concepts or meal-kit options. Meal delivery may overtake e-grocery in terms of market size.

Achieving profitability as an online grocer is challenging and requires flexibility, robust logistics, and infrastructure. One key to achieving profitability is to employ advanced personalized marketing and online strategies to enhance the user experience during online shopping. Similar to other e-commerce sectors, grocery retail has the potential to provide advanced analytics on customers, demographics, and trends. Grocers will also benefit from increased automation during fulfillment and improved last-mile delivery to lower costs.

We are currently witnessing a convergence within the online channel between retail and foodservice specialist platforms. Restaurant-focused platforms are moving into grocery, and grocery delivery platforms are moving into meal delivery. This is driving greater competition for share of wallet and, as a result, will continue to accelerate market consolidation as fewer platforms gain consumer loyalty. The breadth of some "super apps" in Asia represent interesting examples of how this ecosystem may evolve.

Other EU F&B Industry Trends

The EU F&B industry is also characterized by a number of longer-term pervasive trends that will increasingly impact operators through the value chain.

1. Private label expansion and reduced manufacturer brand loyalty
    - Saving money on food remains a top priority for both high- and low-income consumers in 2023. All income groups were trading down in 2022, and the difference between income groups diminished. Across Europe, consumer downtrading has led to substantial growth for private labels. Private labels have witnessed remarkable growth in Europe, capturing a substantial portion of the fast-moving consumer goods (FMCG) market, accounting for 35% of total sales amounting to €230 billion.[15]
        - Germany and Spain experienced a 14% increase in private label value sales in 2022,
        - Italy experienced a 12% increase,
        - The Netherlands experienced a 9% increase,
        - France experienced a 7% increase,
        - The U.K. only experienced a 4% increase.
    - Even if market conditions improve, consumers are likely to continue buying private labels and shopping with discounters. Consumers are highly satisfied with private-label products, with 84% of respondents in a McKinsey survey saying the quality of private labels is similar to or better than the quality of branded products.[16]
    - Brand loyalty is continuing to falter. About half of consumers reported switching brands in 2022, compared with only one-third in 2020. What's more, about 90% said they'll keep switching, according to a recent McKinsey survey.[17]

2. Weaker retail and foodservice brand loyalty
    - Consumers are shopping fluidly across channels, with the purchase journey now more fragmented. Grocery shopping in the EU is now solidly omnichannel.
    - Shoppers are visiting twice as many different stores as they were 10 years ago, with >50% saying they would change where they shop to find savings.
    - Whilst this has been accelerated by the macroeconomic environment, with greater transparency across potential points of sale, customers are expected to continue to optimize purchases by looking across multiple brands and platforms.
    - For delivery platforms, geographic competition is one of the primary drivers of their business, with platforms sharing the same demand within an area. As consumers are increasingly cross-shopping between platforms, the competition for their share of wallet continues to grow.

This has driven the growth of loyalty programs and subscription-based models, trying to lock consumers in.

3. Pervasion of virtual foodservice brands
    - Virtual brands can be instantly conjured nationwide, hitting peak sales velocities within a few months of their launch. On delivery apps, small but quick-moving brands are now routinely outperforming larger, more entrenched players—despite being a fraction of the size offline.
    - Their lower cost base, largely due to the use of dark kitchens, gives many of these companies a notable advantage in more pressured supply chains.
    - This also helped to drive greater consumer experimentation and exposure to new cuisines.

4. Greater technology uptake by retailers & the supply chain
    - In retail, digital leaders have invested in a range of AI and analytics, from customer-facing to back-end operations. Leading retailers increasingly use analytics to inform and partially automate merchant decisions on assortment, pricing, promotions, and more.
    - AI is being used to improve inventory management, which can lead to reduced costs and improved customer service. For example, AI can be used to predict demand for products, which can help retailers improve inventory management and reduce shrinkage.
        - Carrefour uses AI to curate its customer experience by tracking customer behavior and providing personalized messaging at scale.[18]
        - Lidl uses AI to improve its customer service with AI-powered chatbots, which can answer customer questions and resolve issues 24/7.[19]
        - Freshflow uses data-driven forecasting to help retailers optimize stock replenishment of fresh and perishable goods to minimize waste and maximize revenue.[20]
        - At Amazon, almost every short-term pricing decision is algorithmic.
    - Due to the increase in labor costs and declining prices for warehouse automation technologies, more companies are integrating automated warehouses. For example, REWE announced the construction of an automated warehouse in 2021 to increase efficiency and reduce labor costs.[21]
    - Connected kitchens and smart appliances, whilst in the early stages of development, are expected to gain traction, helping to tackle certain sustainability and food waste challenges.

5. Supply chain due diligence requirements
    - The EU Commission proposed the CSDD (Corporate Sustainability Due Diligence Directive), obligating companies to implement due diligence processes and address their impact on various aspects, including slavery, child labor, labor exploitation, biodiversity loss, pollution, and environmental degradation.
        - On June 1, 2023, the parliament voted in favor of the proposed CSDDD.

    - Member states must appoint a supervisory authority with investigative and enforcement powers. Companies need to acknowledge and mitigate negative environmental and social impacts within their supply chains.
    - They must establish a complaint procedure accessible to all supply chain stakeholders.
- Food companies should proactively improve their supply chain practices in anticipation of the forthcoming legislation, with this likely to have cost implications.

6. Supply chain transparency
- A number of apps have been developed to provide consumers with increasing transparency for the products they are purchasing. This covers a range of metrics, but health and the environment are the two key areas of focus.
    - Yuka (founded 2016, France) is an app that allows scanning over 1.5 million products to identify their carbon footprint and health profile.
    - Connecting Food (founded 2016, France) has a fully digital quality and audit module to enable clients to trace and navigate each step of their production and create a dynamic map for consumers.
    - Setai (Italy/ UK) has developed an app to determine carbon emissions of food and a health score according to the Nutri-Score and Nova system (level of processing). It is currently available in the UK.
    - Tracifier (founded 2019, Germany) is a supply chain inspection data monitoring and tracking tool for food products based on Blockchain technology.
    - Unova (founded 2019, Belgium) has a solution to measure and trace the entire supply chain for food products with blockchain technology so consumers can scan a product and view its full farm-to-fork path.
- This increased transparency will have wide-reaching implications for companies operating through the F&B supply chain.

7. Regenerative agriculture practices
- Increasing number of commitments by EU companies with concrete climate actions to the EU Code of Conduct:
    - Danone: the French subsidiary is to source 100% of ingredients produced in France from regenerative agriculture by 2025.
    - Nestlé: source 20% of key ingredients through regenerative agricultural methods by 2025, 50% by 2030.
    - Unilever: protect and regenerate 1.5M hectares of land, forests, and oceans by 2030.
- The EU proposed Farm to Fork strategy targets decreasing the use of fertilizers and chemical pesticides and reducing nutrient loss.
- These will drive increasing constraints through the supply chain and will likely add costs.

8. Government focus on fat, sugar, and salt
    - UK government policy restricts the promotion of high-fat, sugar, and salt foods in favor of healthier options (effective since October 2022).
        - Aiming to combat obesity and related diseases.
        - Restrictions apply to store entrances, aisle ends, checkouts, and online equivalents.
    - The EU is also developing policies regarding the labeling and promotion of HFSS foods and will release mandatory labeling legislation in 2023. The two common systems, Nordic Keyhole, and Nutriscore, are still voluntary for food manufacturers.
    - Nordic Keyhole front-of-pack nutrition label uses a positive endorsement label (green keyhole) for products that are healthier options compared to other products in the same category.
    - The introduction of taxes on "unhealthy" and "processed" food categories is also expected to take place in the coming years.

9. Food system resilience
    - Increased investment and focus are anticipated on automation, connectivity, and traceability.
    - This encompasses precision agriculture, crop condition monitoring, data sharing within agri-food supply chains, and blockchain technologies to enhance transparency in the food system.
    - The EU also proposed legally binding food waste targets for member states.

        - If this is adopted and enforced, EU countries will have to reduce food waste by 10% in manufacturing and 30% per capita in retail, foodservice, and households by the end of 2030.

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