



What the **Experts Say?**  
**Ten Highlights of China's  
Commercial Sector 2018**

January 2018



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# Commercial Sector 2018

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# Foreword

2017 marked the opening of the 19th National Congress of the Chinese Communist Party (CPC) – the most important political event in China, held every five years. General Secretary of the CPC Xi Jinping announced the beginning of a “new era” for socialism in China and outlined the country’s policy direction in all major fields. Xi called for more effort to promote the integration of the Internet, big data and artificial intelligence with the real economy. The aim is to foster new growth areas and drivers of growth in medium-to-high end consumption, innovation-driven development, the green and low-carbon economy, the sharing economy, modern supply chains and human capital services. Xi also advocated support for upgrading traditional industries and for accelerating the development of the modern services industry. These will all open up new opportunities for commercial enterprises to tap or further expand their presence in China.

In producing this 15th anniversary edition, Fung Business Intelligence is delighted to join forces once again with the Expert Committee of the China General Chamber of Commerce. In this report, we present the Ten Highlights of China’s Commercial Sector – the key trends identified by over 170 top-tier experts in China’s commercial sector – together with additional Fung Business Intelligence analysis, to provide enterprises with insightful views of China’s latest commercial developments. Over successive years, the report has been an important reference point for global retailers, commercial enterprises and individuals aiming to have a better understanding of China’s latest commercial trends.

We would like to thank all panel members on the Expert Committee of the China General Chamber of Commerce for sharing their insights. We also thank our colleagues at Fung Business Intelligence for their contributions and assistance.

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# About the Organizations

## **The Expert Committee of the China General Chamber of Commerce**

The Expert Committee of the China General Chamber of Commerce (ECCGCC), a sub-division of the CGCC, comprises over 170 prominent experts from various government departments, research institutes and universities, leading corporations, professional associations, consultancy firms and newspaper offices, which include the Ministry of Commerce, the Chinese Academy of Social Sciences, China Chain Store and Franchise Association, the Development Research Centre of the State Council, the Renmin University, the Capital University of Economics and Business, and the Beijing Technology and Business University, etc.

The ECCGCC serves as a platform for the experts to exchange ideas on the development of commercial enterprises and the distribution sector.

## **The China General Chamber of Commerce**

Founded in 1994, the China General Chamber of Commerce (CGCC) is a quasi-government association endorsed by the State Council. The CGCC has around 70,000 members, encompassing enterprises from retail, distribution, services and tourism sectors, local commercial chambers, national professional associations, intermediary organizations and individuals.

Commissioned by the Chinese Government, the CGCC consists of 14 committees, working on areas such as retailing, wholesaling, public relations and industry analyses, etc.; it also supervises 40 national associations, and over 30 newspapers and magazines published both inside and outside China.

## **Fung Business Intelligence**

Fung Business Intelligence collects, analyses and interprets market data on global sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to track and report on these issues with a particular focus on business trends and developments in China and other Asian countries. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments around the world through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consultancy services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

## **The Fung Group**

The Fung Group is a privately held multinational group of companies headquartered in Hong Kong whose core businesses are trading, logistics, distribution and retailing. The Fung Group employs 39,900 people across 40 economies worldwide, with total revenue of over USD22.51 billion as of December 2016. Fung Holdings (1937) Limited, a privately held business entity headquartered in Hong Kong, is the major shareholder of the Fung group of companies.

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# Executive Summary

01

**A key principle of China's 19th Party Congress: China's distribution industry to evolve from big to strong; aims to meet people's desire for a better life through innovation and transformation**



The 19th National Congress of the Communist Party of China set out new and clear directions for China's future development. The government's determination to speed up the transformation and innovation of the domestic trade and distribution industry will facilitate the rapid development of the industry's standardization, digitalization and modernization. A series of changes and adjustments are expected to take place in the domestic trade and distribution industry in 2018 focused on improving quality and efficiency; industry practitioners will aim to satisfy the needs of different consumer segments; new retail formats and business innovations that accentuate the importance of consumer behavior and experience will continue to emerge. In the near term, the distribution industry is set to become a truly important element in the economy's foundation and the leading industry to meet people's growing needs for a better life.

02

**New commercial input and innovation sustains consumer market growth; technology brings smart advantages**



China's economy has been transitioning from a phase of rapid growth to a stage of high-quality development, underscored by stable economic growth. The government's determined efforts to push forward supply-side structural reforms, promote innovation and strengthen the role of consumption in driving economic growth have led to the country's steady economic development. At the same time, commercial enterprises have been eager to carry out format revisions and innovation to accommodate changing customer needs. Consumption will remain a major driver of economic growth. In 2018, China's GDP growth is expected at 6.7% yoy and total retail sales of consumer goods is expected to grow at 10.1% yoy.

## 03

### Business innovations become evident, embracing “New Retail” strategies to attract consumers



The “New Retail” concept that uses customer data and technologies to integrate online and offline businesses – offering a more efficient and flexible retail experience – has and will continue to revolutionize the way companies operate as they move into 2018. Many new business models and formats have evolved in this transformative journey. The “New Retail” concept and other new business innovations have one common aim: to anticipate and satisfy customers’ needs. With increasing adoption of technologies and upgraded consumption, the “New Retail” concept is expected to continue to shape the development of China’s retail sector.

## 04

### Artificial Intelligence facilitates the creation of new retail formats; smart business models become the next digital frontier



China’s artificial intelligence (AI) market has entered a period of rapid growth while receiving strong support from the government over recent years. Three leading Chinese Internet players, namely Baidu, Alibaba and Tencent, have dominated the AI market and made substantial investments in AI technologies and infrastructure, as well as in product development. As a result, new retail formats facilitated by AI, such as unmanned stores, have come on the scene. Meanwhile, increasing numbers of commercial enterprises in China have also incorporated AI in their day-to-day operations and invested heavily in retail technologies as part of their customer engagement strategies. China’s AI development is set to see great strides with the emergence of new smart businesses and retail formats.

## 05

### Convenience stores see robust growth; technological innovation a key driving force



The development of convenience stores (CVS) has taken an increasingly significant role in online and offline (O2O) integration in 2017, extensively applying technology-driven innovation. Two key trends have emerged in the sector over the past year. First, traditional retailers are branching out into the CVS sector; secondly, technology companies are partnering with CVS operators to trial various types of technologies in-store in order to enhance customer experience and streamline operations. These trends are set to continue into 2018 with greater depth and variation. transformed the retail landscape.

# Executive Summary

06

## Distribution sector supply chain integration: leading to optimal supply-demand matching, national supply-side structural reform



In response to demand and Chinese consumption upgrading, enterprises are integrating their supply chains to achieve more precise supply-demand matching to adapt. Supply chain transformation and upgrading have focused on balancing supply and demand and optimizing resource allocation; these are also key tenets of national supply-side structural reform, galvanizing the distribution sector. With the government's support for supply chain innovation and application, coupled with the advent of new technologies, distribution enterprises are set to speed up their supply chain integration processes by combining leading-edge digital technologies with supply chain operations.

07

## Rural areas become a new powerhouse for e-commerce growth; e-commerce plays a larger role in agricultural upgrading, alleviating rural poverty



In recent years, rural e-commerce has witnessed explosive growth on the back of the government's strong policy support to cultivate e-commerce in poverty relief and economic restructuring of underdeveloped villages. Prompted by sustained governmental support and the promising outlook of rural e-commerce, major e-commerce players have expedited their expansion in rural towns in search for new growth; as a result, the rural e-commerce sector is a fast new growth engine. This e-commerce boom is expected to drive deeper online integration with traditional industries in the countryside, promoting the growth of the digital economy and agricultural upgrading in rural areas.

# 08

## Demand for localized lifestyle services surge; growth rate far exceeds consumer goods consumption



With China's unprecedented O2O development, lifestyle services subsectors such as catering, accommodation, housekeeping, beauty and car repairs have entered a new trend for growth, with even more service varieties. In particular, the “sharing economy” is on the rise as increasing numbers of consumers conduct business transactions via different online sharing platforms. Proactive measures taken by the government to promote healthy development of lifestyle services ensures that the sector can realize its huge development potential. While China is entering an important juncture in upgrading consumption, lifestyle services that are O2O driven and customer- and experience-oriented are set to see huge growth in the coming year.

# 09

## Physical retail market rebounds; transformation and innovation are imperative for the future of China's commercial sector



In 2017, key physical retailers including brands, supermarket and department store operators showed signs of stable recovery with reports of upbeat sales, indicating a rebound in China's physical retail sector. In particular, retailers that have continued to innovate, remained active in product optimization and made use of online and offline resources – including technology to enhance service and customer experience – have enjoyed significant success. Conversely, the arrival of China's e-commerce giants into brick and mortar retail has also been very successful, pioneering many innovations and new business models. Into the future, the market will be dominated by the “best of breed” in “boundless retail” – companies which consistently transform and upgrade to meet evolving consumer needs.

# 10

## Digitization facilitates transformation and upgrade of China's agricultural produce wholesale markets, with electronic clearing and settlement systems greatly enhancing product traceability



Thanks to accelerated digitalization, the agricultural produce wholesale industry has undergone rapid transformation and upgrading over recent years. To match consumers' rising expectations and take on challenges brought about by new business models such as “farming-supermarket docking”, agricultural e-commerce and direct-farm sourcing, increasing numbers of traditional farm produce wholesale players have increased their digital transformation efforts; they have embraced informatization and big data analytics, establishing electronic clearing and settlement systems as well as allying with e-commerce platforms.

# Implications and Key Tips for Foreign Investors

China's development has entered a "new era" of challenges and opportunities, as declared by Xi Jinping, General Secretary of the Central Committee of the Communist Party of China (CPC) during the 19th National Congress of the CPC. It is an era that is not only of great importance to China but also to the world. The Chinese government vowed to open the economy by constructing a "modern economic system" – to further promote economic openness, reduce the barriers to entry, expand the openness of the services sector, and protect foreign investment. This will present significant opportunities for both foreign and domestic investors.

Indeed, under the "New Retail" era to encourage innovative retail formats and business models, China's market is undergoing profound and complex changes. This makes doing business – especially in retailing – an enormous challenge, while providing ample opportunities for foreign investors. Enterprises are advised to act ahead of evolving trends and developing the needs of highly-connected, Internet-savvy Chinese consumers, and to be flexible in adapting to China's unique commercial landscape.

## 1. Customer experience becomes the new battlefield for enterprises under the "New Retail" regime; embracing O2O is at the heart of business innovation

With China entering the "New Retail" regime, companies have shifted their strategies towards far greater focus on the customer. Many businesses see the customer experience as a sustainable source of competitive differentiation. They now strive to strengthen the connections between customers, products and stores, create specially-themed stores so as to create a unique shopping ambiance, and promote instant interactions with customers with the help of technologies. Creating a "convenience-driven" shopping experience is of paramount importance.

At the same time, commercial enterprises should embrace O2O strategies to provide seamless experiences to consumers across multiple touch points. In particular, they should enable electronic payment methods that are widely adopted in China – Alipay and Wechat Pay in particular – and offer efficient logistics and delivery to meet last mile delivery demand.





## 2. Innovation, innovation and innovation

Innovation is another key focus for commercial enterprises in their transformation efforts. Many leading corporations widely adopt format innovation and store optimization strategies to seek new breakthroughs and boost consumer satisfaction, resulting in the emergence of new business models and retail formats in the market. For example, traditional retailers such as Yonghui Superstores opened 64 new stores in 1H17, of which 29 are innovative-format stores like Yonghui Select and Super Species; these stores integrate retail, fresh food and catering, enriching consumer offerings. Such stores have also embraced data analytics to predict consumer needs and provide relevant products or services. Some forward-thinking enterprises have launched smart stores such as unmanned outlets to tap the checkout-free retail market.

To keep pace with the rapidly evolving commercial landscape along with the increasingly important notion of technological advancement such as the Internet of Things (IoT), cloud computing and Internet Plus, enterprises need to constantly evaluate their business models to carry out format revamps and innovative transformation to better satisfy the needs of a new generation of customers.



## 3. Data and technology offer a wealth of opportunities to understand customer needs and act upon them swiftly

In China, big data has become the lifeblood of businesses. All major Internet companies, brands and retailers consider big data analytics as one of the most important elements for success. By analyzing immense amounts of data, companies can generate valuable real-time insights, especially to understand customer preferences, predict their needs, and provide relevant products and services accordingly. Enterprises that harness the power of big data can reveal their competitive advantages and are able to innovate faster.

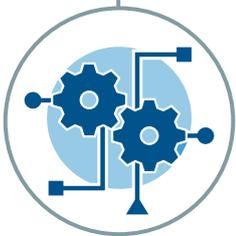
Similarly, advanced technologies are revolutionizing the ways in which enterprises operate their businesses. Many brands and retailers are applying artificial intelligence (AI), virtual reality (VR) and augmented reality (AR) technologies with the support of cloud technology in physical stores to enhance consumer experience, perform targeted marketing and offer more personalized services. In the past year, new business models and operations powered by AI such as unmanned stores, automated warehouses and drone delivery have attracted considerable attention. To sustain growth in the increasingly digitalized commercial landscape, enterprises need to have an innovative and forward thinking mindset. They also need to be prepared to embrace technologies in different aspects of their operations.



#### 4. Keep looking for blue oceans in new markets; consider rural e-commerce and lifestyle services sectors

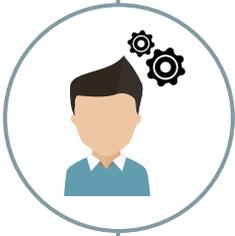
In recent years, the rise of e-commerce has revitalized China's rural landscape. With historically lower income levels, dispersed populations and logistics and infrastructure deficiencies, most rural areas have failed to attract brick-and-mortar retailers. Physical retailing in rural China is still subject to many constraints, including limited product varieties, inflated prices and counterfeit products. However, rural consumers' growing demand for quality products combined with an increasing acceptance of online shopping have fuelled the growth of rural e-commerce over recent years, providing tremendous opportunities for foreign companies.

The rapid development of e-commerce has also opened up new consumer demand for lifestyle services. Driven by the diverse needs of consumers, local lifestyle services industries such as online catering, beauty and spa, housekeeping, car repair and photography – all tightly bound up with many aspects of daily life – are enjoying rapid development. Enterprises will have to be closely aware of the latest market developments and scrutinize these markets for new business development options.



#### 5. Fluid and agile supply chains keep businesses on the cutting edge of strategy and innovation

Chinese consumers nowadays expect specialized products with high levels of availability, service and customer experience at a competitive price. There is a growing trend for traditional retailers to adopt “fast-fashion-style” practices to improve the responsiveness of their supply chains. Enterprises should refine supply chain operations to keep pace with the “New Retail” environment; they are expected to respond swiftly to changing consumer preferences, be flexible, innovative and locally responsive. They need to align production with real-time sales trends to meet consumers' preferences for “on demand” fulfilment rather than “on the shelf” fulfilment.



## 6. More personalization and consumer-focused production models will take the lead

The Chinese middle class and new generations of consumers (especially the millennial generation) have gradually become a powerful force in the consumer market. They are highly connected, sophisticated and with exposure to western cultures and ideas. They have high aspirations for a better life and a strong desire for premium products and services to provide them with status and a sense of entitlement. Niche brands that are of high quality, limited quantity and are creative have become increasingly popular. Enterprises should consider adopting consumer-focused production models that allow more participation from consumers in the products or services design process. Winning players are those that can engage consumers in co-creating ideas and concepts for products or services based on their preferences; they then offer quality products and services to meet the demands of Chinese consumers who are looking for quality, value and service.



## 7. Keeping up-to-date with government policies

The Chinese government has been very supportive towards the development of the domestic trade and distribution industry. During the 19th National Congress of the CPC, General Secretary of the CPC Xi Jinping announced the beginning of a “new era” for socialism in China and laid out his vision for the country’s future. In the report he spoke of deepening supply-side structural reform. China’s economic development must focus on the real economy, Xi stressed, and he also called for more effort to develop advanced manufacturing, promote further integration of the Internet, big data, and AI with the real economy. Additionally, Xi favored fostering new growth areas and drivers of growth in medium- to high-end consumption, innovation-driven development, the green and low-carbon economy, the sharing economy, modern supply chains, and human capital services; the government would support the upgrade of traditional industry, accelerate the development of the modern services industry, and improve quality to match international standards. Enterprises are advised to pay close attention to the new growth areas and policy directions.

# 01

A key principle of China's 19th Party Congress: China's distribution industry to evolve from big to strong; aims to meet people's desire for a better life through innovation and transformation



Since the 18th National Congress of the Communist Party of China (CPC), the government has put great emphasis on promoting the sound development of the domestic trade and distribution industry. In the past five years, supply-side reforms on upgrading and transforming the distribution industry have achieved remarkable results. Domestic consumption has grown steadily and has constituted a higher proportion of GDP growth, while its role in driving economic growth has been further strengthened. During the 19th National Congress of the CPC, the Chinese government stated its determination to continue to push forward the healthy development of the domestic trade and distribution industry, and to further transform the economy into a consumption-driven economy so as to build a moderately prosperous society in all respects and to meet people's ever-growing need for a better life.



The 19th CPC National Congress has set out a new blueprint for China's future. It will have a profound impact on China's socioeconomic development in the coming years.

*Fu Longcheng, Vice Chairman, China General Chamber of Commerce.*

### **Domestic trade and consumption played a crucial role in facilitating economic growth**

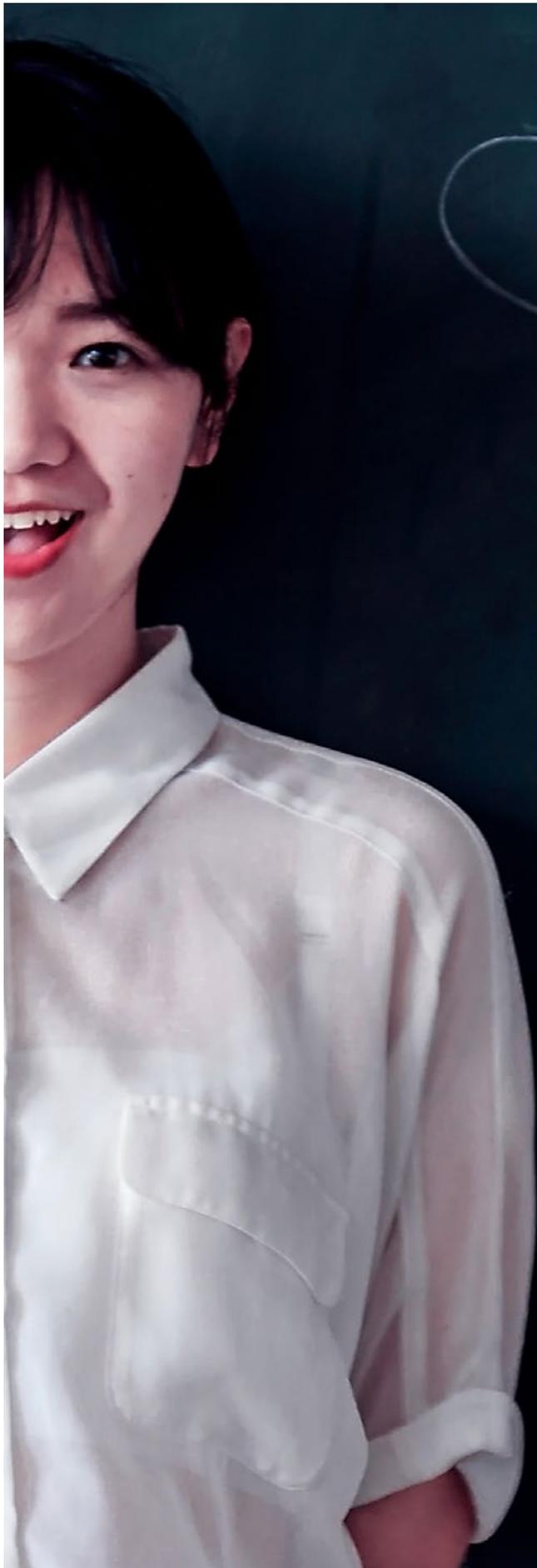
The achievements of the distribution industry's reform and development over the past five years were demonstrated in numerous ways. In 2016, the share of the services sector as a constituent of China's GDP hit a record high. The services sector value-added contributed 51.6% of China's nominal GDP, up 1.4% yoy, growing 7 percentage points (ppts) over 2012. Also, total retail sales of consumer goods reached 33.2 trillion yuan in 2016, an increase of 55% over 2012. The total retail sales growth rate in the past five years was 14.3%, 13.1%, 12%, 10.7% and 10.4%, respectively. In 2016, the value-added of domestic trade in major industries including wholesale and retail trade, hotel and catering, residential services, repair and other services was 12.9%, an increase of 0.3 ppt from 2012. The contribution of total consumption to economic growth was 64.6% in 2016, an increase of 9.7 ppts from 2012.

With the continuous expansion of economic sectors and the labor force, the total number of employed people reached 170 million in 2016, an increase of 40 million from 2012. In 2016, the domestic trade sector achieved total revenue of 2.16 trillion yuan, accounting for 15.3% of China's total tax revenue. In general, the gap between urban and rural areas in the consumer market has been narrowing; the regional structure of the distribution industry has improved; the industrial structure has been further optimized; lifestyle services and e-commerce have grown rapidly. China has become the world's largest e-commerce market in terms of market share and transaction value.

### **Unbalanced and inadequate development still exist**

During the 19th National Congress of the CPC, General Secretary of the CPC Xi Jinping delivered a report to outline the ruling party's objectives. The report of the 19th National Congress of the CPC pointed out that the major social contradictions in society have been encapsulated in the contradiction between the growing needs of a better life and unbalanced and inadequate development. In terms of consumption, this contradiction is manifested in an imbalance and mismatch between people's consumption upgrading and the inadequate supply of quality products. Rapid consumption upgrading in China is creating new consumer demands; consumers' spending focus is shifting away from price to quality of products and services, and from mass to premium goods and services. However, these new demands have yet to be fully met.

Also, despite rapid infrastructure development across the country, many areas still suffer from the problem of oversupply and lack of distribution facilities. At the same time, the rapid growth of the number of distribution companies and expanding workforce in the distribution industry have also been accompanied by business malpractices; lack of trust and a credible consumption environment remain key issues in the distribution industry. Despite many business innovations in recent years their profitability and sustainability are under question. Last but not least, the rise of e-commerce and digital disruption are driving both traditional physical retailers to continue innovating and transforming their businesses – but there is a growing need for more seamless O2O (online to offline) integration.



## What the experts say ?

**Series of changes to take place in 2018; the distribution industry to play a pivotal role in fulfilling people's aspirations for a better life**

To implement the spirit of the 19th National Congress of the CPC in fulfilling the people's pursuit of a better life, our experts expect to see a series of changes and adjustments taking place in China's domestic trade and distribution industry in 2018.

First, the era of size and scale is over; for the future, the distribution industry will focus on improving quality and efficiency. At the same time, the industry will strive to achieve a balanced development among the eastern, central and western regions, between the urban and rural markets, and in the integration of online and offline channels.

Secondly, to achieve a more balanced and thorough development of the distribution industry in the new era, industry practitioners will focus on satisfying the needs of different consumer segments. They will cultivate new growth points and generate greater momentum by adapting to consumption upgrading, especially in the areas of high-end consumption,

green and low-carbon consumption, shared economy and modern supply chains. For instance, in order to meet the rapid growth of demand in local lifestyle services, the distribution industry will develop new products and services in various local lifestyle services subsectors including catering, accommodation, tourism, leisure, information, sports, culture, housekeeping and education. The proportion of people's consumption in lifestyle services is expected to further grow and such services experience rapid development in the coming year.

Thirdly and finally, our experts believe new retail formats and business innovations that accentuate the importance of consumer behavior and experience will continue to emerge. Enterprises involved in distribution are set to continue exploring an array of business models. For instance, increasing numbers of department store operators will shift from the concessionary model relying on commissions as the predominant source of income, to engaging in merchandise direct sales and developing private labels.

### **Fully understand and implement the spirit of the 19th National Congress of the CPC**

The 19th National Congress of the CPC set out new and clear directions for China's future development. The government's determination to speed up the transformation and innovation of the domestic trade and distribution industry will facilitate the rapid development of the industry's standardization, digitalization and modernization. To capitalize on opportunities brought about by these initiatives, it is imperative to study and implement the spirit of the long-term guidelines for the distribution industry as laid out by the 19th National Congress.

Our experts believe that in the near term, the distribution industry is set to become a truly important foundation for the economy and will be the leading industry to meet people's growing needs for a better life. In order to enable this aspiration it is vital for the distribution industry to continue upgrading and modernizing through innovation, particularly by leveraging new technologies.

## 02 New commercial input and innovation sustains consumer market growth; technology brings smart advantages



China's economy has been transitioning from a phase of rapid growth to a stage of high-quality development, underscored by stable economic growth in 2017. The government's determined efforts to push forward supply-side structural reforms, promote innovation, and strengthen the role of consumption in driving economic growth have led to the country's steady economic development. At the same time, commercial enterprises have been eager to carry out format revamps and innovation to accommodate changing customer needs. Some major initiatives include enhancing product quality, offering more experiential elements, enriching retail formats, deploying smart technologies and improving shopping convenience. All these government-led or enterprise-driven initiatives have provided a solid foundation for the steady development of the consumer market. Our experts are confident that the growth momentum will continue into 2018.



In the coming year, I believe the government will put greater emphasis on innovation in the distribution sector, and further strengthen the role of consumption in economic development. China's economy is expected to grow at 6.7% yoy in 2018.

*Cao Lisheng, Deputy Secretary General, China General Chamber of Commerce.*

Consumption upgrades will continue to advance in 2018. Consumption of physical goods will be stable, while consumption of services will enjoy tremendous growth.

*Ren Xingzhou, Research Fellow, former Director-General, Institute of Market Economy, Development Research Centre of the State Council.*

## Domestic trade review: major developments in 2017

### GDP growth was stable at 6.8% yoy in 1-3Q17

China's real GDP growth was 6.8% year-on-year (yoy) in 3Q17, slightly lower than 6.9% yoy in both 1Q17 and 2Q17. In 1-3Q17, China's nominal GDP amounted to 59.3 trillion yuan, up 6.9% yoy in real terms. Our experts expect GDP growth in FY17 to be about 6.8% yoy. The Chinese economy has been growing steadily since the beginning of the year. The services sector has continued to grow at a faster pace than the secondary sector, with service sector value-added contributing 52.9% of China's nominal GDP in 1-3Q17, gaining 7.8% yoy in real terms, 0.2 percentage point (ppt) faster than 1-3Q16. By contrast, secondary sector value-added increased just 6.3% yoy in real terms over the same period. Meanwhile, the role of consumption in driving economic growth has been strengthening. Consumption made up 64.5% of GDP growth in 1-3Q17, 2.8 pts higher than in the same period of 2016 under the new calculation method.

### Retail sales and online retail sales maintained stable growth

China's nominal retail sales of consumer goods rose 10.3% yoy to 33,152.8 billion yuan in the period January to November 2017, growing 0.1 ppt slower than in the same period in 2016. By month, growth of total retail sales of consumer goods remained stable at between

9.5% and 11.0%. Our experts expect retail sales growth in FY17 to stay at about 10.3% yoy. Online retail sales growth of physical goods was fairly stable, but faster than in the same period in 2016, up 32.4% yoy to 6,430.6 billion yuan in the period January to November 2017. The share of online retail sales further increased – online retail sales of physical goods accounted for 14.8% of total retail sales of consumer goods, up 2.3 pts from the same period in 2016. Still, the growth of online retail sales grew faster than physical store sales.

### Growth of rural retail sales exceeded urban sales, but the difference narrowed

Rural retail sales have been growing faster than urban retail sales over recent years, but the difference continued to narrow in 2017. Rural retail sales rose 11.9% yoy to reach 4,699.1 billion yuan in the period January to November 2017, 1.0 ppt higher than in the same period of 2016, while urban retail sales expanded 10.0% yoy to 28,453.6 billion yuan, 0.3 ppt down from the same period in 2016.

The faster growth in rural retail sales was partly attributed to higher rural household income growth. In 1-3Q17, per capita disposable income of rural households increased nominally by 8.7% yoy (or 7.5% yoy in real terms) to reach 9,778 yuan, while per capita disposable income of urban households rose 8.3% yoy in nominal terms (or 6.6% yoy in real terms) to reach 27,430 yuan.

### All categories registered positive yoy growth

All retail sales categories registered sales growth at between 6.0% yoy and 13.5% yoy in the period January to November 2017. Retail sales of cosmetics, furniture and Chinese and western medicines registered the highest growth in the period January to November 2017 when compared with the same period of 2016.

### Catering sales growth rose gradually; small catering enterprises saw higher growth

Catering sales growth rose gradually in 2017. Nominal catering sales growth rose 10.8% yoy to reach 3,595.5 yuan in the period January to November 2017, as in the same period in 2016.

Meanwhile, small catering enterprises continued to perform better than large catering enterprises. Growth for catering enterprises above designated size and individual catering enterprises was up 7.6% yoy in the period January to November 2017, much lower than catering sales growth in general.

### Retail sales of large-scale retail enterprises gradually recovered, while smaller-size enterprises continued to grow fast

According to the China National Commercial Information Center, retail sales of large-scale enterprises recovered in 1-3Q17, with retail sales of 100 key, large-scale enterprises increasing 2.8% yoy, 4.8 ppts faster than in the same period in 2016. On the other hand, enterprises below designated size and individual enterprises saw rapid sales growth of 11.8% yoy, contributing to the fast growth of mass-market consumption.





## What the experts say ?

The 19th National Congress of the Communist Party of China (CPC) was held in October 2017. In a report to the Congress, General Secretary of the CPC Xi Jinping stressed that China must put quality of growth as the top priority for economic development, while the country should also give priority to efficiency and follow the main path of supply-side reform. Our experts expect that the government will put greater emphasis on innovation in the distribution sector and further strengthen the role of consumption in economic development. Our experts also highlight the following key points:

### **Consumption will remain a major driver of economic growth**

The economy is expected to grow at 6.7% yoy in 2018, while domestic consumption is set to grow at a steady pace. The government will continue to strengthen the role of the distribution sector in facilitating economic growth. Total retail sales of consumer goods are expected to grow at 10.1% yoy in 2018.

### **Investment will play a crucial role in stabilizing economic growth**

While China has been gradually shifting towards a consumption-driven economy, investment is set to play an important role in stabilizing economic growth in 2018. Xi's report stressed that China's economic development must focus on the real economy, so fixed asset investments such as infrastructure for high-speed railways, highways, airports, metro lines, underground pipelines and public housing are expected to see steady growth in 2018.

### **Export growth will gather pace**

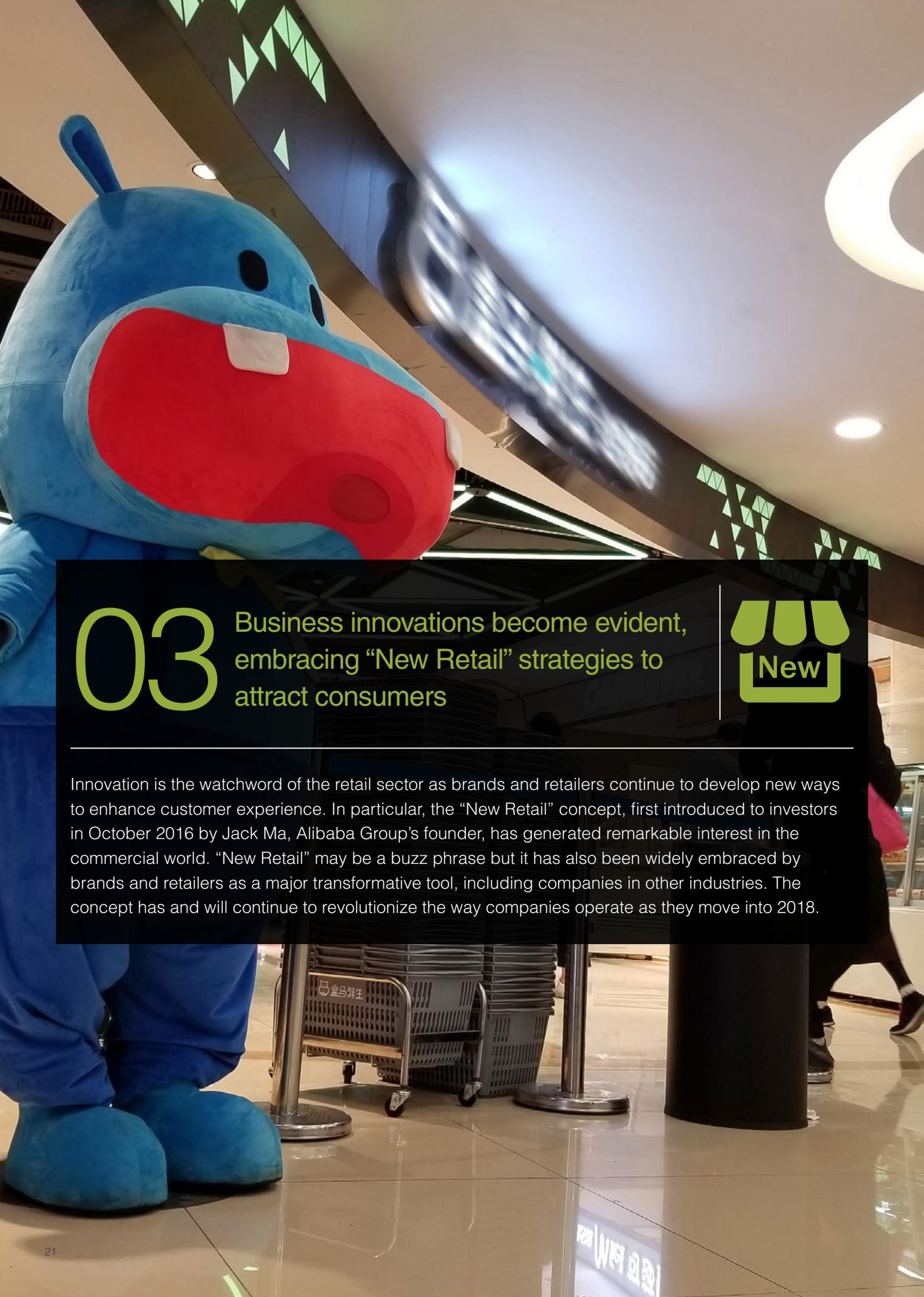
China's export growth turned positive in 2017. The Belt and Road Initiative has and will continue to foster that growth. Xi's report highlighted the importance of promoting foreign trade and forming new business models for trade to support export growth. The government strives to increase product quality; this will enhance the competitiveness of China's exports.

### **Growth of household income will grow steadily**

In 1-3Q17, per capita disposable income of households increased by 9.1% yoy in nominal terms and 7.5% yoy in real terms, faster than GDP growth. According to Xi's report, growth of urban and rural personal incomes has outpaced economic growth while the middle-income group has been expanding fast. Xi also emphasized that the quality of employment and income levels should be further improved. It is expected that household income will continue to rise gradually and the size of the middle-income group will grow considerably in 2018.

### **Reform of the retail and catering sectors will further deepen**

Consumption upgrading will continue to be a trend. Consumption on tourism-related services, sports, culture, entertainment, health and senior care will expand, thereby contributing to the improvement of the overall retail and catering market. The government will further enforce market regulation to ensure a better consumption environment. All in all, products with better quality, more innovative retail formats, an increasingly convenient and diverse shopping experience and more competitive prices will all lead to the steady growth of the consumption market.



# 03

Business innovations become evident, embracing “New Retail” strategies to attract consumers



Innovation is the watchword of the retail sector as brands and retailers continue to develop new ways to enhance customer experience. In particular, the “New Retail” concept, first introduced to investors in October 2016 by Jack Ma, Alibaba Group’s founder, has generated remarkable interest in the commercial world. “New Retail” may be a buzz phrase but it has also been widely embraced by brands and retailers as a major transformative tool, including companies in other industries. The concept has and will continue to revolutionize the way companies operate as they move into 2018.



In the digital age, increasing numbers of retailers leverage technology to reinvent their businesses. New business models such as smart stores are trending in China.

*Wang Xiaodong, Professor, Department of Trade Economics, Renmin University of China.*

### The new retail revolution is here

Chinese consumers are highly connected and more sophisticated. They demand increasingly convenient shopping options both on their smartphones and in physical stores. The “New Retail” concept uses customer data and technologies to integrate online and offline businesses so as to offer a more efficient and flexible retail experience.

Online and offline (O2O) integration is the essence of “New Retail”. Traditional retailers are actively upgrading and transforming their businesses to stay relevant in the market. Yonghui Superstores is a case in point. The company keeps on evolving – from operating only supermarkets targeting the mass market to launching premium supermarkets Bravo YH and innovative retail stores YH Super Species, with O2O concepts at the core of this transformation. Customers can purchase in stores or via the Yonghui app, settling payments with the Yonghui shopping card or with other third-party payment tools.

Wumart Stores, a Chinese supermarket and convenience store operator, has also embarked on digital transformation to reinvent its business. For instance, Wumart has formed a strategic alliance with local startup Dmall; customers who place orders on the Dmall online grocery app can receive their products in less than two hours. Wumart has also replaced all paper product tags in its supermarkets with electronic shelf labels.

Conversely, online players are also rapidly expanding their offline presence as part of their O2O push. Hema Xiansheng is a prime example. Launched by Alibaba in 2015, Hema is very much part of Alibaba’s “New Retail” strategy, which aims to seamlessly integrate online and offline shopping by strengthening the connections between customers, products, services and stores. Customers can shop from home using Hema’s mobile app – they can order fresh food to cook at home or have it prepared by Hema chefs and delivered within 30 minutes. Customers who prefer the in-store experience can visit the supermarket to hand-pick their fresh produce (such as seafood), and choose to have it cooked for carry-out, delivered to their nearby home or office – or eat it on the spot in the store’s dining area. Hema’s physical stores also serve as a warehouse and order fulfilment center, thereby enabling it to provide fast and flexible delivery services.

Another large B2C online player, JD.com, made a strategic investment in brick-and-mortar fresh-produce supermarket chain operator Qiandama in June 2017. The move appeared to follow JD.com’s broader strategy to combine its online and offline retail services to better meet the shopping needs of its Chinese consumers both on their smartphones and in local community stores.

## **New business models emerge, with technology as a key enabler**

Many new business models and formats have evolved in today's retail environment. In many cases, advanced technology acts as a key enabler in retailers' transformational journey. The rise of unmanned stores in 2017 exemplifies this trend. These automated stores, such as Bingo Box, use RFID as well as artificial intelligence (AI) technologies including biometric identification systems, machine learning and voice and image recognition technologies extensively in their operations, allowing shoppers to check in at the entrance of the store with an app, choose whatever items they need and check out automatically through an unstaffed cashier counter.

Recently, some retailers have been stretching their business boundaries by tapping other retail segments and adjacent businesses or forming closer relationships with suppliers. To better meet Chinese consumers' increasing demand for convenience, fresh and quality products – including a “lifestyle shopping” experience – some traditional retailers have trialed a new “fresh food + catering” format. For instance, Yonghui Superstores and Rainbow Department Store launched a new type of supermarket to encompass sales of fresh and high-quality food products while at the same time offering catering services. These supermarkets leverage data, the mobile Internet, the Internet of Things (IoT) and other technologies to integrate their online-offline systems. Another example is Jihood, a multi-brand store launched by Intime and Alibaba. The store sells mainly popular and top selling items from Tmall, as well as products from local designers. The store curates its merchandise by tracking customers' on-site data in each location as well as analyzing online sales data.

Smart logistics is another important O2O ingredient, with customers requiring products at increasing speed and convenience. To improve operational efficiency, JD.com has stepped up efforts to automate and streamline its logistics process via AI algorithms and robots. In October 2017, the company launched a highly automated warehouse in Shanghai to support its last-mile delivery service.

## **Enhancing customer experience is the common goal**

The “New Retail” concept and other new business innovations all have one common aim: to anticipate and satisfy customers' needs. China's rapid consumption upgrading is creating new consumer demand. Additionally, consumers' experience-centric shopping habits are driving retailers to better understand their needs and provide upgraded and more personalized products and services. For instance, House Selection – a lifestyle-themed homeware store launched by Intime Department Store and Alibaba in December 2016 – has displayed all products in configurations that customers can envision in their own homes. This type of scenario-based display truly seems to appeal to customers, since foot traffic has increased considerably. Likewise, in Sp@ce supermarket – a premium supermarket launched by Rainbow Department Store in January 2017 – all merchandise is displayed in thematic “zones” according to product category.

Some newly-opened, smart outlets such as unmanned convenience store Z Spot in Dongguan, Guangdong also aim to enhance customer experience by stocking best-selling and trendy products. Others use various technologies such as virtual reality (VR), augmented reality (AR) and facial recognition to attract and engage customers.



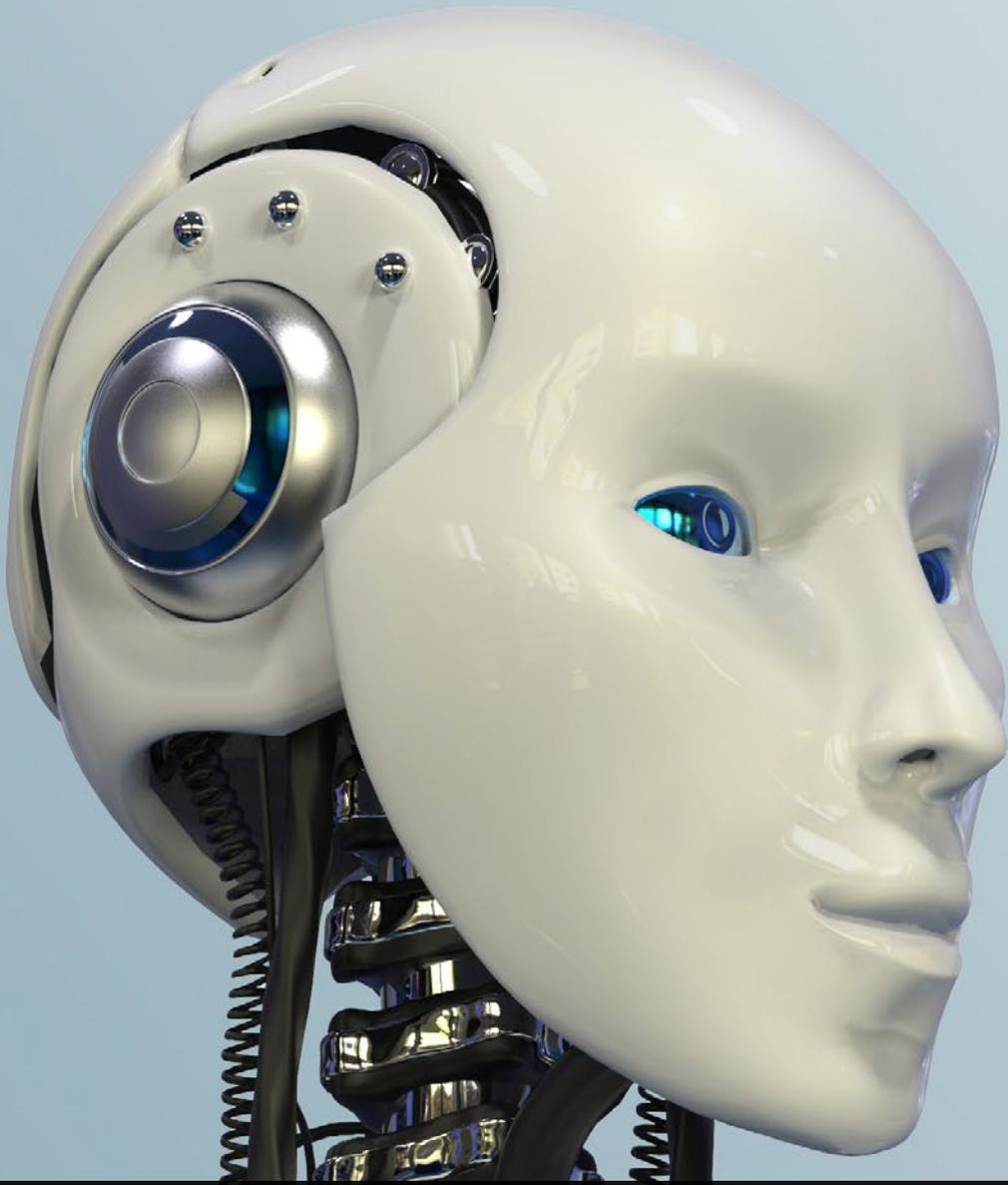
## What the experts say ?

In recent years, the government has supported the development of “New Retail” ecosystems with the promulgation of a number of major policies, including the *Opinions on Promoting Online-Offline Interaction to Expedite the Innovation Development, Transformation and Upgrade of Commercial Circulation*, the *Opinions on Implementation of the Action Plan for Internet Plus Circulation* and the *Opinions on Facilitating Innovation and Transformation of the Physical Retail Industry*. These measures have greatly contributed to the advancement of China’s “New Retail”, particularly enhancing efficiency in the retail and distribution sector and facilitating cross-sector collaboration.

Against the backdrop of a positive policy environment, coupled with the adoption of an increasing number of technologies and upgraded consumption, the “New Retail” concept will continue to shape the development of China’s retail sector in 2018; undoubtedly, new retail formats and business model innovation will dominate the retail scene.

That said, there are risks and uncertainties associated with business innovation. To begin with, setup costs and maintenance fees for technological applications involved are high. For some innovative retail formats such as unmanned stores, security problems are also key concerns. Additionally, some industry practitioners believe these innovative business models are still at the exploratory stage, only suitable and applicable to certain businesses or retail segments.

To achieve lasting success and sustainable development, companies need to focus on the basics of retailing which, in essence, are about producing desirable goods and service offerings to customers. To better meet the needs of customers, enterprises may well consider adopting consumer-focused production models to facilitate greater consumer participation in the products and services design process. This would enable companies to better align product supply and demand while achieving significant cost reductions.



# 04

Artificial Intelligence facilitates the creation of new retail formats; smart business models become the next digital frontier



Commercial enterprises today use data, information systems and technologies in almost every facet of operation. Many companies are striving to build their smart business models and ecosystems with the help of new technologies. The use of artificial intelligence (AI), in particular, is becoming a more prominent path into the new digital topography.



Increasing applications of AI and other mobile technologies in the retail sector have led to more interactions and connections between retailers and consumers. In the coming year, the use of new technologies and big data to offer more personalized products and services will become a key trend.

*Tang Shaojuan, Founder and CEO of IBMG.*

### **AI development in China proliferates, receiving strong support from the government**

China's AI market has entered a period of rapid growth over recent years. According to iiMedia, China's AI market is expected to reach 34.43 billion yuan in 2019, up from over 10 billion yuan in 2016 and 15.21 billion yuan in 2017. This phenomenal growth path is attributable in part to the country's huge population – the tremendous volumes of data being generated are essential for building AI ecosystems.

The development of AI is also on the radar screen of the Chinese government. In the report delivered by General Secretary of the Communist Party of China (CPC) Xi Jinping to the 19th National Congress of the CPC on 18 October, 2017, Xi called for the “embedding of advanced technologies, including the Internet, big data, and AI into the real economy to foster growth engines and develop new business models”.

The government has also rolled out a number of policies to facilitate the development of the AI sector and has allocated significant resources for accelerating the country's AI development. For instance, in May 2016, the Ministry of Industry and Information Technology and the National Development and Reform Commission jointly issued the *Three-year Implementation Plan for 'Internet Plus' Artificial Intelligence*. The Plan laid out the strategic focus in the

development of smart industries, and pointed out that AI has been upgraded to a key strategic level in China. The Plan also stated that China will start building its AI ecosystem. In July 2017, the State Council issued the *Guidelines on Developing Artificial Intelligence* which sets forth the AI roadmap for China through 2030. It is hoped that China will have achieved world-leading levels in terms of AI development and applications, becoming the world's primary innovation center by 2030. The government's intention is to build a domestic AI industry worth over 1 trillion yuan, while AI-related industry will be worth over 10 trillion yuan by that date.

### **AI facilitates the creation of new retail formats; unmanned stores come on the scene**

In today's technology-driven business era, many companies are striving to build their smart business models. In particular, a number of staffless stores have come on the scene in 2017. For example, Bingo Fresh and Auchan jointly opened their first 24-hour unmanned convenience store, Bingo Box, in Shanghai in June 2017. To enter the store, customers need to scan the WeChat QR code at the door, which requires mobile authentication to allow access. By using image recognition and machine learning technologies, the staffless checkout counter can automatically recognize the products, allowing customers to checkout and settle payments quickly and easily. The system has a reported accuracy rate of 99.9%.

In July 2017, Alibaba also unveiled the Taocafé, its first cashier-less experiential store, at the Taobao Maker Festival. The store is equipped with biometric facial recognition technology to track targeted customers and analyze their choices. Consumers can enter the store by scanning a QR code on their Taobao app; they can choose products or order meals by “telling” the screen what they like, and a speech recognition system will order accordingly. When customers leave the Taocafé, the system at the entrance will detect the goods selected automatically and consumers can settle payments by Alipay.

Suning recently opened three unmanned, self-service stores under the brand Suning BIU on 11 November, 2017 in Beijing, Chongqing and Xuzhou. The stores sell mainly sportswear and sporting goods, as well as other products from Suning’s supermarkets and department stores, including gadgets, personal electronics, food and FMCG goods. The entire shopping journey is automated: consumers can access stores via facial recognition and complete self check-out by stepping into a specific payment area and checking in through an overhead camera for facial recognition; payment is settled automatically.

## **Application of AI in commercial activities gains traction**

AI technologies affect the entire supply chain from design to production to logistics and product distribution; this also impacts the customer-facing aspects of businesses. Recently, increasing numbers of commercial enterprises in China have incorporated AI in their day-to-day operations.

### **Using AI to optimize customer experience and create a smart shopping journey**

A number of traditional retailers have invested heavily in retail technologies over recent years as part of their customer engagement strategy. For instance, in July 2017, Uniqlo launched an AI-supported smart buying device in over 100 stores in Beijing, Shanghai, Guangdong, Tianjin and Fujian. The device has an interactive touch screen, allowing customers to search

and view Uniqlo’s new collections, promotion information, tips on “mixing and matching” apparel and locations of in-store products. It also collects customer data such as customer profiles and the types of clothes they have browsed. All these information are stored in Uniqlo’s client resource library.

In September 2017, KFC introduced a facial recognition function for payments in its Hangzhou concept restaurant, K Pro. The facial recognition system is supported by Ant Financial, Alibaba’s financial arm. After placing their orders at the appropriate kiosk, customers can pay by scanning their faces and entering a phone number that is connected with their Alipay accounts to complete the authentication process. The whole process takes less than 10 seconds to complete.

Another example again includes Suning. In October 2017, the group introduced an AI-powered smart robot called Wang Bo in its Suning BIU store in Nanjing. The robot not only chats and interacts with customers, but also provides product recommendations and personalized offerings based on aspects such as customer profiles, browsing histories and previous spending records.

### **Leveraging AI to optimize inventory control and streamline logistics**

Some commercial enterprises use predictive analytics to figure out the types of products that customers want; analytics include the optimal amount to produce, the appropriate time for production and products for promotion or replenishment. By aligning supply and demand, they can optimize inventory control and minimize unnecessary financial losses due to mark down, waste and popular items selling out.

JD.com launched the world’s first unmanned warehouse in Shanghai in October 2017, in an attempt to streamline the logistics process. The warehouse is fully automated and digitalized, from warehousing to storage, packing and sorting, with the help of AI technologies. The unmanned warehouse will be able to handle more than 200,000 orders daily upon full operation.



## What the experts say ?

China's AI development is set to see great strides with the emergence of new smart businesses and retail formats. The AI market is dominated by three leading Chinese Internet players, namely Baidu, Alibaba and Tencent. They have made substantial investments in AI technologies and infrastructure, as well as in product development. Going forward, the three companies are expected to continue in their efforts to drive the country's AI coverage.

While our experts agree that AI technologies can bring a great deal of convenience to the commercial sector, they also pinpoint some issues and challenges in AI deployment. First, AI requires significant capital investment, while both maintenance and repair costs may also be very high. Secondly, companies take time to fully command the technology or fully experience the benefits of AI. Besides, if AI begins to replace people in various fields, this will lead to job losses. Low-skilled workers are most at risk of losing work due to automation. Last but not least, AI collects huge amounts of consumer data, making data privacy and security more important than ever.

# 新鲜

## 05

Convenience stores see robust growth; technological innovation a key driving force



The development of convenience stores (CVS) has taken an increasingly significant role in online and offline (O2O) integration in 2017, extensively applying technology-driven innovation.

Two key trends have emerged in the sector over the past year. First, traditional retailers are branching out into the CVS sector; secondly, technology companies are partnering with CVS operators to trial various types of technologies in-store to enhance customer experience and streamline operations. These trends are set to continue into 2018 with greater depth and variation.





Convenience stores, which require smaller investment, have seen a fast pace of expansion over recent years. They are also taking the lead in adopting new technologies to create new business models in the 'New Retail' era.

*Zeng Lingtong, Director, China Retail Human Resource Research Center.*

### Traditional retailers actively tap the CVS sector

CVS have gained popularity in recent years, with Chinese consumers more willing to spend, increasingly desiring quicker services and better shopping experiences. Crucially, CVS can better support O2O initiatives with its proximity to local communities. In view of the huge development potential of CVS, increasing numbers of traditional retailers have set their sights on this lucrative sector and sought to expand into it. Below are the three most common ways traditional retailers can enter the CVS sector.

- Form strategic alliances with CVS enterprises. Regional retail chains Wuhan Zhongbai Group, Nanjing Central Emporium Group and CSF Market formed a partnership with Japanese CVS brand Lawson, while Beijing-based retailer Wangfujing has cooperated with regional CVS brand Henan Aibianli. This is a quick entry method for enterprises in other retail formats to tap the CVS market. Regional leaders and foreign CVS brands that hope to further expand in China would be popular targets for such cooperation.
- Expand current supermarket businesses into the CVS sector by opening smaller-sized format stores. These players can leverage their sourcing capabilities to serve residents in individual neighborhoods. Yonghui Life, Easy Carrefour and CP Fresh Mart are some significant examples of this strategy. Yonghui Superstores launched its offline convenience store Yonghui Life in June 2017. Each store has an operating area of around 100 sqm,

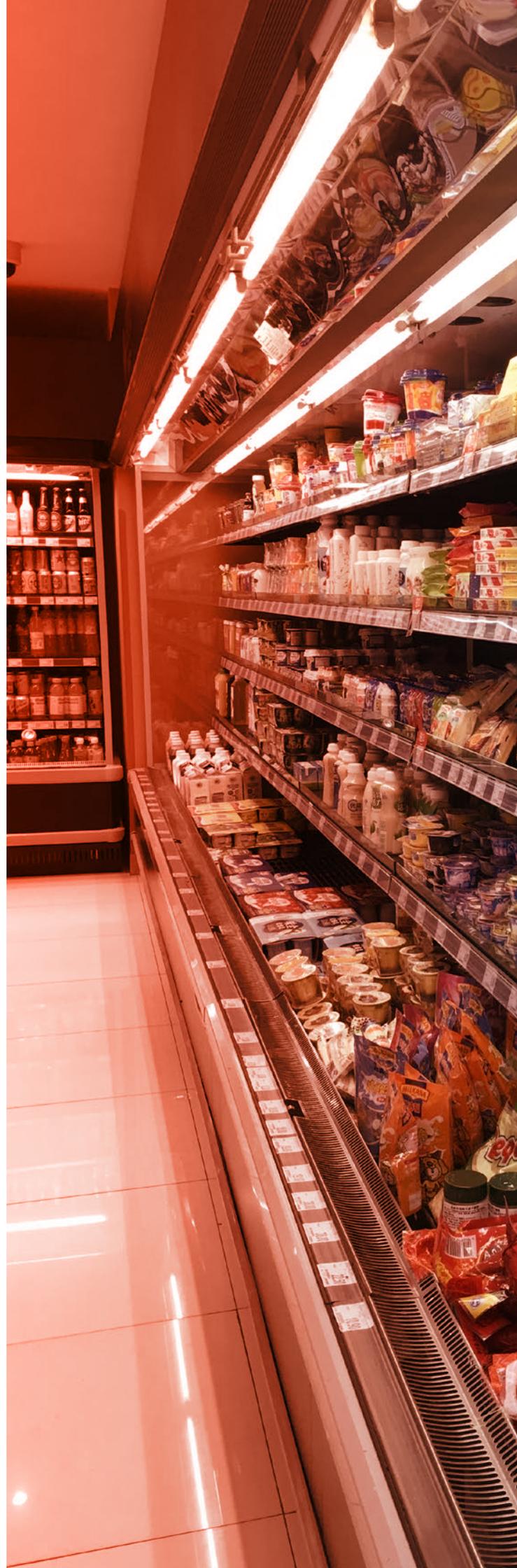
selling 800 stock keeping units (SKUs) of fresh food including fruits, vegetable, meat and other daily necessities. Easy Carrefour, which was launched by France-based Carrefour in 2014, has an average store size of around 400 sqm, selling approximately 4,000 SKUs. CP Group, the Thailand-based conglomerate, opened several CP Fresh Mart stores in 2015, selling mainly fresh food and frozen seafood.

- Revamp and transform so-called mom-and-pop stores into CVS. Indeed, quite a number of retailers such as Suning, Better Life and RT Mart have leveraged their sourcing capabilities and launched B2B platforms over the past two years so that mom-and-pop stores could source their products. In 2017, Alibaba and JD.com entered the market by launching similar initiatives with the intention of gathering mom-and-pop stores on their platforms. For instance, Tmall Xiaodian (or Tmall small retail store) is an initiative launched by Alibaba in August 2017. Alibaba provides business and digitalization services for small retail stores in areas such as sourcing, logistics, marketing and other value-added services. Tmall Xiaodian can access the retail intelligence system on Alibaba's 1688.com platform. Alibaba aims to team up with 10,000 Tmall Xiaodian stores by March 2018. In another initiative, JD Convenience Store was launched by JD.com in April 2017. As with Alibaba, JD.com provides a broad range of services for mom-and-pop stores, particularly those in rural areas. It intends to partner with 1 million JD Convenience Stores over the next five years.

## Technological innovation is a major driving force

Technological advancement has been and will continue to be a significant factor in the rapid growth of the CVS sector. Starting from 2H17, there have been several significant new attempts in the CVS sector involving the wide adoption of advanced technologies to bring about further retail transformation. Unmanned CVS illustrate the point. Such stores use advanced technologies such as artificial intelligence (AI) to replace manpower in their operations to improve efficiencies. A significant number of players are testing the unmanned retail store model, including Internet giant Alibaba and several large-scale retailers such as RT Mart, Auchan and Easyhome. Several unmanned CVS operators including Xiaomai, TakeGo and F5 Future Store have completed a venture capital financing round of over 100 million yuan. As of November 2017, Xingbianli completed a 500 million yuan round in venture capital financing. These investments show that the new business model to launch unmanned stores is gaining rapid attention. Another trending model involves unmanned shelves, where Pagoda, Yiguo and Wahaha are some of the pioneers.

Indeed, the development of unmanned stores has provided insights for the operation of traditional CVS, from backend to storefront. In particular, traditional CVS are expected to incorporate some of the new innovations to upgrade operations, reduce costs and improve efficiencies.





## What the experts say ?

China's CVS sector has been expanding fast over recent years. In 2017, retailers in non-CVS sectors as well as large Internet companies introduced more innovation and investment, marking a significant step forward from only acting as pick-up points for online orders. While our experts expect that the CVS sector will continue to transform and grow in 2018, involving more innovative business models and technological transformations, they also believe some challenges will remain.

First, service is an important aspect of retailing; replacing manpower by machines in unmanned stores may not turn out to be the best solution. Instead, incorporating new technologies to streamline supply chains, and improving logistics efficiencies and backend operations would be better options in the transformative process.

Secondly, many domestic CVS players are regionally focused. They tend to open stores in areas near their place of origin. However, they increasingly face fierce competition from foreign players. Foreign operators are more active in expanding nationally and they have been accelerating their pace of expansion. For instance, Lawson, one of the largest foreign players in the CVS sector, aimed to have opened 1,400 stores in China by 2017, with 2,000 stores open by end-2018. FamilyMart announced in October 2017 that it had opened more than 300 new stores in China since the beginning of 2017. Facing this aggressive foreign expansion planning, domestic players need to react promptly and adopt their own strategies.

Last but not least, most domestic CVS players still lag behind their foreign competitors in terms of operation, scale, digitalization, logistics, human resources management and financial strength. Many smaller domestic players still take the role of landlord, solely leasing their shelf spaces to brands without developing their own CVS brand strategies.

That said, the industry has undergone changes recently. Increasing numbers of players are revamping their formats by developing private labels, embracing O2O initiatives, increasing product and service offerings and more intensely innovating to differentiate themselves from competitors. For instance, in May 2017, FamilyMart in Shanghai launched a new retail format to include a café inside its CVS. 7-Eleven also introduced fresh food such as vegetables and fruits in one of its Beijing branches. Our experts believe the next wave of consolidation is gathering pace.

# 06

## Distribution sector supply chain integration: leading to optimal supply-demand matching, national supply-side structural reform



Driven by a dramatic rise in income levels, Chinese consumers have been demanding ever-higher quality products and services. At the same time, increasing online retailing and evolving lifestyles underline the personalized experiences that have led to a more diversified consumer market. In response to these changes, enterprises are integrating their supply chains to achieve more precise supply-demand matching to adapt to new consumer trends. Supply chain transformation and upgrading have focused on balancing supply and demand and optimizing resource allocation; these are also key tenets of national supply-side structural reform, galvanizing the distribution sector.

More retailers now place stronger focus on creating more fluid, standardized and digitalized supply chains; at the same time, they are trying to build extraordinary flexibility into their supply chains to adapt to fast-changing consumer needs.

*Xie Lijuan, Associate Professor, Department of Trade Economics, Renmin University of China.*

Supply chain development in China will enter a new era with the endorsement from the government. Supply chain innovation and application will become an important starting point of supply-side structural reform.

*Zhang Jing, Senior Economist, Circulation Industry Promotion Centre, Ministry of Commerce of the PRC.*

## Supply chain innovation and application in focus

Recognizing the importance of supply chain integration in national supply-side structural reform, the General Office of the State Council released the *Guidelines on Promoting the Innovation and Application of the Supply Chain* in October 2017; this stresses the importance attached to enterprises in major industries – including the distribution sector – to establish smart supply chain systems. The guidelines also underscore the significance of an upgraded and more developed supply chain system to encourage major industries to transform, upgrade and better align demand and supply of commodities. They can thereby very significantly reduce costs and waste. In line with the State Council's initiative to promote the modernization of the domestic distribution sector, other government authorities including the Ministry of Commerce, the National Development and Reform Commission, the Ministry of Industry and Information Technology and the Ministry of Science and Technology have joined forces to encourage supply chain innovation and upgrading in the distribution sector, aiming to facilitate transformation. Robust government support for supply chain integration could well further promote the distribution sector's supply chain upgrading. By adopting new supply chain technologies and smart supply chain networks, distribution enterprises can better manage their supply chain activities and generate more precise forecasting and market insight. This, in turn, assists upstream partners to better allocate their resources and optimize the production process, raising overall supply-chain performances to new levels.

## Creating private labels in collaboration with upstream manufacturers

Integrating supply chains to drive new growth has become an effective way for distribution enterprises to transform and upgrade. Enterprises involved in distribution are thereby playing a more active role in production planning and supply-demand matching. To create their own private lines, many online and offline players have already established their distribution networks and are exerting their influence and control over upstream supply chain operations by forging closer ties with producers and suppliers. For example, Beijing-based supermarket chain CSF Market has formed long-term partnerships with over 90 production bases. Under these partnerships, over 70% of CSF Market farm produce comes directly from production bases, satisfying customer demand for fresh supplies from source. In July 2017, CSF Market announced that it would focus on fresh food and lifestyle supermarket operations as the company's core business. Backward supply chain integration (the purchase of or merger with suppliers in the supply chain) as well as closer partnerships with suppliers have enabled the company to sell fresh produce sourced directly from farms, greatly enhancing the company's core competencies.

In different sectors, some companies are actively seeking to create private labels. In March 2017, local supermarket chain Yonghui Superstores announced that it would roll out between four and five private clothing labels, increasing its scope to develop its own fashion

brands. In May 2017, major department store operator Intime Retail and e-commerce giant Alibaba co-developed a private snack products label called Onmine. Major online player JD.com launched its private label for smart refrigerators in 2016 while in June 2017 the company joined hands with local pulp producer Asia Symbol to develop its own paper brand.

### **End-to-end connectivity enhances supply chain flexibility**

With integrated supply chain networks, enterprises can seamlessly connect the entire supply chain upstream to downstream, enabling them to perform end-to-end analysis and planning across various activities. They can leverage dynamic sales data and consumer insights from downstream parties to accurately predict market demand and trends, as well as design products accordingly. One example is pure-click, fast fashion retailer Handu.com (or Handu). The company's highly responsive supply chain enables it to produce 30,000 new designs per year. By connecting upstream and downstream activities across the supply chain, Handu can utilize its online sales data and customers' pre-order status to predict market trends and demand, so that upstream suppliers and/or producers can better manage their resources and plan for future needs. Such end-to-end connectivity has led to an agile and flexible supply chain, allowing the company to swiftly react to changing customer demand. Through establishing lean and agile supply chain practices, Handu has successfully evolved from a purchasing agency to a brand incubator. It currently owns about 20 private fashion labels and provides distribution and support services to over 40 fashion brands.

### **Digitalization facilitates supply chain integration**

Supply chain integration relies greatly on informatization and big data analytics, both playing significant roles in optimizing supply chain operations and driving integration. To ensure an effective transformation of the supply chain, a growing number of companies are undergoing technology upgrades and digitalization to improve the efficiency of their supply chains. Yonghui is a good example. In collaboration with Shenzhen-based technology company Mei Cloud, Yonghui has capitalized on big data analytics and digital technologies to optimize different supply chain processes. Also, during the 11.11 Global Shopping Festival in 2017, JD.com drew on AI technologies to optimize its demand forecasting; the company motivated business partners to upgrade their supply chain operations. Handu is another case. It has started constructing its own informatization system since 2014. To step up its efforts in supply chain integration, Handu has introduced advanced IT technologies, taking advantage of big data analytics for more accurate demand forecasting. Based on insights generated by big data, Handu can adjust its product mix to meet changing market demand and align trend and demand forecasting with product design and production.



## What the experts say ?

With the government's support for supply chain innovation and application, coupled with the advent of new technologies, distribution enterprises are set to speed up their supply chain integration processes by combining leading-edge digital technologies with supply chain operations. Increasing numbers of retailers and distributors are taking up a dominant role in supply chain activities. This is expected to bring greater efficiencies in resource allocation and supply and demand matching, enabling market players to stay ahead of changing consumer demand.

With larger numbers of retailers working with suppliers to develop private label products, our experts believe backward supply chain integration will become a new trend in the distribution sector. This should certainly provide impetus for national supply-side structural reform and take Made-in-China labels to new heights.

# 07

Rural areas become a new powerhouse for e-commerce growth; e-commerce plays a larger role in agricultural upgrading, alleviating rural poverty



Rural e-commerce is undoubtedly one of China's development priorities. On February 5, 2017, the Central Committee of the Communist Party of China and the State Council unveiled the No. 1 Document titled the *Opinions on Deepening the Supply-side Structural Reform in Agricultural Sector to Cultivate New Development Engines in Rural Areas*. One of the development goals is to modernize agricultural distribution in rural areas by fully integrating e-commerce in wider fields, including agricultural production, processing and distribution. The document also highlighted the importance of cultivating e-commerce businesses in underdeveloped villages, implying that e-commerce is set to play an even greater role in poverty relief and economic re-structuring in rural areas.



Internet giants are striving to increase their presence in the countryside. They have been pouring money into improving logistics, building service centers and training farmers. I believe e-commerce will play an even greater role in poverty alleviation in the rural areas in 2018.

*Wang Shuiping, Associate Research Fellow, Institute of Consumption and Distribution, Chinese Academy of International Trade and Economic Cooperation, Ministry of Commerce.*

### **Rural e-commerce boom unleashes consumption power in rural areas**

According to the National Bureau of Statistics of the PRC and the Ministry of Commerce (MOFCOM), total retail sales of consumer goods in 1-3Q17 increased by 10.4% yoy to 26.3 trillion yuan, with the growth rate remaining flat from the same period in 2016, while online retail sales surged 34.2% yoy to 4.9 trillion yuan, with the growth rate adding 8.1 percentage points (ppts) yoy. Of the 4.9 trillion online sales, rural area transactions posted an even stronger growth of 38.3% to 836.1 billion yuan, 5.6 ppts higher in growth rate when compared to online sales in urban areas. Online sales from rural areas are projected to exceed 1 trillion yuan in 2017. The robust growth momentum in rural e-commerce suggests enormous consumption potential in rural areas.

China's explosive growth of rural e-commerce is mainly driven by top-to-bottom engagement from the Central government. The government has so far invested nearly 15 billion yuan to develop the e-commerce sector in 756 counties. More than 800-plus service and logistics centers as well as tens of thousands of e-commerce service access points were set up in the countryside by the government, creating more than 2,000 jobs in rural villages. The government's rural e-commerce initiatives have played a pivotal role in reducing poverty, creating job opportunities and encouraging entrepreneurship.

Robust governmental support for the development of rural e-commerce has engaged active participation from major e-commerce players such as Alibaba, JD.com, China Post Group and China CO-OP Group. These players have made substantial investments in infrastructure, igniting the e-commerce boom in rural areas.

Our experts believe that the rural e-commerce boom will drive deeper collaboration between e-commerce players and agricultural producers, leading to the integration of e-commerce, production, processing, distribution and marketing of agricultural produce. While promoting the modernization of agricultural distribution, further convergence between e-commerce and the agricultural sector will also facilitate distribution of products between rural and urban areas – bringing industrial products to villages and agricultural products to cities, underpinning the growth of the digital economy in rural areas.



## What the experts say ?

China's rural e-commerce has continued its robust growth momentum. According to the MOFCOM, rural e-commerce sales in China's eastern, central, western and northeastern regions for 1-3Q17 amounted to 530.2 billion yuan, 171.3 billion yuan, 115.6 billion yuan and 19.1 billion yuan respectively, up 31.6% yoy, 47% yoy, 58% yoy and 62% yoy, with the combined growth rate surging 51.9% yoy. This remarkable growth was driven by the integration of e-commerce into various traditional industries in rural areas, including agricultural, processing, tourism and catering industries.

Our experts believe the ongoing consumption upgrade among Chinese consumers will continue to fuel strong demand for safe, high-quality and healthy agricultural products, providing ample opportunities for rural e-commerce businesses. At the same time, the expansion of rural e-commerce will also pave the way for further development in other fields, including cold chain logistics, smart warehousing and product traceability services, to name a few; all are closely connected within the rural e-commerce ecosystem and play an active role in promoting the overall upgrade of the rural e-commerce sector.

To establish a strong foothold in the longer run, enterprises need to ensure that they can consistently provide high-quality products and services that can address customers' new demands.

## E-commerce plays a larger role in rural poverty relief; leading Internet players respond by stepping up poverty-relief efforts

Attending the National E-commerce Rural Poverty Relief Forum in Guiyang on 15 September, 2017 China's Vice-Premier Wang Yang stated that e-commerce should be more targeted and effective in reducing poverty to benefit more people. He added that the government is to provide stronger policy support and a more favorable business environment to support rural e-commerce development, especially in national-level impoverished counties. In 2017, among the 756 model counties chosen for developing e-commerce, about 260 are national-level impoverished counties where sales from online retailing reached 71.6 billion yuan in the period January to August 2017, up 55% yoy; the growth rate was 17 pts higher than overall, national rural e-commerce sales. With more government poverty-relief policies being put in place, rural residents – especially those in impoverished counties – are expected to experience significant increases in income levels. This should lead to higher spending power and a further spur to rural e-commerce.

The promising outlook of rural e-commerce has prompted many leading e-commerce and Internet players to upgrade their "going rural" initiatives, while deepening their poverty-relief efforts. Key "going rural" strategies adopted by selected e-commerce giants are illustrated as follows.

### Alibaba

Alibaba initiated its rural e-commerce strategies in October 2014. As of July 2017, the company operated about 30,000 service centers or so-called “Taobao Villages” in rural towns and created 60,000 jobs across some 700 counties nationwide, including 178 national-level impoverished counties and 147 provincial-level impoverished counties. The extensive network of service centers in the countryside facilitates two-way product distribution between rural and urban areas, bringing industrial products to villages and agricultural products to cities.

### JD.com

JD.com has made inroads into the countryside by establishing self-operated service centers and regional cooperatives in partnership with different parties, including villagers, logistics carriers and agricultural enterprises, to provide online purchasing and delivery services. To encourage villagers to engage in e-commerce businesses, the company has provided financial support to allow poor farmers to receive non-collateral loans and has set up e-commerce incubator centers to organize e-commerce training programs for farmers.

### China Post Group

In response to the government's poverty alleviation strategy, China Post Group has optimized its logistics and distribution systems in the remote countryside to complement rural e-commerce operations. The company has planned to also develop different financial services, looking to integrate financial services with rural e-commerce.

### Suning

Suning offers agricultural produce sourced from regional farming cooperatives on its online platforms Suning Dajuhui (<https://ju.suning.com/>) and Suning Crowdfunding (<http://jinrong.suning.com/>) as well as its 1,000-plus offline retail chain stores. The move has not only promoted the distribution of local agricultural produce nationwide but also helped with the marketing and brand development of agricultural produce from rural areas, leveraging e-commerce to reduce poverty.

Our experts point out that Internet companies have been at the forefront in the battle against poverty. Their entry into remote areas has facilitated the distribution of rural agricultural products to cities and urban industrial products to villages, further connecting rural areas with cities. However, eliminating poverty in the longer term still relies on deeper integration of e-commerce with traditional industries in rural regions. To support the convergence between e-commerce and traditional industries still further, human resources is an important element. The so-called “talent crunch” remains a major barrier to e-commerce development in the countryside. Local governments and market players are advised to devote more resources to cultivate e-commerce talent and ecosystem players, as well as retain homegrown talent to start e-commerce businesses in their rural hometowns.

# 08

## Demand for localized lifestyle services surge; growth rate far exceeds consumer goods consumption



China's lifestyle services sector has been developing rapidly. Statistics from the Ministry of Commerce (MOFCOM) show that total sales receipts from local lifestyle services subsectors amounted to 58 trillion yuan in 2016, an increase of 11.5% compared with the same period in the previous year. The growth rate was higher than the national GDP growth rate (6.7%) and also higher than the growth rate for total retail sales of consumer goods (10.4%). As China enters a new era of remarkable consumer growth, the demand for high-quality lifestyle services continues to rise.

The proliferation of the local lifestyle services sector in China was a key trend mentioned in last year's *Ten Highlights of China's Commercial Sector*. Continuing that trend in 2018, we identify several key features.



The lifestyle services sector continues to proliferate; catering, accommodation, tourism and other local lifestyle services industries enjoy rapid development.

*Hong Tao, Professor, School of Economics, Beijing Technology and Business University.*

### **“Internet + lifestyle services” makes rapid advances; the lifestyle services sector has become fully integrated with information technology; applications grow in range and variety**

With Premier Li Keqiang’s “Internet Plus” action plan advancing since 2015, the Internet has gradually evolved into a new medium for mass entrepreneurship and innovation. The combination of Internet and lifestyle services – including catering, entertainment and other daily life-related services – has induced a proliferation of transformative and innovative opportunities.

The catering industry has witnessed rapid changes when it started to embrace the Internet and become an O2O lifestyle services subsector, offering online food ordering and delivery services. Several popular e-commerce catering platforms have emerged such as Meituen, Eleme and Baidu Waimai, serving to reshape people’s dining habits. Turnover in China’s online catering market is estimated to have exceeded 160 billion yuan in 2017, an increase of over 60% yoy; the transactional value is expected to exceed 240 billion yuan in 2018 while the growth rate will be a phenomenal 50% yoy increase.

With China’s unprecedented O2O development, other lifestyle services subsectors such as accommodation, housekeeping, beauty and car repairs have also entered a new trend for growth, with even more service varieties joining them over recent years. The “sharing economy”

is particularly on the rise as increasing numbers of consumers conduct business transactions via different online sharing platforms. According to the “China Sharing Economy Report 2017” released by the Sharing Economy Research Center within China’s National Information Center, the market size of the sharing economy for local lifestyle services – mainly catering, housekeeping, beauty, community delivery, car repairs and related services – reached 723.3 billion yuan, an increase of 101% yoy.

### **Service levels show steady improvement; further specialization in types and categories of services**

The lifestyle services sector has made great strides in terms of levels and range of services. For instance, backed by government support and active enforcement, the online catering business has achieved substantial improvement in service standards and food quality over the past year. Earlier, the China Food and Drug Administration released *the Measures for Online Catering Services Food Safety Supervision and Management*, requiring online catering companies to set up physical stores and obtain food business licenses as prerequisites for operating online catering businesses. These measures have also strengthened specifications for online catering companies to process food delivery and distribution, ensuring food safety and quality. Also, to solve difficulties of managing and monitoring huge numbers of online catering business entities, relevant government departments have also applied technologies

in regulatory means. For example, the Shanghai Food and Drug Administration co-established a big data sharing mechanism for food safety with various key online catering platforms. All consumer feedback will automatically be screened and filtered by keywords, thereby informing the regulatory authorities in a timely manner.

Similarly, the housekeeping services industry has witnessed gradual improvement in standards with strong support by the government. The MOFCOM has promulgated the *Interim Measures for the Administration of Family Services Sector*, the *Housekeeping Services Contract* and 17 industry standards such as the *Housekeeping Services Standards and Common Terms of Housekeeping Services*. To improve service quality, over one million housekeepers have been trained through the “Housekeeping Services Project”. On-the-job training has also enhanced the overall quality and skills of services providers. Furthermore, the government has supported over 300 leading players in infrastructure upgrading and management improvement to help more than 400 SMEs in various lifestyle services subsectors that include baby nursing, early education, housekeeping and elderly care to improve their services management systems.

### **Mass consumption is flourishing**

The proportion of affordable lifestyle services within larger lifestyle services subsectors is on the rise. Lifestyle services featuring good quality and reasonable prices are becoming increasingly popular. One prominent phenomenon is the prevalence of mass and casual dining. According to Meituan-Dianping's “New Consumption Upgrade, New Dining Trend: China Food and Beverage Report (White Paper 2017)”, total revenue for the catering industry in 2016 reached 3.5 trillion yuan, growing by 11.2% yoy and is expected to reach 5

trillion yuan in 2020. Mass dining consumption has become a major component of the catering industry's revenue, accounting for about 70%.

In addition, fast-growing, affordable tourism accommodation such as inn and boutique hotels, short-term rental apartments and chain business hotels has witnessed sound development over the past year. Customized, personalized tourism has also gained acceptance by mass consumers. Moreover, consumption related to beauty, hair care and spa treatment are no longer limited to the high-end consumer segment but are being popularized in the mass market.

### **Strong government support for the lifestyle services sector**

Proactive measures taken by the government to promote healthy development of lifestyle services ensures that the sector can realize its huge development potential. The MOFCOM has pledged to strengthen research and promotion of localized sectoral services. It is estimated that these will be fully promoted nationwide in 2018.

The MOFCOM, in conjunction with the National Development and Reform Commission, the Ministry of Education and the Ministry of Housing and Urban-Rural Development are poised to promote green development in the food and beverage services industry and advocate resource saving and establishment of an effective mechanism for conserving food and beverage supplies – important aspects of its drive. The MOFCOM will also work with other relevant departments to propose systematic plans and policies for the lifestyle services industries, expand supply capacity of lifestyle services effectively, improve service quality, expand service functions, strengthen brand building and facilitate innovation.



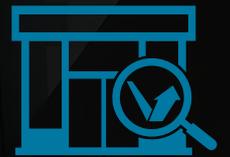
## What the experts say ?

China's consumer demand for high-quality lifestyle services has moved far beyond market supply capacity. Our experts believe that the lifestyle services sector is set to play an even more significant role in China's supply-side reform, closely related to daily life. Consumption of daily lifestyle services are set to continue growing rapidly, while service supply capacity will further enrich the types and quality of services in 2018.

China is now at an important juncture in upgrading consumption, so individualized and diversified products and services are becoming increasingly prevalent. Lifestyle services that are O2O driven and customer- and experience-oriented are set to see huge growth in the coming year.

# 09

## Physical retail market rebounds; transformation and innovation are imperative for the future of China's commercial sector



China's retail market saw a positive rebound in 2017. According to the China National Commercial Information Center, 100 key large-scale retail enterprises increased their sales by 2.8% yoy in 1Q-3Q17; the growth rate was 4.8 pts higher than for the same period in 2016. Key physical retailers including brands, supermarket and department store operators also showed signs of stable recovery with reports of upbeat sales, indicating a rebound in China's physical retail sector. Additionally, consumer sentiment continues to be positive, with people increasingly willing to spend throughout the year.



Experiential elements remain indispensable for physical retailers. Operators of retail stores, shopping malls and department stores are all allocating more space to lifestyle and experiential usage in order to attract more customers.

*Lai Yang, Director, Institute of Commerce and Economics,  
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Indeed, China's consumer market registered positive and steady growth in 2017. The National Bureau of Statistics of the PRC reported that total retail sales of consumer goods increased 10.3% yoy to reach 33,152.8 billion yuan from January to November 2017. Online retail sales reached 6,430.6 billion yuan, a large increase at 32.4% yoy. With the steady growth of China's economy, the consumption power of consumers continues to increase and consumer sentiment has continued to be positive. Since the beginning of 2017, Chinese consumer confidence figures have frequently hit record highs. Neilsen's China Consumer Confidence Index showed that consumer sentiment soared to a historical high of 114 points in 3Q17, up two points from the previous quarter. The index recorded positive growth for four consecutive quarters, increasing from 106 points in 4Q16 to 114 points in 3Q17.

Nevertheless, our experts believe the retail market rebound was partial and structural. Retailers who keep innovating, remain active in product optimization and make use of online and offline resources – including technology to enhance service and customer experience – have enjoyed significant improvement if not outstanding performances. By contrast, those retailers that resisted business reforms have been struggling in a complex economic environment and could eventually drop out of the rapidly changing marketplace.

### **Traditional retailers' business transformation and revitalization pay off**

The impact of e-commerce players on offline retail has caused plenty of challenges for many physical retailers recently. That said, some large retail corporations such as Wal-Mart China, Yonghui Superstores and Rainbow Department Store still achieved both revenue and profit growth. Through a series of reviews and upgrades, these retailers have blazed new trails of innovation and transformation to create a new retailing landscape. Their business transformation endeavors, particularly in embracing Internet technology, format revision, product and category optimization, digital transformation as well as O2O integration have become valuable lessons for other physical retailers.

#### **Wal-Mart China**

Wal-Mart China reported better than expected financial results for 3Q17. Total sales rose 4% yoy while comparable sales increased 2.5% yoy, which was Wal-Mart China's best comparable sales result in four years. Its much better performing sales growth was due in part to a series of innovative changes in recent years, including continuous efforts to upgrade existing stores and launch new supermarket formats. Furthermore, Wal-Mart China also accelerated the integration of online and offline channels and deepened its strategic

cooperation with JD.com as well as local on-demand logistics and grocery O2O e-commerce platform New Dada (www.imdada.cn). During the “88 Shopping Festival” which was launched by JD.com and Wal-Mart on 8 August, 2017, the three flagship Wal-Mart stores on JD.com – the Wal-Mart China flagship store, the Wal-Mart Global flagship store and ASDA flagship store – reportedly hit a new sales high.

### Yonghui Superstores

Grocery giant Yonghui Superstores reported outstanding performances in recent quarters. In 3Q17, the company's operating revenue grew by 17.0% yoy, while its net profit attributable to listed company shareholders increased 70.7% yoy. Yonghui is considered a reform pioneer in China's grocery sector. In recent years, Yonghui actively embraced the “New Retail” concept and kept evolving its business – from operating only supermarkets targeting the mass market to launching premium supermarkets and rolling out new retail formats with O2O concepts at the core of its transformation. One of Yonghui's most striking initiatives is the new supermarket format YH Super Species featuring an innovative “catering + retailing” model; its first store was launched in Fuzhou in January 2017. YH Super Species sells mainly fresh products, including seafood, frozen food, fruits, meat and vegetables as well as dry food products. Some stores also feature a large catering area surrounded by various counters selling different products – customers can purchase fresh ingredients in the supermarket, have them cooked in the affiliated cooking areas in-store and dine in the catering area.

### Rainbow Department Store

Rainbow Department Store achieved a growth of 4.7% yoy in operating income and a stunning 43.18% yoy growth in net profit attributable to shareholders for

1-3Q17. In recent years, Rainbow has embarked on store optimization and format innovation to generate returns and boost consumer satisfaction. For instance, it launched the new supermarket format Sp@ce in Shenzhen in January 2017. Sp@ce embraces a flexible product mix to suit different consumer groups. It sells more than 6,000 stock keeping units (SKUs), including local and imported goods, fresh food and grocery products, home products and skincare products, positioning itself as an urban lifestyle supermarket offering mainly premium products with on-site catering facilities.

### China's e-commerce giants emphasize brick and mortar

China's leading e-commerce companies have been expanding their footprint in offline retail, particularly grocery and food retail, along with catering services. The arrival of China's e-commerce giants into brick and mortar retail has been very successful, pioneering many innovations and new business models. Hema Xiansheng is a prime example. Hema is an O2O fresh food retailer within the Alibaba Group. The first offline experiential store was opened in Shanghai in January 2016. Hema is a new retail format that showcases Alibaba's vision of “New Retail” – the integration of online and offline, featuring modern logistics and big data. Customers can use Hema's mobile app to shop anytime and anywhere. Hema store is an entirely digitally operated model with all products being attached with RFID tags, allowing Hema to unify pricing across offline and online stores, enabling real-time track-and-trace of all products and big data performance. Hema's innovative practices also include its direct control and ownership of logistics services and its undertaking that delivery times will be no more than 30 minutes within five kilometers from points of sale; Hema stores serve as warehouses and delivery centers for online orders.



## What the experts say ?

### New retail formats and concepts flourish

The new retail industry puts consumers at the center of its business while building a consumer-centric model around core components, being O2O operations and advanced supply chain systems. Such initiatives will have a ripple effect throughout the entire commercial landscape. Through innovation, increasing numbers of retailers will improve existing retail formats and create new models that can better satisfy changing consumer needs. Retailers will also work to form different types of partnerships to transform and create a new retailing topography. Our experts expect to see more traditional physical retailers undertaking bolder innovations. Resulting new formats based on consumer demand will further drive the growth momentum of the retailing sector.

### The future of retail is re-defined as “boundless retail”

Into the future, retail will no longer be divided into online and offline but become cross-generating channels as consumers increasingly expect offerings between physical store, online and mobile apps to be complementary. Retailers that implement omni-channel strategies to offer customers seamless shopping experiences and ensure consistent information across all channels will improve customer satisfaction and create loyalty. As a result, the market of the future will surely be dominated by the “best of breed” in “boundless retail” – companies which consistently transform and upgrade to meet evolving consumer needs.

# 10

Digitization facilitates transformation and upgrade of China's agricultural produce wholesale markets, with electronic clearing and settlement systems greatly enhancing product traceability



With Chinese consumers' rising expectations (along with accelerated urbanization), traditional agricultural produce wholesale markets can no longer satisfy new trends. Transformation and upgrading are vitally important to sustain these traditional agricultural markets nationwide. Realizing the need to promote upgrading, the Ministry of Commerce and nine other government authorities in 2015 promulgated the *Development Plan for Facilitating Domestic Agricultural Produce Circulation*, specifying a target for achieving significant progress in agricultural modernization by 2020. With a prime focus on upgrading and transforming domestic agricultural wholesale markets through capitalizing on the advantages of e-commerce to complement the country's circulation of agricultural produce.



### **Traditional agricultural produce wholesale markets are losing share to new business practices**

According to the National Bureau of Statistics of the PRC, the number of agricultural produce wholesale markets exceeded 4,400 as at the end of 2016, of which those with a turnover of more than 100 million yuan numbered 1,671. Nationwide, agricultural wholesale markets recorded total turnover and volume of 4.7 trillion yuan and 850 million tons for 2016, up 8.8% yoy and 5.1% yoy, respectively. Despite high turnovers, the dynamics of the agricultural produce wholesale industry have been changing drastically, making it much harder for traders to turn profits in an ever more competitive environment. Meanwhile, the emergence of new business models – such as “farming-supermarket docking”, agricultural e-commerce and direct-farm sourcing, to name a few – has also diluted the market share of traditional agricultural produce wholesale markets; total market share fell to 66.9% in 2016, down from some 75% in 2012 and compared to over 80% in 2000.

### **Digitalization facilitates wholesale market transformation**

Thanks to accelerated digitalization in the agricultural produce wholesale market sector, increasing numbers of traditional farm produce wholesale players have undergone rapid transformation and upgrading over recent years. Our experts have identified the following major initiatives adopted by market players.

### **Integrating online-offline businesses**

Collecting and analyzing big data have become major priorities for many farm produce wholesale businesses. Big data allows them to better manage their sourcing and manufacturing activities along the supply chain and provide optimum services and products to customers. To achieve this, many traditional wholesale markets have gone online and set up their big data systems to pass on to downstream players.

### **Allying with e-commerce platforms**

To further complement their physical operations, some traditional farm produce wholesale markets have formed strategic partnerships with e-commerce players. The collaboration between Wuhan Baishazhou Agricultural Sideline Products Wholesale Market (WHBSZ) and farm produce e-commerce platform Gudeng (<http://www.gdeng.cn/>) is a case in point. WHBSZ is the first traditional farm produce wholesale market to feature on Gudeng. Under the partnership, WHBSZ can utilize Gudeng's e-commerce platform to gather and consolidate farm produce information in the market and provide updated information about various agricultural commodities such as for fruits and vegetables, grain, oil and aquatic products. With price information available publicly online, farm produce prices are no longer manipulated by parties such as vendors and farmers but are determined according to market rules and regulations. The move has not only promoted market price stability but also served to effectively lower prices of agricultural produce. In addition, WHBSZ has made

use of big data provided by Gudeng to optimize its market management and positioning. With the assistance of Gudeng, WHBSZ has launched a number of value-added services; these include making regular checks on agricultural produce to ensure product quality and safety, eliminating polluted and/substandard products and providing buyers with logistics services. All of these practices have made WHBSZ a highly efficient platform for wholesale distribution of farm produce.

### Embracing informatization

Besides utilizing big data, some agricultural produce wholesale markets have embraced informatization (or adopting information-based measures) as part of their transformation process. For instance, Shenzhen Agricultural Products Co., Ltd., which operates nearly 50 sizable farm produce wholesale markets across 35 cities in China, has enhanced the level of informatization through its e-commerce platform Dabaicai ([www.dbc61.com](http://www.dbc61.com)), with the bold intention of transforming China's wholesale distribution system for agricultural produce. By adopting advanced IT systems, Dabaicai can gather product information such as points of origin, volumes, sales, prices and inventories, to provide wholesalers with multi-dimensional analysis and present the latest market trends. Also, the e-commerce platform can help wholesalers establish their credit profiles based on past trading records and online market data while providing them with personalized supply chain financing services. Additionally, Dabaicai serves as a social networking platform where wholesalers can interact and exchange information to boost brand awareness. As for product safety, Dabaicai has set up filing systems to track farm produce from point of origin to marketplace, enhancing the benefits of traceability.

### Establishing electronic clearing and settlement systems

A significant bright spot in the transformation of agricultural wholesale markets has been the recent development of electronic clearing and settlement systems. A number of forward-thinking market players such as Liaoning Shenyang Shengfa Fruit and Vegetable Wholesale Market have already implemented these systems, allowing vendors and buyers to carry out electronic transactions through prepaid cards embedded with personal identity details. In addition, the wholesale market is using QR code technology for product traceability – users have access to important product information ranging from data on farm produce varieties, origin, producers and output to quality inspection and traders' contacts. This information can also be shared with buyers across the country. Further implementation of electronic solutions for transactions and information sharing enables the wholesale market to greatly enhance traceability across the entire farm produce supply chain, ensuring quality and safety from field to final customer.

Some local governments have also been actively promoting the use of electronic clearing and settlement systems. For instance, the local government of Yinchuan city, Ningxia Hui Autonomous Region, announced the *Implementation Plan for Establishing Large-scale Agricultural Produce Wholesale Markets for Public Use* in November 2017. This aims to boost the operational sustainability of the five major agricultural wholesale markets in Yinchuan by stepping up local infrastructure developments, including setting up a unified information platform and electronic clearing system – Yinchuan Exchanges and Clearing Center for Agricultural Produce – for the five agricultural wholesale markets.



## What the experts say ?

In recent years, the Chinese government has been actively rolling out “Internet Plus Agriculture” strategies to facilitate the circulation of agriculture products nationwide, encouraging innovation and advanced technologies across traditional agricultural wholesale markets. Our experts believe that following the “Internet Plus Agriculture” principle, digitalization will come to the fore among these wholesalers, along with accelerated transformation and upgrading in the sector.

That said, the sector still faces challenges amid the transformation process. Problems like new markets being opened without due regard to viability, a disrupted market order and unfair market competition have arisen in some areas that lack government guidance and supervision. Our experts urge the government to accelerate the relevant legislative process to ensure development plans for facilitating agricultural produce distribution can be fully and properly implemented. This is key to creating a fair and orderly market environment for development of the sector.



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