CHINA COMMERCE ASSOCIATION FOR GENERAL MERCHANDISE
FUNG BUSINESS INTELLIGENCE

China's Department Stores Report 2019-2020

(abridged version)

July 2020

Preface

China's department store sector has been mired in turbulent times with an endless stream of challenges posed by other retail formats and the macro-economic environment. COVID-19 has further compelled department store operators to accelerate their transformation.

Jointly produced by Fung Business Intelligence and China Commerce Association for General Merchandise, ***China's Department Stores Report 2019-2020*** analyses the macroeconomic data and collects financial data from 103 domestic department store operators in China from the end of November 2019 to the end of May 2020 to gauge the sector's performance. Despite the fact that the growth of China's department store sector has slowed down, corporate gross profit margin, net profit margin and customer unit price have all increased.

The report also discusses major issues and challenges faced by the sector and analyses key innovations and transformation initiatives by leading department store operators. It recommends four ways for the sector to transform challenges into opportunities— adopt a precise digital strategy based on own capabilities and operating conditions, improve product quality and expand product variety, exploit membership marketing as well as increase technology and experiential consumption elements.

Although COVID-19 has dealt a heavy blow to the sector, it has forced department store operators to accelerate digitalization and elevate the quality of goods and services. The sector's long-term outlook remains positive. In fact, we have already seen some department stores reaching new sales heights and even recorded double-digit growth in 2Q20. The pandemic has compelled them to pursue more rigorous transformation and seize upcoming opportunities in a post-pandemic world. Department store players from abroad may have something to learn from their mainland Chinese counterparts.

The full version of this report is available in simplified Chinese on Fung Business Intelligence website [Report Link].

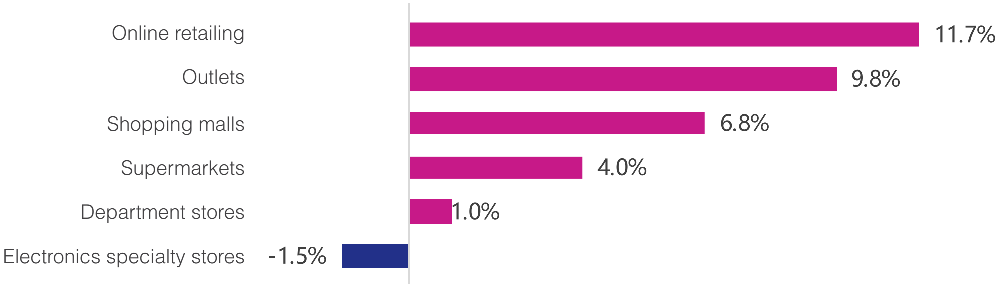
Key highlights

1. Overall sector development

(1) Sales growth of department stores continues to slow; online retailing and outlet businesses outperform other segments

In our survey, 80% of department stores are engaged in multiple retail formats/ business segments. Total sales revenue (including sales proceeds generated from other retail formats) of the 103 surveyed department stores amounted to 765.3 billion yuan in 2019, up 2.8% yoy. Among which, revenue from online retailing business recorded the highest growth of 11.7%, followed by outlets (9.8%), shopping malls (6.8%) and supermarkets (4.0%). By contrast, department store business only recorded modest growth of 1.0% yoy (Exhibit 1).

Exhibit 1: Sales growth of surveyed department store operators in 2019, by business scope



Source: "China department store survey 2019-2020" by CCAGM and FBIC.

Exhibit 2 shows the major operating indicators of selected operating indicators for the department store business of surveyed operators in 2019. The department store business of the surveyed operators achieved total sales of 358.8 billion yuan, up 1.0% from 2018. Among which, 51% of surveyed operators recorded positive sales growth and 49% witnessed a drop in revenue. The surveyed department stores struggled a bit in terms of same-store sales – only 52% of operators recorded same-store sales growth in 2019, and the rate of growth was minimal (0.3% yoy compared with 2% yoy in the previous year).

Exhibit 2: Selected operating indicators for department store business of surveyed operators

Operating indicators	2019 vs 2018 yoy changes
Total revenue	1.0%
Same-store sales	0.3%
Operating area	3.5%
Number of retail employees	-8.7%

Source: "China department store survey 2019-2020" by CCAGM and FBIC.

(2) Operating expenses remain under control; cost pressure shows some signs of easing

In 2019, three major types of operating expenses, including selling expenses, management-related expenses and finance charges of the surveyed department stores reduced by 2.9% yoy, and accounted for 18.1% of net revenue, which is 0.2 percentage point lower than that of 2018. Staff costs also went down by 6.0% yoy due to a 7.8% drop in staff count (Exhibits 3 & 4). This is an indication of easing of cost pressure in 2019. That said, the average wage growth continued at a moderate pace; the average annual salary of employees went up by 7.3% yoy to 79,000 yuan in 2019. 67% of the surveyed department stores reported an increase in labor costs.

Exhibit 3: Gross profit margin and net profit margin of surveyed department store operatorsoperators

Operating indicators	2019 vs 2018 yoy changes
Total operating expenses	-2.9%
Average operating expenses	-0.2%
Total salary and wage expenses	-6.0%

Source: "China department store survey 2019-2020" by CCAGM and FBIC.

Exhibit 4: Number of full-time employees of surveyed department store operators

Operating indicators	2019 vs 2018 yoy changes
Total number of full-time employees	-7.8%
Average number of full-time employees	-3.8%

Source: "China department store survey 2019-2020" by CCAGM and FBIC.

(3) Operators' profitability and performance improve

Amid the economic downturn, department stores implemented a series of cost reduction measures, while optimizing staffing levels, with an aim to improve profitability and enhance efficiency. The surveyed department stores' gross profit margin increased 0.1% yoy to 18.1% in 2019; 71% of the surveyed department stores reportedly saw an increase in gross profit margin (Exhibit 5). 11% of the surveyed department stores recorded net losses in 2019.

Exhibit 5: Gross profit margin and net profit margin of surveyed department store operators

Operating indicators	2018	2019	Changes
Gross profit margin	18.0%	18.1%	+0.1%
Net profit margin	4.1%	4.2%	+0.1%

Source: "China department store survey 2019-2020" by CCAGM and FBIC.

(4) Business transformation and upgrading activities become mainstream

Increasing numbers of department stores operatives have reinvented and upgraded their businesses over the past two years. 55% of the surveyed department store operators have transformed and upgraded their stores – 25% have revamped their storefronts and 6% have temporarily shut down part if not all of their stores to undergo renovation and upgrading projects. Department stores' transformation efforts started to pay off – the average customer unit price increased 5.7% yoy to 805 yuan in 2019.

2. Major development issues

As a traditional retail format, China's department store sector has long been facing significant development headwinds, both internally and externally.

- ***Weak product appeal.*** Product appeal and competitiveness of department stores are affected by market positioning, product composition, operation and management model, relationship with brands and merchants as well as pricing. Weak product appeal means that department stores are not as competitive and popular as other retail formats among consumers. This hinders the growth and development of the sector.

- ***Lack of experiential elements; low foot traffic.*** As offline retail price is generally higher, pricing is not a competitive edge of physical stores. Experiential elements are an important driver of foot traffic. However, the department store sector has not made good use of their physical space to provide refreshing shopping experience. Foot traffic at department stores remained stagnant.

- ***Huge room of improvement in digitalization progress.*** As restricted by their business model, department stores made limited progress in digitalization and deployment of omni-channel strategy in the past year. However, given the rise of new digital channels, such as Mini Programs, social media and livestreaming, department store operators are implementing new sales and marketing strategy to cater to these shopping scenes.

- ***Financial pressures weigh on department store operators.*** In the past year, a number of department stores had been shut down for months to undergo transformation upgrade. As normal operation was disrupted, overall sales and revenue were affected. In addition to reduced profit, expenses increased due to large scale of renovation and decoration work have also put short term financial pressure on department store operators.

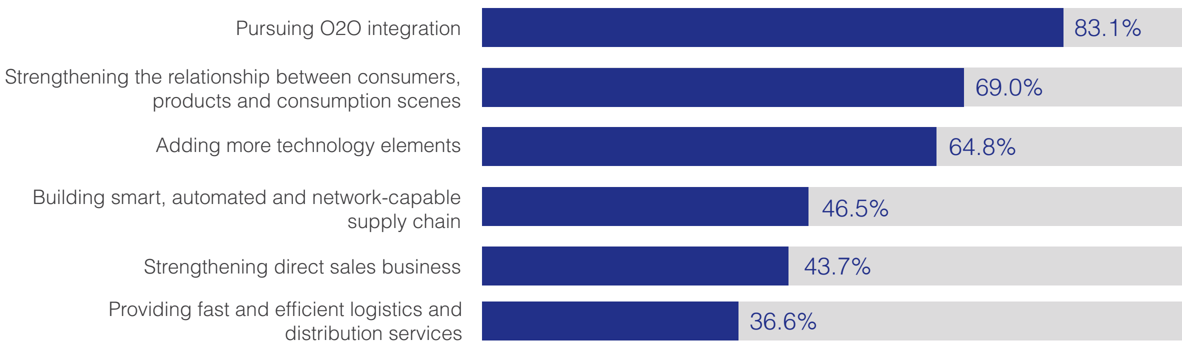
3. Innovation and transformation trends

As a retail format that sells not only quality goods but lifestyle and taste, the department store sector has made significant contribution to the growth of the retail market in China. As the industry is going through consumption upgrade, department stores will continue to play a role and spearhead innovation and transformation development. Our survey has identified the following key trends:

(1) Omni-channel strategy becomes indispensable

Over 80% of the surveyed department store operators prioritized O2O integration as their development goal for 2020 (Exhibit 6). 69% and 64.8% said that they would strengthen the relationship between consumers, products and consumption scenes as well as add more technology elements respectively.

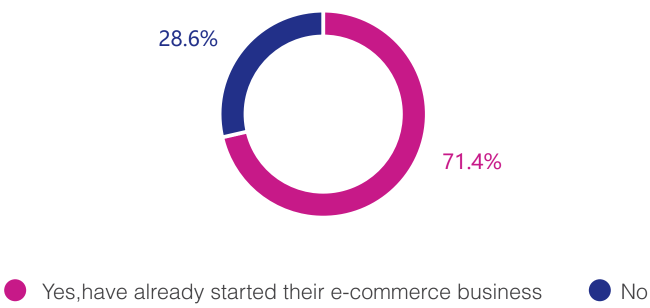
Exhibit 6. Developmental goals of surveyed department store operators in the next 12 months



Source: "China department store survey 2019-2020" by CCAGM and FBIC.

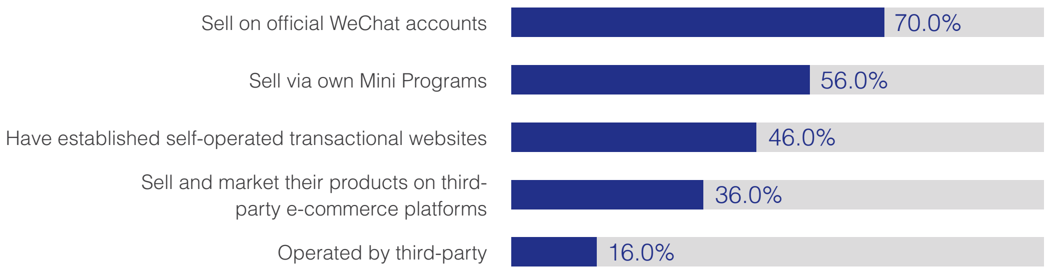
In our survey, 71.4% of department store operators have already started their e-commerce business (Exhibit 7), compared to less than 60% from the previous year. Among them, 70% have been selling on their official WeChat accounts, while 56% sold via Mini Programs (Exhibit 8). The results suggested that department stores have become more determined in launching e-commerce business and have developed diversified online sales channels.

Exhibit 7: Penetration of e-commerce business among surveyed department store operators



Source: "China department store survey 2019-2020" by CCAGM and FBIC.

Exhibit 8. Forms of e-commerce business among surveyed department store operators



Source: "China department store survey 2019-2020" by CCAGM and FBIC.

In view of consumers' growing needs for convenience and immediacy, on-demand delivery services have become an important part of the omni-channel strategies. 46.5% of surveyed department store operators have already offered on-demand delivery services (Exhibit 9). Instead of setting up their own delivery fleets or additional warehousing facilities which involve high investment costs, some players choose to team up with third- party O2O local lifestyle service platforms such as JD Daojia, Ele.me and Meituan (Exhibit 10). In the post-COVID-19 era, we believe on-demand delivery services will become a key consideration when consumers make their purchase decisions.

Exhibit 9: Offer of on-demand delivery services by surveyed department store operators

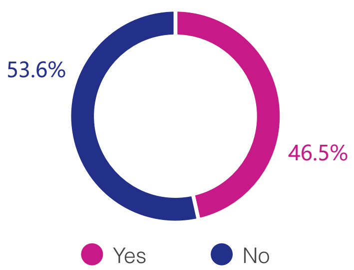
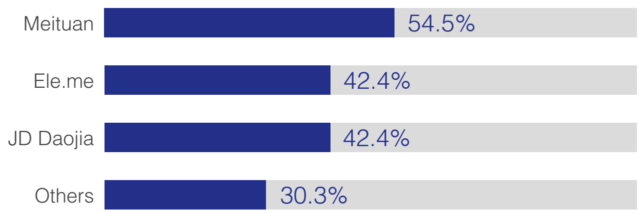


Exhibit 10: Partners of on-demand delivery services



Source: "China department store survey 2019-2020" by CCAGM and FBIC.

(2) Leverage social commerce and livestreaming to engage with consumers and boost sales

Social commerce and livestreaming gained a lot of traction in the past year. Our survey found that 75% department store operators have used social media for promotion; while 47.1% have employed them for sales (Exhibits 11 and 13). Among all social media channels, WeChat is the most popular one, followed by short video sharing platform Douyin (Exhibits 12 and 14).

Exhibit 11: Usage of social media for promotional purposes among surveyed department store operators

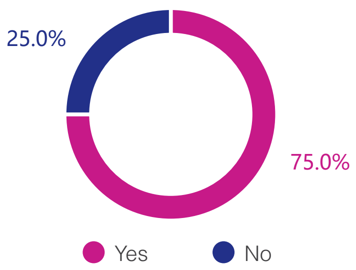
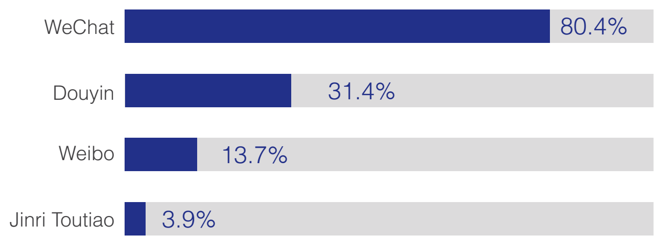


Exhibit 12: Social media tools for promotion



Source: "China department store survey 2019-2020" by CCAGM and FBIC.

Exhibit 13: Usage of social media for sales purposes among surveyed department store operators

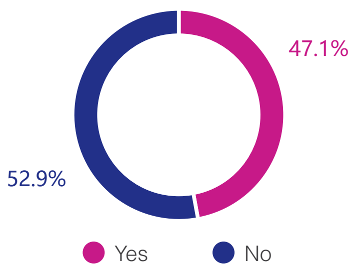
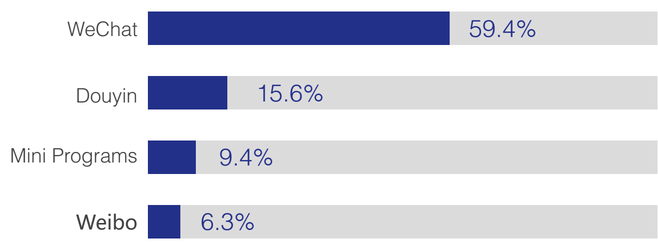


Exhibit 14: Social media tools for sales



Source: "China department store survey 2019-2020" by CCAGM and FBIC.

Amid the COVID-19 pandemic, many department store players including Intime, Wangfujing, Rainbow, New World and Golden Eagle launched their own livestreaming channels to interact with consumers and promote sales. Some reported remarkable increases in online traffic, viewership and sales. Shopping guides and sales representatives of department stores also invited online shoppers to join private WeChat groups such that they can enjoy preferential services and obtain the latest sales information. Such interactions in the private realm has forged a stronger bonding between stores and consumers and encouraged repeated purchases.

(3) Harness consumer data to implement precision marketing

Many operators have realized the power of big data analytics in understanding customers' needs and predicting behavioral trends. 84.1% of the surveyed department store operators revealed that they have collected consumer data and carried out big data analysis (Exhibit 15). Among them, 98.3% have gathered consumer data through membership card/ membership scheme, 32.8% through store WiFi, 31% through online merchandise purchase history (Exhibit 16). The collected consumer data were mainly used to understand consumer preferences (96.6%), carry out precision marketing (93.1%), provide customers with more personalized products/services (81%), optimize in-store merchandise mix (72.4%) and new product development (22.4%) (Exhibit 17).

Exhibit 15: Proportion of surveyed department store operators that have collected consumer data and carried out big data analysis

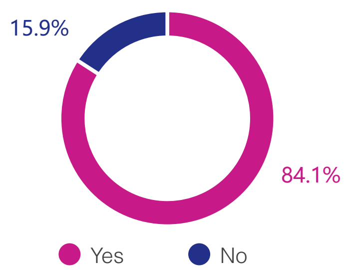


Exhibit 16: Means of collecting customer data by surveyed department store operators

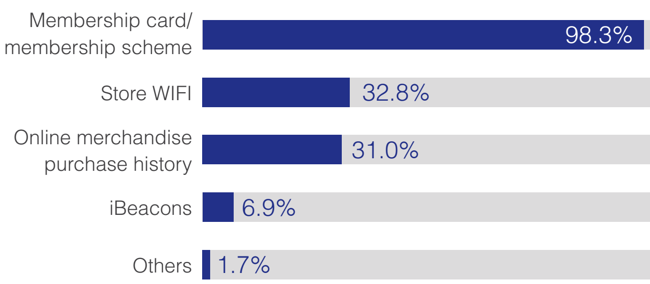
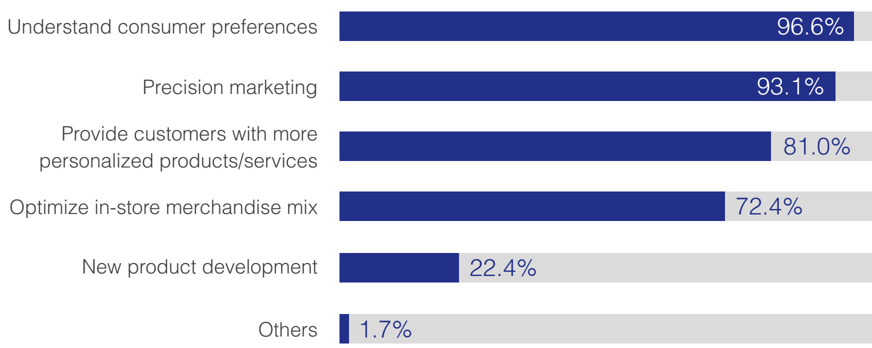


Exhibit 17: . Major purposes of collecting consumer data of surveyed department store operators



Source: "China department store survey 2019-2020" by CCAGM and FBIC.

For example, Rainbow Department Store has already built a fully digitalized membership management system and deployed an intelligent customer services tool known as the "Smart Tooth" to consolidate and analyze customer data collected from WeChat, app, official website and store branches. Whenever a member made a new request, the tool will instantly retrieve his/her membership profile, service records, browsing history, etc. such that the customer services officers can respond efficiently and accurately. Other department store operators have introduced similar technologies to paint consumer portraits.

(4) Strengthen ties and interactions with brands through data sharing

The core competency of department stores lies on their brand portfolio, especially in the categories of cosmetics, jewelry, shoes and sportswear. To maintain their competitive edge, 71.4% of surveyed department store operators have strengthened cooperation with suppliers and brands (Exhibit 18), mainly through involving more in inventory management (62%), single product management (60%) and terminal sales management (58%) (Exhibit 19).

Exhibit 18: Proportion of surveyed department store operators that have strengthened cooperation with suppliers and brands

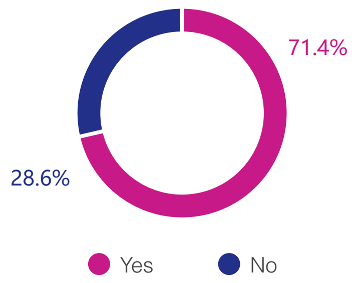
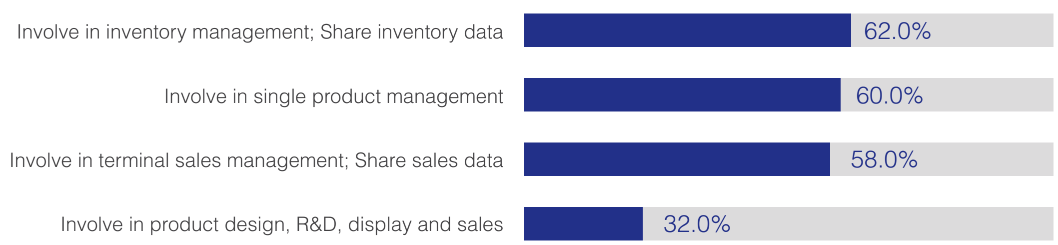


Exhibit 19: Means to strengthen cooperation with suppliers and brands by surveyed department store operators



For example, Intime Department Store has developed a new operating system for its "Miao Street" app. The system connects middle office database with front business desks, providing technological support to frontline sales and merchants while at the same time improving Intime's control over products. On a sales promotion day, the system can inform Intime instantly the best-selling products of different brands and the amount of stock on shelves and in storage. By sharing such valuable information with merchants, they can adjust sales tactics as well as pricing swiftly, presenting the right products at the best time.

(5) Add technology elements to enhance shopping experience

Increasing number of department stores have utilized technologies to elevate shopping experience and boost customer flow as well as sales. Among the department store operators in our survey who have applied technologies in their physical stores, 90.1% have set up free WiFi storewide, 49.3% have launched automated payment system, and 43.7% have set up QR code system (Exhibit 20). It is worth noting that department store operators who have adopted in-store camera to capture consumption behavior went up from 18.7% in 2018 to 26.8% in 2019; and those who have analyzed customer flow based on dynamic track grew from 16.5% to 26.8%.

When asked about the benefits of adopting technologies in their stores, 9.1% and 68.2% of surveyed operators claimed to see significant increase and slight increase in customer traffic respectively after adding technological elements in-store. A combined of 74.3% of surveyed operators claimed to see an increase in sales after introducing technological elements in-store (Exhibit 21). Meanwhile, over 72.7% of surveyed department store operators said that they plan to add more technology elements in-store in the coming 12 months (Exhibit 22).

Exhibit 20: Adoption of technologies in physical stores of surveyed department store operators

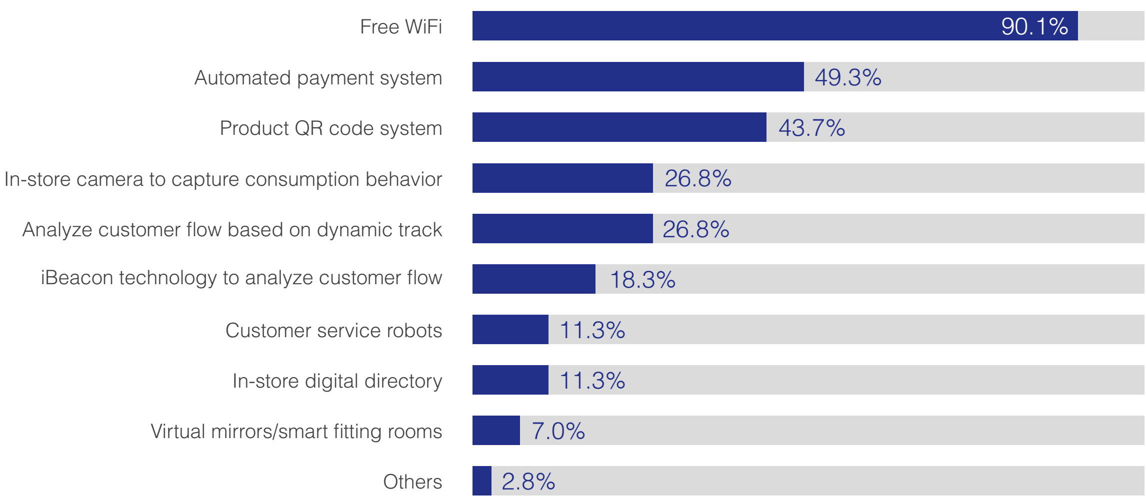
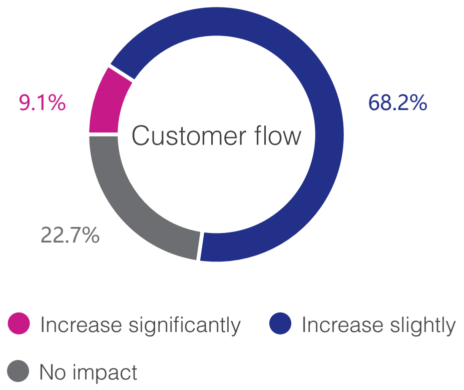


Exhibit 21: Impact of adding technology elements in-store among surveyed department store operators



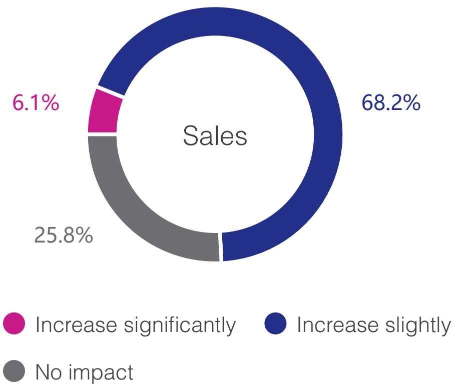
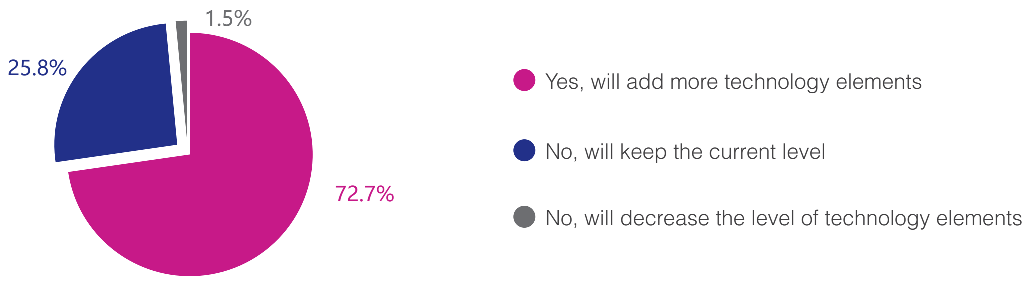


Exhibit 22: Likelihood of adding technology elements in-store among surveyed department store operators



Despite the fact that the growth of China's department store sector has slowed down, the effort put in by the sector in recent years to transform and elevate the quality of goods and services laid a solid foundation for its future growth. The sector's long-term outlook remains positive even though it was greatly impacted by COVID-19. In fact, we have already seen some department stores reaching new sales heights and even recorded double-digit growth in 2Q20. The pandemic has compelled them to pursue more rigorous transformation and seize upcoming opportunities in a post-pandemic world. Department store players from abroad may have something to learn from their mainland Chinese counterparts.

About the Organizations

CHINA COMMERCE ASSOCIATION FOR GENERAL MERCHANDISE

Founded in January 1990, China Commerce Association for General Merchandise (CCAGM) is a non-profit social organisation endorsed by the Ministry of Civil Affairs, under the guidance of the Stated-owned Supervision Administration Commission and the Ministry of Commerce. The CCAGM has nearly 800 members, encompassing large-and medium-sized domestic department stores, enterprises engaging in retail, wholesale, and manufacture of daily industrial products, and enterprises which provide related services to the department store industry. Its members come from 31 provinces, autonomous regions and municipalities in the country, covering all forms of ownerships. The CCAGM has 60 corporate members, including City Department Store Industry Association, Trade Association and Trans-regional Department Store Company Union Organisation, linking more than 15,000 indirect members.

After 20 years of growth and development, the CCAGM has completed the transformation of its work model from one that was influenced by the planned economy to one influenced by socialist marketing economy. In 2009, the CCAGM was appraised as a 4A social organisation by the Ministry of Civil Affairs.

FUNG BUSINESS INTELLIGENCE

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

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments 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 consulting 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

Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including sourcing, logistics, distribution and retail. The Fung Group comprises over 34,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

For more information, please visit www.fbicgroup.com.

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