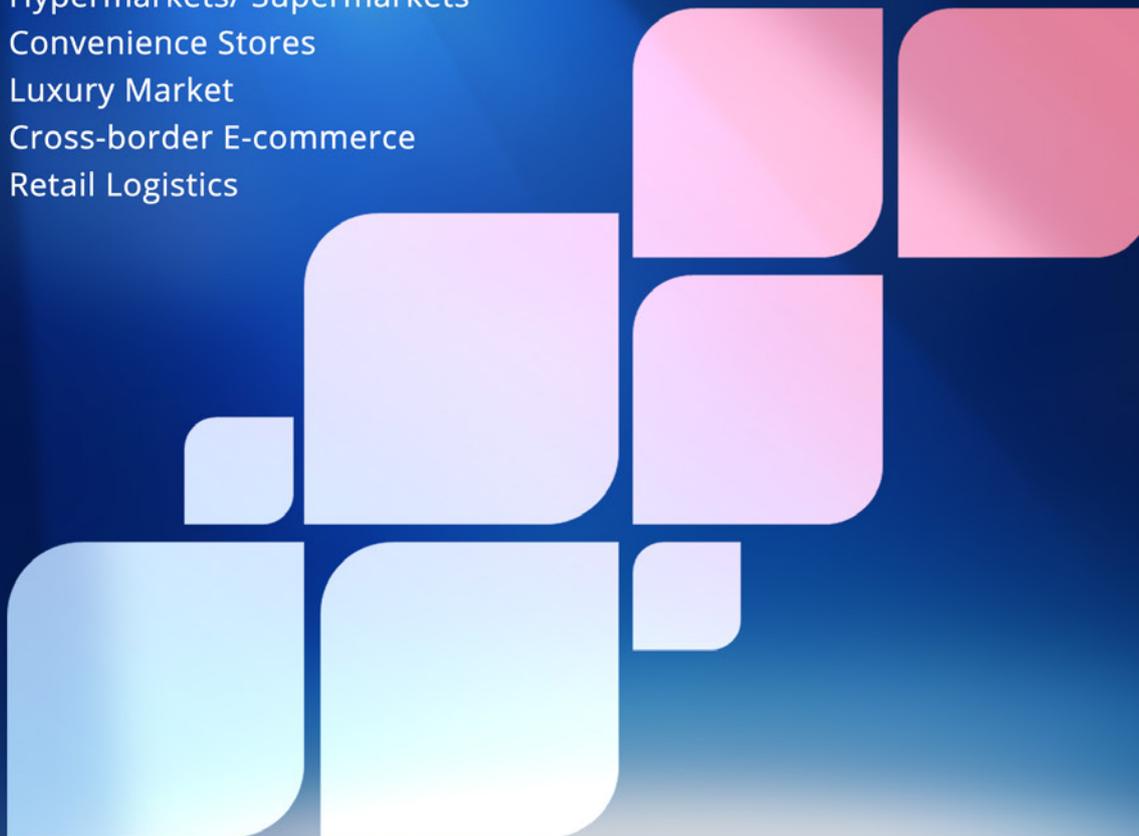


Spotlight on China Retail

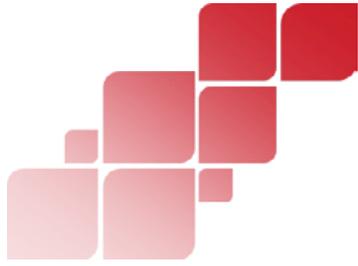
October 2018

General Retail
E-commerce
Department Stores
Shopping Malls
Hypermarkets/ Supermarkets
Convenience Stores
Luxury Market
Cross-border E-commerce
Retail Logistics



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Issue 1 | General Retail

Executive Summary

China's retail sector sees modest growth in 2017; yet China-U.S. trade war is set to dampen consumer sentiment and drive down retail sales growth.

China has been the world's second-largest retail and consumer market after the U.S. since 2014. Total retail sales of consumer goods reached 36.6 trillion yuan in 2017, up nominally by 10.2% yoy. In 1H18, total retail sales of consumer goods increased nominally by 9.4% yoy to reach 18.0 trillion yuan. However, the escalating China-U.S. trade war is set to hinder economic growth, which in turn will affect consumer sentiment and consumer spending. China's retail sector as a whole will be adversely affected and is expected to see single-digit sales growth in the coming year.

Millennials and generation Z reshape the retail landscape. Middle class consumers in China, particularly the millennials and post-millennials (or generation Z), are becoming increasingly influential in the retail sector. China will have the world's largest middle class population by 2027, a segment whose strong spending power will reshape consumption domestically and internationally over the next decade. Local and international retailers are ramping up efforts to engage more effectively with these influential consumers. To lure young shoppers, brands are increasingly turning to young celebrities and influencers to market their products, and are launching new product lines with younger tastes.

Retailers strive to diversify their product and service offerings and deliver enriched lifestyle shopping experiences.

To entice shoppers, many retailers have expanded into new sectors and collaborated with other market players to expand service offerings and generate new revenue streams. Meanwhile, to meet the higher expectations of today's consumers, more and more retailers -- especially department stores and shopping mall operators -- have upgraded by introducing new and innovative concept stores and more lifestyle services.

O2O continues to dominate the retail scene. Pursuit of online-to-offline (O2O) strategies has become a preoccupation for most brands and retailers. Many traditional retailers in China have actively pursued digital expansion and deployed O2O strategies to ensure seamless integration of all channels -- physical, online, mobile and social. At the same time, some leading e-commerce companies and "pure-clicks" enterprises have tiptoed into bricks-and-mortar in the hope of providing a better shopping experience.

Use of smart technologies gains steam. China's retail sector is being redefined by a new wave of technologies to facilitate O2O integration while significantly enhancing customer experience. A multitude of technology-driven business models and business formats has emerged recently. Digitized experiential stores and AI-driven pop-up stores, unmanned stores are examples.

Pop-up retailing comes on the scene. Pop-up retailing has gained popularity in recent years, with brands and retailers opening pop-up stores backed by innovative marketing content to promote products and raise awareness. Some also use the pop-up format to test new technologies, concepts and collections, and to gain market insights. One of the major advantages of pop-up retailing is that the set-up costs are far lower than for permanent stores with long-term leases.



Issue 2 | E-commerce

Executive Summary

China's online retail market continues to drive economic growth. China's online retail market, the world's largest, has shown resilient growth despite a slowing economy. The transaction value of China's online retail market increased 32.2% yoy to reach 7.18 trillion yuan in 2017. This rapid growth is attributable mainly to China's large population of Internet users and the early adoption of mobile shopping by Chinese consumers. Mobile commerce accounted for 81.3% of total online shopping transactions in 2017.

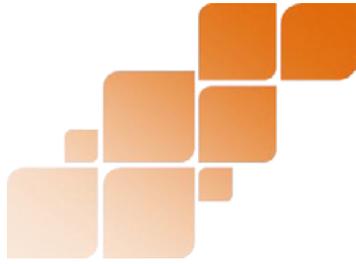
E-commerce giants strive to increase offline presence and expand their ecosystems. With the rise of omnichannel retailing, e-commerce giants are actively penetrating offline retailing with the idea of perfecting their physical retail networks and further expanding their business ecosystems. Alibaba and JD.com, in particular, have accelerated the pace of their offline expansion by merging with or acquiring physical retailers. They hope to build an all-encompassing business ecosystem that fully blends online and offline channels so as to become ubiquitous and indispensable in the daily life of all Chinese consumers.

Social commerce becomes increasingly popular; short video platforms facilitate digital marketing. Eying the high level of consumer penetration by social media platforms such as WeChat, Weibo, Pinduoduo, and live-streaming and short video platforms, such as Douyin, brands and retailers are increasingly trying to sell and market their products via these channels.

E-commerce players and Internet giants launch their own private labels. Some e-commerce companies have taken bold initiatives to launch their own private labels to offer consumers quality, premium and personalized products and services. NetEase, Alibaba, JD.com, Tencent, Xiaomi and Mia.com are cases in point. Some e-commerce companies have even set up physical stores to sell their own private labels.

Rural e-commerce continues to thrive. The rural online retail market has become a new growth engine for e-commerce in China with the near saturation of the urban online market. The government has been very supportive of this development. Recognizing the ample growth potential of the rural e-commerce market, leading retailers and e-commerce companies have adopted "going rural" strategies.

China's first E-commerce Law launches. The E-commerce Law, which is to take effect on 1 January 2019, is designed to safeguard the legitimate rights and interests of all parties involved in e-commerce; to regulate e-commerce practices; maintain the sound order of the market, and foster the further development of e-commerce in a manner that is sustainable and healthy.



Issue 3 | Department Stores

Executive Summary

Department store sector maintains stable sales growth; new store openings continue. China's department store sector witnessed positive and stable growth in the past year. According to the NBS, retail sales of department stores above a designated size (enterprises with annual sales of 5 million yuan or above and with employee strength of 60 or more) increased by 4.6% yoy in 1H18. MOFCOM statistics also show that the yoy growth of 5,000 key retailers reached 4.6% in 1H18, with department stores accounting for 4.5% yoy. In terms of new store openings, over the past two years, the number of newly opened department stores was still slightly more than that of department stores which were closed or revamped, resulting in a net rise.

Transformation efforts have started to pay off. Recently, the department store sector has made every effort to transform and adjust to keep pace with changing consumer needs, whether through the upgrade of hardware and stores, the refinement of merchandise and services, supply chain integration, or the restructuring of business models and operating systems. The sector as a whole has started to reap the benefits. According to a survey by the China Commerce Association for General Merchandise, nearly 65% of 85 department stores surveyed enjoyed positive yoy sales growth in 2017.

Leveraging technologies to pursue O2O integration; forming partnerships with Internet companies and e-commerce players is common practice. Many department store operators have adopted advanced technologies such as mobile Internet, big data, the IoT (Internet of Things) and even AI to achieve O2O integration -- namely, a seamless integration across physical stores, online platforms and mobile terminals -- along with digital transformation. Meanwhile, increasing numbers of department store operators have formed strategic alliances with Internet or large-scale e-commerce companies to roll out O2O initiatives that leverage the latter's huge traffic resources, big data as well as logistics capabilities.

Diversifying retail formats and tapping into other business sectors. To adapt to the changing needs of consumers, more and more department stores have sought to expand their scope of business and engage in multi-format, multi-sector operations. For example, in recent years Golden Eagle Retail Group has launched boutique supermarkets, bookstores, pet stores and beauty stores, to meet the discerning needs of middle class consumers. Recognizing the fast growth potential of convenience stores, players such as Wangfujing Group, Rainbow Department Store and New World Department Store have tapped into the convenience store segment, launching their own convenience store brands.

Offering additional sales channels to enhance product uniqueness and gross profit margins. To enhance product and service uniqueness and provide customers with a differentiated shopping experience, many department store operators have expedited the expansion of direct sales business. Some operators such as the Bailian Group, Wangfujing Group, Wanda Department Store and New World Department Store have taken even bolder steps by developing their own private labels and set up buyer (multi-brand) shops to sell exclusive brands and private labels.



Issue 4 | Shopping malls

Executive Summary

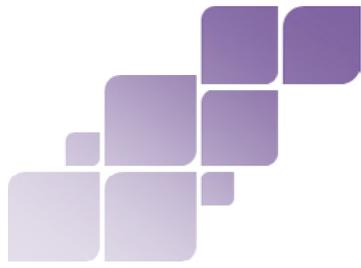
Shopping malls sector maintains robust development. In 2017, most large-scale shopping malls in China delivered a positive sales performance. According to iziRetail, the total sales of 190 such centers across 51 cities in China reached 441.3 billion yuan in 2017, up 11.3% yoy. A study by Linkshop also shows that the top 20 shopping malls in China all achieved positive yoy sales growth in 2017.

Shopping mall operators shift to more consumer-centric business models. In recent years, increasing numbers of mall operators have changed their mindset and transformed their operations and business models by adopting a more consumer-centric approach. Many shopping malls have endeavored to strengthen their physical assets in all aspects including upgrading hardware and facilities, reconfiguring unit layouts, refining tenant mixes, as well as enhancing in-mall service facilities. They are also responding swiftly to consumers' needs by providing more interactive features in the mall, including entertainment, leisure activities, a variety of food options and unique concepts that differentiate their offerings.

Exploring new development concepts. Shopping mall operators in China have actively been exploring new development concepts. A trend is emerging of “shopping mall + shopping precinct” (or “streetscaped”) malls with Sanlitun Taikoo Li as a successful forerunner, followed by Chengdu Taikoo Li, and the recently opened MIXc World and UpperHills in Shenzhen. The new concept features a combination of indoor and outdoor elements, with a shopping center plus a pedestrian area that has shops and restaurants – all within a landscaped environment. It can create a unique ambiance for shopping and bring consumers a special experience.

Leveraging technologies and multichannel strategies to transform the mall experience. Many shopping mall operators realize that the best way to deal with rapid technological change is to embrace it. They are utilizing digital capabilities to take the shopping experience to the next level. Beyond providing basic services such as free WiFi; accepting mobile payments, and running different promotions to encourage social media engagement, mall operators are adopting in-mall technologies such as AI-powered services to improve the omnichannel experience and strengthen relationships with consumers.

E-commerce giants make forays into shopping mall sector. Recently, the shopping mall sector in China has seen the emergence of a new competitive landscape with the entrance of e-commerce giants. The opening in April 2018 of the Alibaba Group's first bricks-and-mortar shopping mall, in Hangzhou, is a major step by the Group towards achieving its goal of blending digital prowess with a footprint in the physical world.



Issue 5 |

Hypermarkets/ Supermarkets Executive Summary

Hypermarket and supermarket operators see improvement in sales growth. In recent years, the hypermarket and supermarket sector has faced fierce competition from the e-commerce sector as well as from smaller-scale retail formats such as convenience stores, community stores and specialty stores. That being said, many hypermarket and supermarket operators have stepped up efforts to revamp their operations to cater the changing needs of Chinese consumers. Their efforts have paid off with solid improvements in sales performance. The sales growth of supermarkets above a designated size (enterprises with annual sales of 5 million yuan or above and with employee strength of 60 or more) was 7.4% yoy in 1H18, up from 6.3% yoy in 1H17. Most of the top hypermarket and supermarket chain operators in China achieved a better performance in 2017 than in 2016, thanks both to new store openings and format expansion.

Players are adapting to “New Consumption” era. Over the past year, many traditional hypermarket and supermarket operators have proactively adapted themselves to the “New Consumption” era. Many have used data analytics to increase store traffic and offer more targeted promotions to shoppers. Some have integrated their inventory and supply chain management systems with e-commerce or solutions platforms to improve warehouse management, inventory planning and last-mile delivery. Others have invested in technologies and launched “smart stores” to create a better in-store experience and higher level of interaction with shoppers. Meanwhile, many hypermarket and supermarket chain operators have partnered with third-party O2O local lifestyle service platforms, such as JD Daojia and Dmall, to provide O2O shopping and speedy delivery services.

Format revamp is gaining traction. Many hypermarket and supermarket chain operators have revamped their stores or launched new store formats (e.g. smaller-sized format and fresh-food supermarkets) to better suit the changing needs of customers. They have also created more spaces for occasion- or experience-based activities (e.g., in-store dining) to improve customer stickiness.

Putting strong effort into developing private labels. A number of hypermarket and supermarket chains have launched their own private labels in recent years. The profit margin for those who have done so is 15% higher. Developing private labels is thus winning strategy for hypermarkets and supermarkets that wish to differentiate themselves from their peers and earn higher profit margins

Forming strategic alliances with Internet giants is one commonly-used tactic for driving synergies between online and offline retailing. To achieve better O2O integration, some traditional grocery retailers have formed partnerships with Internet companies to gain access to payment tools, social media, big data analytics, etc. In turn, Internet companies can leverage the extensive physical store networks of hypermarkets and supermarkets to reach more customers.



Issue 6 | Convenience Stores

Executive Summary

Convenience stores (CVS) have been the fastest-growing retail format in recent years. Total sales revenue for the CVS sector (including forecourt stores) reached 190.5 trillion yuan in 2017, up 23% yoy, and the growth momentum is expected to continue as the small retail format continues to gain in popularity in China. According to the MOFCOM, the yoy growth of 5,000 key retailers reached 4.6% yoy in 1H18, with CVS recording the fastest growth among all retail formats: 7.6% yoy, compared with 4.5% yoy for supermarkets and 1.6% yoy for department stores. In 2017, the total number of CVS in China topped 100,000.

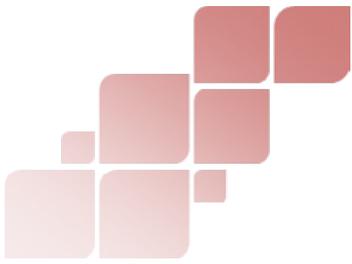
O2O initiatives remain crucial. To stay competitive, many CVS operators have drawn up seamless O2O strategies to attract and retain customers. Providing pick-up services and partnering with O2O local lifestyle service platforms are among common practices.

CVS players make greater efforts to launch private labels. Nowadays, Chinese consumers look for products that are personalized or even unique. To cater to this demand, CVS operators such as FamilyMart, 7-Eleven and Anda Convenience Store have stepped up efforts to launch their own private labels and to offer such products. That being said, private label development in China's CVS sector still lags far behind that of equivalent chains in developed countries such as Japan. Over 80% of sampled CVS operators in China said that sales of their private labels accounted for less than 10% of total sales.

Emergence of technology-driven business models. Technology advancement is a significant factor driving the growth of the CVS sector. Since the second half of 2017, there have been significant CVS initiatives involving the adoption of technologies that can transform retail operations. This had led to the emergence of technology-driven business models including those featuring unmanned/cashierless CVS, smart shelves and smart vending machines.

Launching fresh food community stores is a growing trend. CVS is one of the most relevant formats for serving local communities. Recently, some CVS chains have upgraded and transformed their stores into fresh food community stores, catering to the growing appetite of Chinese consumers for fresh, healthy, quality products.

Many mom-and-pop stores connect with Alibaba's LST and JD Convenience Store. E-commerce giants Alibaba and JD.com have sought to extend their offline footprints by connecting with tens of thousands of mom-and-pop stores to help them digitalize their operations and increase their gross merchandise volume. Under its New Retail initiative, and to advance its O2O strategy, Alibaba has launched the LST "Ling Shou Tong" system to help mom-and-pop stores embark on digital transformation. JD.com has rolled out the JD Convenience Store initiative, partnering with owners of CVS across the country, particularly in rural areas, to help them revamp their stores.



Issue 7 | Luxury Market

Executive Summary

China's personal luxury goods market enjoys robust growth in 2017. Sales of personal luxury goods in China rose significantly to 20 billion euros in 2017, representing a 15% yoy growth at current exchange rates and a 18% yoy growth at constant exchange rates. This notable rebound suggests that the domestic personal luxury goods market has returned to robust growth.

Chinese millennial consumers continue to drive global luxury growth. The growth of Chinese luxury spending in 2017 was driven by several factors, the major one being millennials accelerating their spending on luxury. Millennials in China, especially those from the fast-growing middle class, have stronger spending power and are more willing to spend than counterparts in other countries. It is expected that by 2024, millennials will account for 50% of China's personal luxury market.

Luxury retailers team up with young Chinese celebrities to market their products. Increasing numbers of luxury retailers are ramping up efforts to better engage with millennials, the most powerful consumer group in China's luxury market today. To woo young shoppers, brands and retailers are turning to young celebrities and influencers to market their products. They are also launching new product lines catering to younger tastes.

E-commerce players crack the luxury market; yet Chinese luxury shoppers still prefer offline. Eying the increasing demand for luxury goods online, e-commerce players such as Alibaba and JD.com have set up luxury e-commerce platforms targeting this segment. Despite the enthusiasm of Chinese consumers for online shopping, many still prefer purchasing luxury products at bricks-and-mortar stores. These enable them to see, touch, feel and try out products, as well as to enjoy high-end customer experiences such as refreshments, invitations to private lounges where goods can be previewed, and other customized services.

Luxury players scramble to strengthen social commerce presence; WeChat Mini Program is gaining popularity. Considering that social media and word-of-mouth are major sources of information for Chinese consumers, increasing numbers of international luxury players are striving to boost their social commerce presence as a way to market their products in China. During the Qixi festival (China's equivalent to Valentine's Day), which in 2018 fell on 17 August, many luxury brands used the WeChat Mini Program to offer products exclusively for the festival.

International brands lower prices in China in response to tariff cuts by the Chinese government. To encourage domestic consumption while promoting imports, the State Council announced in May 2018 that the country would reduce import tariffs on a range of consumer goods with effect from 1 July 2018. In response, some international brands have marked down their product prices in China by an average 3% to 5%.



Issue 8 | Cross-border E-commerce (Import) Executive Summary

Cross-border e-commerce (CBEC) maintains stable development but at slower pace. China's CBEC (import) market has maintained stable development in recent years, fueled mainly by individuals upgrading their level of consumption. According to iResearch, the transaction value of the CBEC import retail market increased by 49.6% yoy to 111.3 billion yuan in 2017 and is expected to balloon to over 350 billion yuan by 2021. Hectic though growth has been for China's CBEC (import) market, the pace has, in fact, slowed over the past three years. This is due in part to the launch in late March and early April 2016 of new CBEC tax policies and a positive list for permitted imported goods, which might pose uncertainties for the future development of cross-border trade.

NetEase Kaola, Tmall Global and JD Worldwide continue to top the list among CBEC (import) players. NetEase's CBEC arm Kaola ranked first in the CBEC market by transaction value with 26.2% market share in 1H18, followed by Tmall Global with 22.4% market share and JD Worldwide with 13.4% market share.

Food, beauty and personal care products, and apparel, footwear and bags are the best-selling categories for CBEC (import). CBEC shoppers buy these products mostly from Japan, the U.S. and South Korea.

The Chinese government establishes more pilot zones for CBEC. As of August 2018, China has 35 CBEC Comprehensive Pilot Zones, 22 of which were approved by the State Council on 7 August, 2018. The State Council has also urged relevant government departments to support innovation and development in CBEC Comprehensive Pilot Zones, including streamlining logistics processes and custom clearance procedures, enhancing information sharing, promoting effective regulatory innovation, and pushing forward with international trade liberalization, facilitation and business innovation.

Emergence of new CBEC operation models. In recent years, some CBEC operators have trialed various ways to make shopping via CBEC (import) platforms more convenient and to provide customers with better shopping experiences. Two new operation models have emerged – the first is an **extension of the direct mail model, using overseas warehouses (the “direct mail + overseas warehouse” model)**; the second is the **modification of the bonded area import model, with the setting up of offline stores for transaction (the “bonded area import + offline store” model)**.

Players put more emphasis on product tracking system. Blockchain technology is becoming increasingly popular among CBEC operators as a method for tracking products. With this technology, leading CBEC platforms can collect, integrate and display product information to consumers in a more transparent way, thus gaining customer trust and loyalty.



Issue 9 | Retail and E-commerce Logistics Executive Summary

Strong growth of online retail sales fuels demand for logistics services. The fast growth of online retailing in China has given the logistics industry a boost in line with soaring demand for transport and delivery services. The total value of logistics activity reached a record 252.8 trillion yuan in 2017, up by 0.6% yoy in real terms.

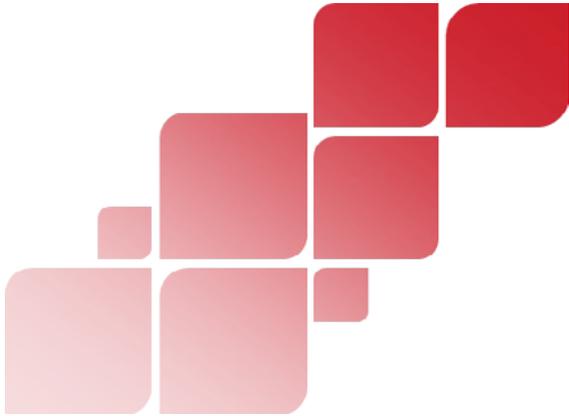
Express delivery market scales up; growing demand for intra-city courier services. As a critical part of e-commerce logistics, the express delivery sector has grown rapidly. The total volume of completed deliveries amounted to 40.1 billion pieces in 2017, up 28.0% yoy, making China's express delivery market the largest in the world in terms of delivery volume. Total sales revenue for the sector amounted to 495.7 billion yuan in 2017, up 24.7% yoy. There has been a surge in demand for intra-city courier with the emergence of new retail practices such as O2O and the creation of large numbers of online channels selling fresh produce and healthcare products, coupled with increasing customer demand for fast delivery.

“Smart logistics” dominates the agenda. Adoption of advanced technologies such as Radio Frequency Identification (RFID), Global Positioning System (GPS), the Internet of Things (IoT), cloud computing, drones and robotics, in addition to automation of logistics processes to improve efficiency, has become imperative for the retail and e-commerce logistics sector. Recently, logistics and e-commerce operators have invested heavily in smart logistics, hoping to enhance fulfilment capability and efficiency, to streamline operations and reduce logistics costs.

Innovations to strengthen last-mile delivery. To cater to consumers' heightened expectations for fast delivery, retailers such as Uniqlo, Walmart (China), Yonghui, YH Super Species and Watsons have introduced “click & collect” services. Many retailers have partnered with O2O platforms or logistics companies to roll out such services. Meanwhile, some retailers and logistics operators have introduced innovative ways to speed up delivery and enhance consumer convenience through, for example, the use of drones and autonomous vehicle, and smart pick-up towers in key locations.

E-commerce and logistics players put more emphasis on global logistics network expansion. In recent years, companies engaged in e-commerce and logistics have stepped up global expansion of their logistics networks to better facilitate cross-border delivery between China and overseas countries. For example, Cainiao plans to build world-class logistics hubs in several locations around the world, and JD Logistics has upgraded its overseas warehousing services.

Rural logistics is the next growth engine. The promising outlook for rural e-commerce has prompted many leading e-commerce and Internet companies to push further ahead with “going rural” initiatives.



Spotlight on China Retail – Issue 1

General Retail

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

October 2018

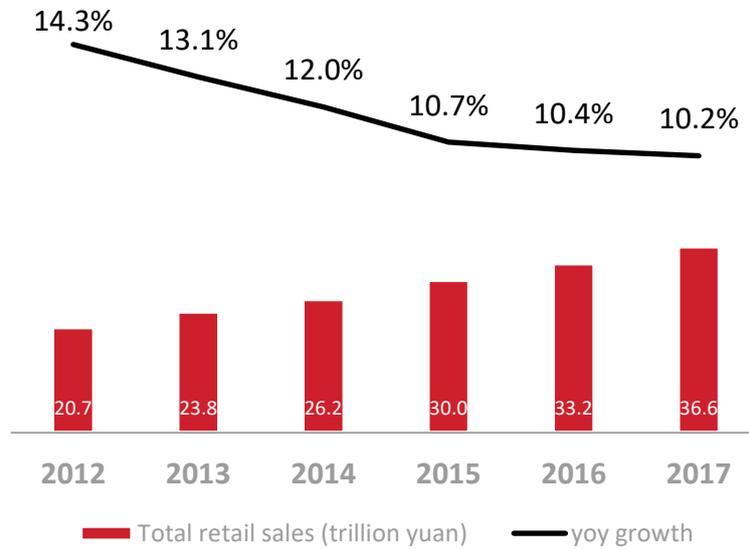
2018 is a year of change and challenge for businesses. In particular, the escalating China-U.S. trade war will negatively impact both economies, particularly the Chinese economy in view of its massive trade surplus with the U.S. China's retail sector is expected to be impacted by the trade war with dampened consumer sentiment and softening retail sales growth. Meanwhile, in the "New Consumption" era, the retail sector is undergoing rapid transformation and profound changes. Brands and retailers are ramping up efforts to transform and reinvent their businesses to cater the new needs of Chinese customers. The Chinese government is also striving to encourage consumption by issuing policies and major guidelines to facilitate the growth and development of the retail and e-commerce sector.

I. Market overview

1. Retail sales see modest growth

China has been the world's second-largest retail and consumer market after the U.S. since 2014. According to the National Bureau of Statistics of the PRC (NBS), total retail sales of consumer goods reached 36.6 trillion yuan in 2017, up nominally by 10.2% year-on year (yoy) (Exhibit 1). In 1H18, total retail sales of consumer goods increased nominally by 9.4% yoy to reach 18.0 trillion yuan. By month, nominal retail sales growth stayed at around 8.5-10.1% yoy throughout 1H18 (Exhibit 2).

Exhibit 1: Total retail sales of consumer goods, 2012 – 2017



Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Exhibit 2: Nominal growth of total retail sales of consumer goods by month, June 2017 – June 2018



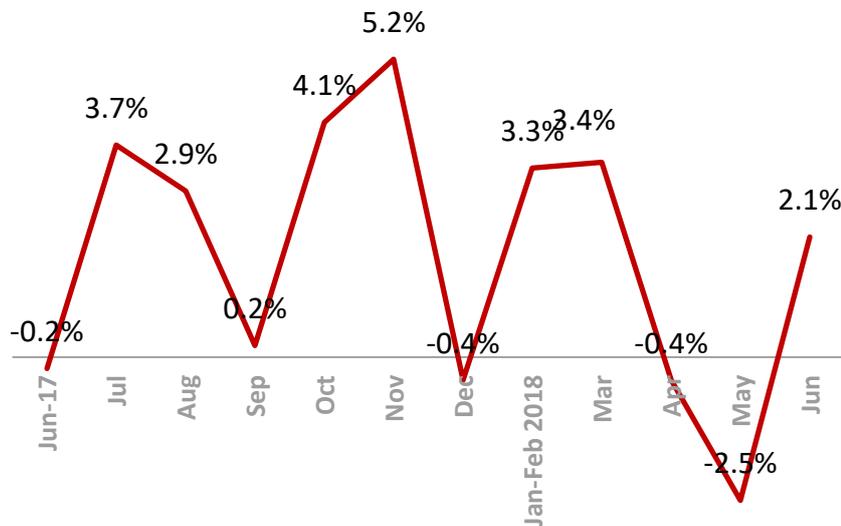
Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Retail sales of consumer goods: Mode of sales

Retail sales of commodities of enterprises reached 32.7 trillion yuan in 2017, up 10.2% yoy; of which, retail sales of commodities for enterprises above a designated size rose 8.2% yoy to 15.1 trillion yuan. In 1H18, retail sales of commodities of enterprises reached 16.1 trillion yuan, up 9.3% yoy.

Statistics from the China National Commercial Information Centre (CNCIC) show that the performance of large-scale enterprises improved significantly in 2017. Retail sales of 100 key large-scale retail enterprises increased by 2.8% yoy in 2017, up from -0.5% yoy in 2016. In 1H18, retail sales growth of 100 key retailers increased by 1.7% yoy (Exhibit 3).

Exhibit 3: YoY growth of retail sales of 100 key retailers in China, June 2017 – June 2018



Source: China National Commercial Information Centre; compiled by Fung Business Intelligence

Total catering sales rose by 10.7% yoy to reach 3.96 trillion yuan in 2017 and up by 9.4% yoy to reach 1.80 trillion yuan in 1H18. Of which, retail sales for enterprises above a designated size in the catering industry increased by 7.4% yoy in 2017 and 7.2% in 1H18, showing that large catering enterprises generally performed less well than small and medium-sized catering enterprises (Exhibit 4).

Exhibit 4: China's total retail sales by mode, 2016 – 1H18 (yoy change, %)

<i>By mode</i>	2016	2017	1H18
Total retail sales of consumer goods	10.4	10.2	9.4
Commodities	10.4	10.2	9.3
of which, enterprises above a designated size*	8.3	8.2	7.6
Catering	10.8	10.7	9.9
of which, enterprises above a designated size*	6.0	7.4	7.2

Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

* "Enterprises above a designated size" refers to enterprises with annual sales of five million yuan or more and with employee strength of 60 or more.

Retail sales of consumer goods: Commodities

In 2017, retail sales of cosmetics saw a 13.5% yoy growth, the highest among all categories, followed by retail sales of furniture with 12.8% yoy growth, and Chinese and western medicine with 12.4% yoy growth (Exhibit 5). The trend continued into 1H18, while sales of cosmetics saw a 14.2% yoy growth.

Exhibit 5: China's nominal retail sales growth of enterprises above a designated size, by product, 2016 – 1H18 (yoy change, %)

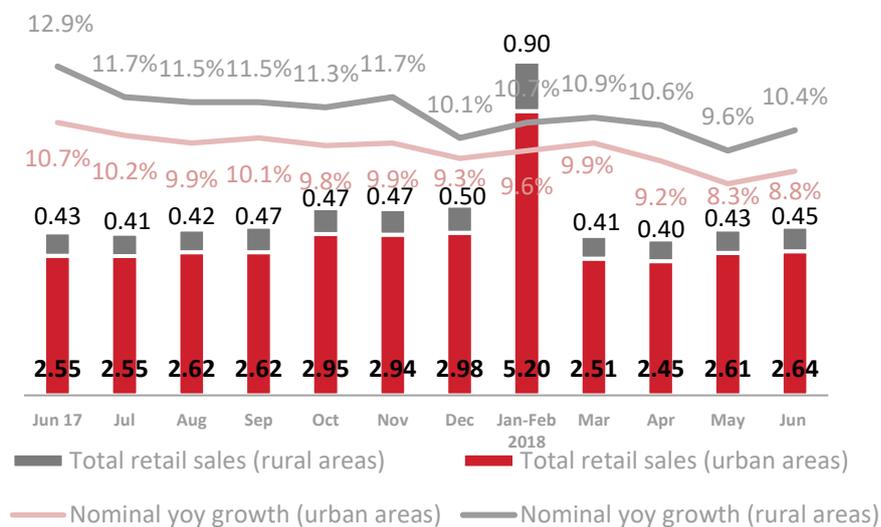
<i>By product</i>	2016	2017	1H18
Grain, oil, food	10.9	10.2	9.8
Beverages	10.5	10.3	9.6
Tobacco and liquor	9.3	7.9	8.9
Clothing, shoes, hats, and textiles	7.0	7.8	9.2
Cosmetics	8.3	13.5	14.2
Gold, silver, and jewelry	0.0	5.6	7.4
Daily use products	11.4	8.0	12.6
Home appliances and video equipment	8.7	9.3	10.6
Chinese and western medicines	12.0	12.4	9.3
Stationery and office accessories	11.2	9.8	6.6
Furniture	12.7	12.8	10.1
Telecommunications equipment	11.9	11.7	10.6
Petroleum and related products	1.2	9.2	11.9
Automobiles	10.1	5.6	2.7
Building and decoration materials	14.0	10.3	8.1

Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Retail sales of consumer goods: Urban vs rural

Rural retail sales have been growing at a faster pace than urban retail sales over recent years, but the gap narrowed in recent years. Rural retail sales increased nominally by 11.8% yoy to 5.2 trillion yuan in 2017, while urban retail sales rose 10.0% yoy to 31.4 trillion yuan (Exhibit 6). In 1H18, urban retail sales increased nominally by 9.2% yoy to 15.4 trillion yuan, while rural retail sales rose 10.5% yoy to 2.6 trillion yuan.

Exhibit 6: Total retail sales of consumer goods, urban vs. rural areas, June 2017 – June 2018



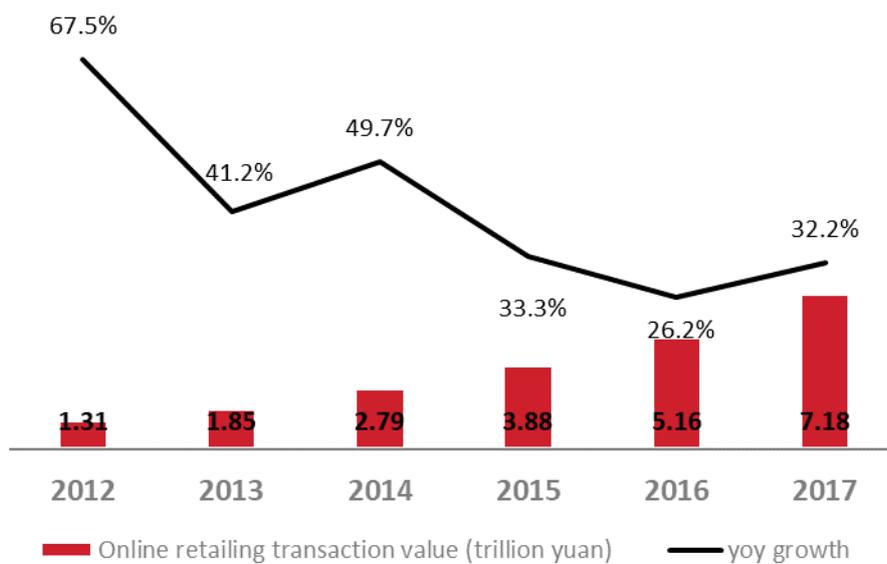
Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

The fast growth of rural retail sales was partly attributable to the steady increase in rural household income. Per capita disposable income of urban and rural households reached 39,396 yuan and 13,432 yuan in 2017, up by 6.5% and 7.3% yoy respectively. In 1H18, per capita disposable income of urban and rural households reached 19,770 yuan and 7,142 yuan, up 7.9% yoy and 8.8% yoy in nominal terms respectively. Rural household income grew faster than that of urban households, but the per capita disposable income of urban households was almost triple than that of their rural counterparts.

2. Online retail market scales up in 2017 amid slower growth

After years of explosive growth, China has become the world’s largest online retail market. In 2017, the transaction value of China’s online market increased by 32.2% yoy to reach 7.18 trillion yuan. Of which, the online retail sales of goods amounted to 5.48 trillion yuan, up by 28.0% yoy and accounted for 15.0% of the total retail sales of consumer goods (Exhibit 7). In 1H18, total online retail sales of goods and services amounted to 4,081.0 billion yuan up by 30.1% yoy. Of which, online sales of goods amounted to 3,127.7 billion yuan, up 29.8% yoy and accounted for 17.4% of the total retail sales of consumer goods.

Exhibit 7: China’s online retail market, 2012 – 2017



Source: National Bureau of Statistics of the PRC, Ministry of Commerce; compiled by Fung Business Intelligence

The phenomenal growth of the online retail market has been driven in part by the huge Internet and mobile Internet population and rapid uptake of online shopping by Chinese consumers. China has the world’s largest number of Internet users and online shoppers. As of June 2018, there were 802 million Internet users in China, and the Internet penetration rate was 57.7%. Of which, a total of 788 million people used mobile devices to access the Internet. 569 million people were online shoppers and 557 million people shop via mobile devices.

M-commerce takes the lead

Over the years, mobile commerce (m-commerce) has been gaining share at the expense of PC-based transactions. The penetration rate of mobile shopping reached 70.7% in June 2018. 81.3% of the online shopping transactions were made on mobile devices in 2017 and total transaction value of mobile shopping reached 4,934.5 billion yuan. More retailers have been actively investing in m-commerce. It is expected that m-commerce will play a more important role in driving e-commerce development in coming years.

Rural e-commerce becomes the new growth engine of online sales

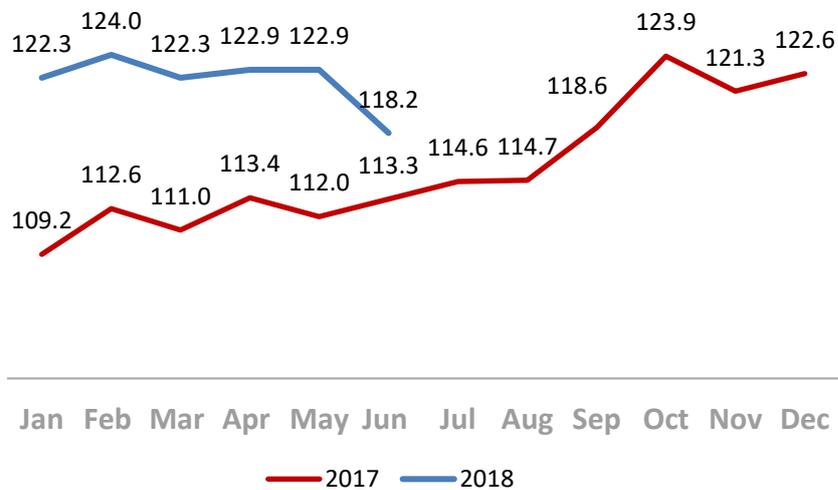
China's rural e-commerce has become a new growth engine with the near saturation of urban e-commerce. In June 2018, the number of Internet users in the rural area rose to 211 million, accounting for 26.3% of the total Internet population, down from 27.0% in December 2017, according to China Internet Network Information Centre (CNNIC). The decrease in rural Internet population was due to the continual urbanization process in China. According to the China e-Business Research Center, the transaction value of rural online market is estimated to reach 1,245 billion yuan in 2017, up 39.1% yoy.

The development of rural logistics and infrastructure has driven the growth of the rural e-commerce market. In recent years, some leading e-commerce players and Internet companies have increased efforts to expand their distribution network in rural areas. For instance, Alibaba launched its Rural Taobao initiative in October 2014 to create a network of e-commerce service centers in rural areas to provide services that enable villagers to purchase goods online, as well as sell their goods. Alibaba announced in June 2018 that it aims to expand the coverage of Rural Taobao to 1,000 counties and 150,000 villages across China in the next three years. JD.com, on the other hand, announced in June 2018 that in the next five years, it targets to open 1 million JD Convenience Stores, of which half of them will be in rural areas.

3. Chinese consumers are more upbeat as consumption environment improves; consumer confidence surges in 2017

Consumer confidence index continued to rise gradually in 2017 and remained fairly stable in 1H18, suggesting that the consumption atmosphere in China has remained positive (Exhibit 8).

Exhibit 8: Consumer Confidence Index, January 2017 – June 2018

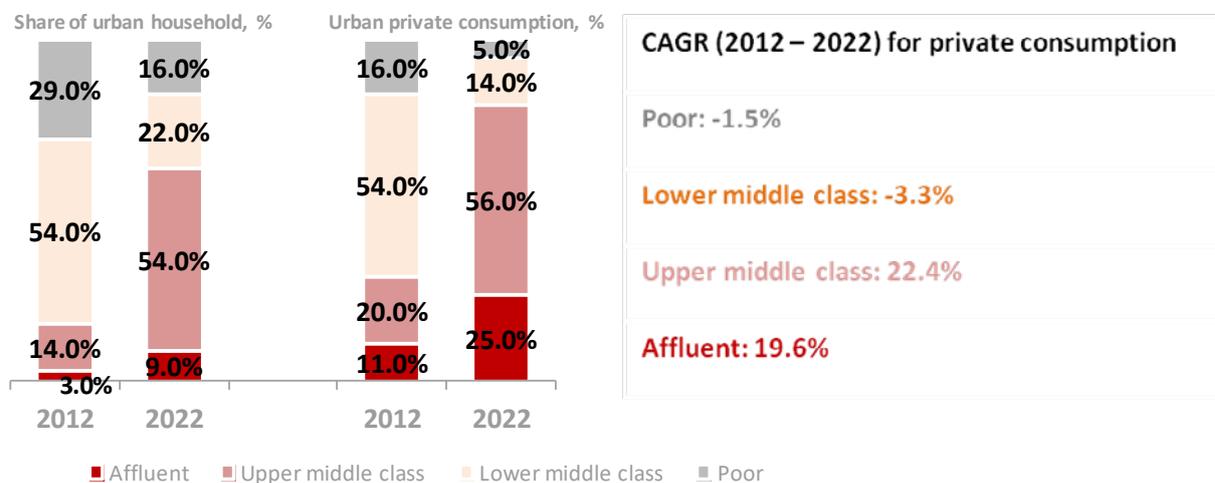


Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

4. Growing middle class transforms the retail landscape

Middle class consumers in China are becoming increasingly influential in the retail and consumer market. McKinsey & Co. predicts that by 2022, more than 75% of China's urban consumers will earn between 60,000 yuan and 229,000 yuan per year. This middle class segment, especially the upper middle class (those earn between 106,000 and 229,000 yuan per year), is a major consumer group in China. As shown in Exhibit 9, the upper middle class is estimated to account for over 56% of urban private consumption in 2022, up from only 20% in 2012.

Exhibit 9: Share of urban household and urban private consumption, 2012 and 2022 (estimates)



Source: Deutsche Bank; McKinsey & Co.; compiled by Fung Business Intelligence

Income segment defined by annual disposable income per urban household, in 2010 real terms; affluent, >229,000 yuan (equivalent to >US\$34,000); upper middle class, 106,000 to 229,000 yuan (equivalent to US\$16,000 to US\$34,000); mass middle class, 60,000 to 106,000 yuan (equivalent to US\$9,000 to US\$16,000); poor, <60,000 yuan (equivalent to <US\$9,000).

A report issued by the World Economic Forum in January 2018 predicts that China will have the world's largest middle class¹ population by 2027, a segment whose strong spending power will reshape consumption domestically and internationally over the next decade. From 2016 to 2027, consumption is expected to grow by an average 6% annually to reach 56 trillion yuan (US\$8.2 trillion) in 2027, driven by the middle class that will comprise an estimated 65% of households by 2027.

¹ Definition of middle class by the World Economic Forum includes lower middle class, i.e. households earning 66,000-198,000 yuan (US\$10,000-30,000); and upper middle class, i.e. households earning 198,000-363,000 yuan (US\$30,000-55,000).

5. Luxury market is thriving again in China

In 2017, Chinese luxury spending accounted for 32% of global luxury purchases, up from 30% in 2016. The rebound of luxury spending by Chinese consumers made the country the third largest luxury goods market in 2017, sharing the same rank with Japan, just behind Europe and the U.S. It is projected that China's personal luxury goods market will expand by 6% annually through 2024, by then Chinese shoppers will contribute 40% of global luxury sales and drive 70% of global luxury growth, according to Boston Consulting Group.

The growth of Chinese luxury spending is driven by several factors, with the major one being millennials accelerating their spending on luxury. Millennials in China, especially those from the rising middle class, have very strong spending power and are more willing to spend their income on premium products than their foreign counterparts. They start purchasing luxury goods at an earlier age – around 10 years younger than those in Europe and 20 years younger than those in the U.S., and buy more frequently compared with the older generation, making millennials among the major contributors to luxury growth. It is also expected that by 2024, 50% of China's personal luxury market will be made by millennials.

II. Competitive landscape

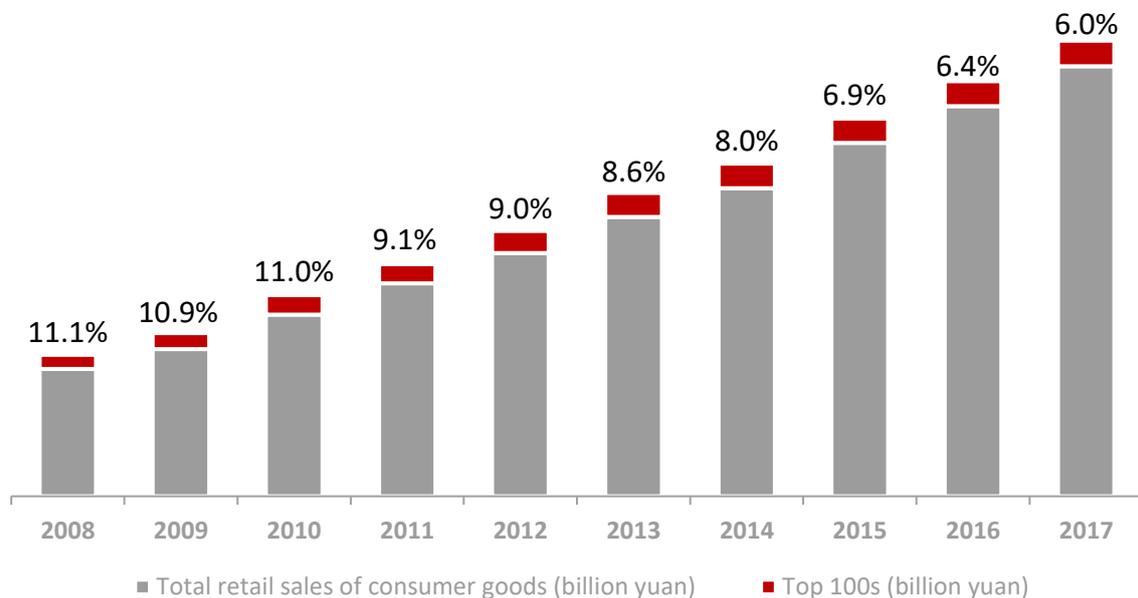
1. Performance of the Top 100 retail chain operators (the Top 100s)

Growth pace of the Top 100s picks up in 2017

Total sales of the Top 100s in 2017 amounted to 2.2 trillion yuan, up 8.0% yoy. The growth rate of the Top 100s was slower than that of the national total retail sales of consumer goods. However, it has picked up from 3.5% yoy in 2016, showing that the performance of large retail enterprises has improved over the past year.

As shown in Exhibit 10, the Top 100s made up only 6.0% of total retail sales of consumer goods, down from 11.1% in 2008, indicating the increasingly fragmented nature of China's retail market.

Exhibit 10: The Top 100s' share in national retail sales, 2008 – 2017



Source: China Chain Store and Franchise Association, compiled by Fung Business Intelligence

Exhibit 11 shows the Top 10 retail chain operators by retail sales in 2017. Suning.com Group Co., Ltd. ranked the top with total sales of 243.3 billion yuan, followed by Gome Retail Holdings Ltd. and China Resources Vanguard Co., Ltd. The rankings for the top 5 enterprises are the same as the previous year.

Exhibit 11: Top 10 chain retailers, 2017 (Ranked by retail sales)

Rank		Name of company	Sales, pre-tax (million yuan)		Number of stores	
2017	2016		In absolute terms	yoy change (%)	In absolute terms	yoy change (%)
1	1	 Suning.com Group Co., Ltd.	243,343	29.2%	3,799	10.9
2	2	 Gome Retail Holdings Ltd.	153,691	-6.7%	1,604	-1.5
3	3	 China Resources Vanguard Co., Ltd. ^①	103,646	0.1%	3,162	-1.9
4	4	 Sun Art Retail Group Ltd. ^②	95,400	2.3%	383	4.6
5	5	 Walmart (China) Investment Co., Ltd.	80,278	4.7%	441	0.5
6	10	 Yonghui Superstores Co., Ltd.	65,400	20.2%	806	65.5
7	8	 Chongqing General Trading (Group) Co., Ltd.	58,281	3.9%	322	-0.6
8	7	 Lianhua Supermarket Holdings Co., Ltd. ^③	56,460	-5.6%	3,451	-5.4
9	14	 Sinopec Group	51,950	48.0%	25,775	0.7
10	11	 Carrefour China Inc. ^④	49,796	-1.3%	321	0.6

Source: China Chain Store and Franchise Association, compiled by Fung Business Intelligence

① Sales of China Resources Vanguard Co. Ltd. included sales of Suguo Supermarket. The pre-tax sales for Suguo Supermarket were 28,000 million yuan in 2017.

② Sales of Sun Art Retail Group Ltd. excluded sales of its e-commerce platform feiniu.com.

③ Sales of Lianhua Supermarket Holdings Co., Ltd. included sales of Carrefour in Shanghai.

④ Sales and store number of Carrefour China Inc. included stores in the Greater China region.

21 enterprises out of the Top 100s recorded negative sales growth in 2017, compared with 34 enterprises in 2016; overall speaking, the Top 100s saw better performance in 2017. Gross profit margin was 16.5% in 2017, up from 15.6% in 2016.

That said, rising labor and rental costs continued to exert pressure on the Top 100s. Labor costs increased 8.0% yoy, while rental costs and electricity costs increased 5.6% yoy and 4.6% yoy.

Smaller-sized stores continue to see the fastest sales growth

Smaller-sized store format, particularly convenience stores, continued to gain traction. Among all the traditional retail formats, in 2017, convenience stores recorded the highest sales growth at 16.9% yoy, while the growth in number of stores was 18.1% yoy. Meiyijia Convenience Store (Rank #54) continued to be the market leader in the convenience store segment (exclude forecourt convenience store players), with sales revenue amounting to 12,240.8 million yuan in 2017, up 30% yoy and its store number reaching 11,659, up 25.4% yoy.

Apart from convenience stores, other small-format stores also saw rapid growth. In 2017, the Top 100s together opened a total of 9,197 new stores, of which over 80% of them were small-format stores, while only 3.7% were hypermarkets and 1.0% were supermarkets.

Meanwhile, in terms of same-store sales, convenience stores also saw the highest growth at 6.0% yoy, followed by community supermarkets (3.8% yoy), department stores (4.5% yoy), and shopping malls (3.4% yoy). Hypermarkets recorded negative same-store sales growth at -2.3% yoy.

Top 100s see robust online sales growth; O2O provides huge opportunities but challenges remain

Online sales growth of the Top 100s increased from 69.0% yoy in 2016 to 78.9% yoy in 2017, much higher than the national online retail sales growth at 32.2% yoy and offline sales growth at 8.0% yoy. Despite the fast growth, online sales of the Top 100s accounted for a small proportion of total sales (10.3%); 27.2% of the total transaction value were generated from mobile payment tools.

Embracing online-to-offline (O2O) integration is a key focus of the Top 100s; however, some real challenges remain in this process. Rising costs of e-commerce, particularly delivery costs and costs of acquiring new customers; limited fundings; insufficient e-commerce expertise; inefficient supply chain to support O2O business are some of the major challenges cited by the Top 100s.

2. Store closures are here to stay

China's retail sector has witnessed a trend of store closures amid the tough market environment. Over-expansion in the previous years, together with rising rental and labor costs, have posed huge challenges to many physical retailers, forcing them to close stores that are not making a profit and revamp or suspend expansion plans. According to Linkshop, in 2017, there were over 800 store closures involving 14 listed hypermarket/ supermarket chain operators; and 45 store closures involving department stores in China. Meanwhile, some foreign players exited the China market recently. One significant example is South Korea's Lotte Group. In April 2018, it agreed to sell 21 Lotte Mart to Wumei Holdings Inc. for about 1.5 billion yuan. In May 2018, it further announced to sell Lotte Mart's 72 stores in Eastern China, including Shanghai and Jiangsu to Liqun Group at 1.67 billion yuan.

3. Analysis by major retail formats

Department stores

China's department store sector witnessed a positive and stable growth in the past year. According to the NBS, the retail sales of department stores of retail units above designated size increased by 4.6% yoy in 1H18. Statistics from the Ministry of Commerce (MOFCOM) also show that the yoy growth of 5,000 key retailers reached 4.6% yoy in 1H18, of which, the growth of department stores reached 4.5% yoy. In terms of new store openings, according to Linkshop's statistics on the store opening of 80 chain stores in China over the past two years, the number of newly opened department stores was still slightly higher than that of closed or transformed department stores, resulting in a net rise in the number of department stores.

Hypermarkets and supermarkets

The growth of hypermarkets and supermarkets in China has slowed down over recent years. Meanwhile, they have been facing fierce competition from the fast-growing e-commerce sector as well as the smaller-scale retail formats such as convenience stores, community stores and specialty stores. Since 2017, many hypermarket and supermarket operators have started to revamp their operations to embrace the changes in the consumer market. According to the NBS, the retail sales growth of supermarkets above designated size was 7.4% yoy in 1H18, up from 6.3% yoy in 1H17. According to the CCFA, the FMCG chain operators in the Top 100s achieved total sales revenue of 1,062 billion yuan in 2017, an increase of 7.3% yoy, up significantly from 4.1% yoy and 4.2% yoy in 2015 and 2016 respectively.

Shopping malls

China's shopping malls sector has enjoyed robust and healthy development over the past year. In 2017, most large-scale shopping malls in China delivered positive sales performance. According to iziRetail, the total sales of 190 large-scale shopping centers across 51 cities in China reached 441.3 billion yuan in 2017, up 11.3% yoy. Of all the 190 surveyed shopping centers, 148 of them recorded positive sales growth, 27 registered a decline in sales and eight remained flat in sales performance. As of 2016, there were more than 4,000 shopping centers operating nationwide. 323 large-scale projects (with commercial area larger than 80,000 sqm) were opened in 2017.

Convenience stores

CVS is the fastest-growing retail format in China. Total sales revenue for the CVS sector (including forecourt stores) reached 190.5 trillion yuan in 2017, up 23% yoy according to the CCFA. The growth momentum of CVS is expected to continue, as small retail format continues to gain in popularity in China's retail market. In 2017, the total number of CVS in China increased by 13% yoy to reach over 100,000, up from 94,000 in 2017, indicating that the store opening speed is very fast in the sector. Statistics from the MOFCOM show that the yoy growth of 5,000 key retailers reached 4.6% yoy in 1H18, of which, the growth of CVS was the fastest among all retail formats, reaching 7.6% yoy.

Pop-up stores

Over the past few years, pop-up retailing has seen rapid growth in China. According to Chinese commercial property research agency RET, pop-up stores have proliferated in China with a compound annual growth rate of over 100% since 2015; and the number of pop-up stores is projected to exceed 3,000 by 2020. Pop-up stores are becoming increasingly popular as they can serve different purposes — selling products, enhancing brand awareness, and gaining market insights. One of the major advantages of pop-up retailing is that the set-up costs are far lower than for permanent stores with long-term leases.

III. Key trends and developments

1. Millennials and generation Z reshape the retail landscape

Considering the strong spending power of millennials (post-80s generation) and generation Z (post-95s generation or post-millennials), both local and international retailers are ramping up efforts to better engage with the most influential groups of consumers. To lure young shoppers, brands are increasingly turning to young celebrities and influencers to market their products, and are launching new product lines with younger tastes (Exhibit 12). For example, in January 2017, British luxury fashion house Burberry collaborated with Kris Wu, one of the most popular millennial idols in China, to launch a new collection dubbed the “Burberry x Kris Wu Edit 2017”. The new collection, featuring five specially curated looks of the brand’s classic English-woven cotton gabardine trench coat and sports striped knitwear, has given a new and fresh interpretation of Burberry classic items and brought a youthful touch to the heritage brand, making the brand more appealing to young buyers. Another example is HLA. The Chinese fast fashion brand has rolled out a sub-brand named “HLA Jeans”, reaching out to young people with stylish denim jeans and leisure wear. Meanwhile, HLA has also revamped their store layout and design to give their storefront a crisp and trendy look, catering to the tastes of young customers.

In addition, some shopping malls in China have also undergone transformation and upgrading to attract young shoppers. Shanghai Shimao Festival City is a case in point. In June 2017, the mall was closed for more than one year for a face lift and brand upgrade. To better cater to the needs of the younger generation, the newly refurbished Shimao Festival City has introduced a slew of concept stores and chic fashion brands popular among young shoppers, including Nike global flagship store, Dior Beauty concept store, Pandora concept store, Sephora Asia flagship store, China’s first indoor Hello Kitty theme park, Lego flagship store and Starbucks Reserve store.

Exhibit 12: Selected marketing campaigns to lure young customers

Brand	Details
Dior	<p>In April 2017, European luxury goods company Dior appointed Chinese actress Angelababy (Angela Yeung Wing) as the new brand ambassador for China region. Angelababy is well-known in China and popular amongst the Generation Z.</p>
Adidas	<p>To cater to the Generation Z, Adidas has cooperated with many of China’s underground musicians, DJs, artists, bloggers and collaborate with other streetwear labels. For example, it invited Bass Gang Berlin to the Shanghai adidas store for the “adidas original x White Mountaineering” collection launch party. Adidas also selected a number of Chinese celebrities such as Andy Lau and Fan Bingbing to wear the NMDs before the shoe was formally released.</p>
Michael Kors	<p>In November 2017, U.S. fashion company Michael Kors hosted an event at the Shanghai Expo-I Pavilion and invited many famous guests including actress Yang Mi, who has become the brand’s new ambassador. The brand created a hashtag #korsshanghai and encouraged guests to live-stream via the Chinese app YiZhiBo. Michael Kors also collaborated with local video-streaming app Douyin to reach out to the Generation Z.</p>
Burberry	<p>In December 2017, British luxury fashion house Burberry collaborated with Kris Wu, one of the most popular millennial idols in China, to launch a new collection dubbed the “Burberry x Kris Wu Edit 2017”. The new collection has given a new and fresh interpretation of Burberry classic items and brought a youthful touch to the heritage brand, making the brand more appealing to young buyers.</p>
Estée Lauder	<p>U.S. premium beauty brand Estée Lauder appointed famous Chinese actress Yang Mi as its brand ambassador in early 2017. The brand also hosted consumer and KOL events in its stores around festivals such as Chinese New Year and Women’s Day to provide memorable experiences based on skincare or make-up services and thus better engage with customers.</p>
Mulberry	<p>In April 2017, U.K. fashion company Mulberry invited famous actress Yang Mi to attend the ribbon-cutting ceremony for the opening of its new store in Shanghai. The brand is also interacting with the Generation Z consumers by asking WeChat followers to leave a comment on which handbag they liked the best from its latest collection. Two lucky winners would receive an in-store gift card worth around US\$1,000.</p>

Source: Various Internet sources, compiled by Fung Business Intelligence

Who are the Chinese post-millennials?



An emerging demographic cohort generally known as the post-millennials or the Generation Z – who were born after 1995 – are now reshaping the Chinese economy. Making up nearly 250 million of China’s total population, these young people – ranging from college age to new entrants into the workforce – represent the most-promising consumer segment and a modern mindset with great sense of individuality. These young consumers are set to power the growth of China’s consumer sector as they have huge consumption intention with wealth accumulated and inherited from previous generations. According to a report jointly released by Deloitte and Tencent Social Media Ads, the new generation of consumers, which include the Generation Z, will own half of the total income and become major consumers of China’s luxury market in 10 years.

A modern mindset

As native users of the Internet, post-millennials are exposed to massive online resources to learn about what is happening around the world. They are informative and resourceful. They have high aspirations for a better life and strong desires to live far beyond the basics of living. They have become sophisticated consumers as they know very well their preferences and can make decisions independently. The post-millennials are also open-minded to express themselves on social media. A survey conducted by Tencent Social Media Ads and Customer Research & User Experience Design Center (CDC) revealed that the Generation Z consumers believe that wealth is not the key to success. Instead, they hold to values such as self-understanding, independence, equality, compassion, and care for society.

Raised during the digital revolution, the Generation Z is using smart devices more than any other generations. This young segment believes that technologies will enhance their happiness and convenience significantly. They spend more time interacting and connecting with friends online than they do offline. Social media has also become a way for the post-millennials to shape their own identity through their posts, comments and interactions.

Who are the Chinese post-millennials? (Cont'd)

New consumer demands

New brand perception

The origin of brands is not a huge concern for the Generation Z and does not determine their shopping decisions. More and more young segment support Chinese local brands as a way to show support to their country. Moreover, the post-millennials lean towards brands that are dedicated, faithful, and that show unique insights. When they make consumption decisions, they also take into consideration whether a brand is sustainable and conscious of the environment.

Personalization and customization

The post-millennials look for unique and personalized products which allow them to express their individuality, as well as innovative products and services which convey their personal tastes. Niche brands, local designer brands, limited edition products and customized products are highly sought-after among the Generation Z.

Convenience-driven shopping experience – seamless channels and fast delivery service

The post-millennials have high expectations on shopping convenience. They are omni-channel shoppers who use whatever channel that best suits their needs, be it online or offline. When they do online shopping, the majority of them use mobile for their entire shopping journey – from product research to purchase, payment, delivery and after-sales services. While at physical stores, they look for convenient payment methods such as Alipay or Tenpay; as well as instant and hassle-free delivery service.

2. Diversifying product and service offerings; crossovers become a norm

In response to consumers' increasing demand for newness and uniqueness, many retailers have endeavored to diversify their product and service offerings through expanding into new sectors and forming collaboration with other market players.

For instance, to expand service offerings and generate new revenue streams, Japanese lifestyle retailer Muji has diversified into the hospitality sector in China by launching Muji Hotel in Shenzhen in January 2018 and in Beijing in March 2018. More than offering accommodation services, the Muji hotels in China has also incorporated Muji retail store, Muji Café and Muji Books, increasing the variety of services and products offered to Chinese customers. In December 2017, China's major electronics appliance chain Suning extended its reach to local

sporting goods market by launching its first sporting goods store in Nanjing in December 2017. The expansion enables Suning to ramp up its product offerings to cover a wide range of sporting goods including sports shoes, fitness equipment, and franchised products.

Crossovers, a combination of two or more elements/ brands to create new products/ services, have become popular in the retail space, particularly the luxury and fashion industry. Different from traditional brand extension, crossover collection creates marketing synergy through joint efforts and satisfies customers' aspiration for newness and uniqueness. It appeals to customers, especially the millennials who are less-conforming and looking for a unique way to express their fashion style. To capitalize on the crossover wave, a number of fashion players have initiated collaboration with popular brands and designers to co-develop new product collections. In July 2017, French luxury fashion brand Louis Vuitton opened a pop-up store at a gallery in 798 Art Zone, Beijing to sell its crossover collection "Supreme X Louis Vuitton" co-created with New York-based streetwear brand Supreme. The crossover collection, which include hoodies, key pouches and the classic LV Keepall emblazoned with logos of both brands, whipped Chinese fans into a frenzy, with hundreds and thousands of Chinese customers flocking to the store for the coveted collection. In February 2018, German footwear brand Birkenstock launched a limited footwear collection "Birkenstock x Ms Min" in collaboration with Chinese womenswear designer brand Ms Min. The crossover collection, in celebration of Chinese New Year, features Birkenstock's classic Ramses decorated with Chinese classic embroidery patterns – dragon and floral designed by Ms Min.

3. Delivering enriched lifestyle shopping experiences to entice shoppers

As shopping experience becomes increasingly important to consumers, retailers nowadays are striving to create unique and fun in-store experience. Increasing numbers of department stores and shopping mall operators have upgraded by introducing new and innovative concept stores and more lifestyle services. For instance, Hopson One shopping mall, which was opened in Beijing in October 2017, has introduced a number of retail and lifestyle-focused tenants with shop formats and trade categories that are new to the market. It has drawn in an indoor ski center, Le Ski which houses large-scale ski training equipment with electronics simulator to simulate the snow effect in reality; an indoor roller skating center for children; a large-scale indoor playroom for children; a kung fu learning center, etc. These types of tenants can help differentiate the mall from other players in the market.

Some forward-thinking mall operators have incorporated value-added elements that attempt to recast the malls as community and cultural hub as well as provide customers a venue for art exhibition, concerts, social events, etc. For example, during April and May 2018, a number of shopping malls in Shanghai's Jing An district, including Jing An Kerry Centre, Crystal Galleria and HKRI Taikoo Hui, respectively held a series of live music concerts featuring American jazz team

Dave Weckl band in celebration of International Jazz Day, with a hope to bring entertaining and memorable experience for shoppers.

In addition, in June 2018, with the approaching of Children’s Day, some shopping malls in Shanghai also launched a series of family-friendly events in an effort to woo parents and their children to their stores. For instance, Ruihong Tiandi's Hall of the Moon hosted the first Robocar Poli exhibition in China in May to August 2018. The 600-sqm exhibition was set against the background of South Korea’s popular preschool animation series Robocar Poli, which was designed to educate children on the importance of traffic safety. To provide an immersive family experience with fun for both children and parents, the exhibition offered various road safety games including road block clearing, firefighting, road rescue and simulated driving, allowing parents to interact with their children and teach them more about traffic safety through playing the games.

4. O2O continues to dominate the retail scene

O2O has and will continue to revolutionize the retail landscape. Pursuit of online-to-offline (O2O) strategies has become a preoccupation for most brands and retailers. Many traditional retailers in China have actively pursued digital expansion and deployed O2O strategies to ensure seamless integration of all channels – physical, online, mobile and social. At the same time, some leading e-commerce companies and “pure-clicks” enterprises have tiptoed into bricks-and-mortar retailing in the hope of providing better shopping experience.

Alibaba’s supermarket chain Hema Xiansheng is a prime example of the O2O model. It’s unique O2O business model seamlessly integrates its supermarkets, online stores (via mobile app), distribution centers, and restaurants. In April 2018, Alibaba opened its first bricks-and-mortar shopping mall near its corporate headquarters in Hangzhou. This is another major effort by Alibaba to blend its digital prowess with physical retail. The mall sells many of Taobao e-commerce brands and features a number of “black technologies” such as virtual labs and virtual makeup mirrors.

Recently, some leading e-commerce players such as Alibaba and JD.com have sought to perfect their retail networks and further expand their ecosystems by merging with or acquiring their online and offline counterparts. For more information, please see ***Issue 2: E-commerce of our Spotlight on China Retail.***



Alibaba's first bricks-and-mortar shopping mall (Photo source: Linkshop)

5. Use of smart technologies gains steam

In today's highly digitized world, China's retail sector is being redefined by a new wave of technologies to facilitate O2O integration, while significantly enhancing customer experience. Many retailers, especially those in the CVS and supermarket/ hypermarket sectors have adopted various types of smart technologies such as scan and go payment service, self-checkout counters, and electronic tags in their stores to create a more unique and enjoyable shopping experience. Selected examples of technology-driven supermarkets include Carrefour's smart supermarket "La Marche", Alibaba's supermarket chain Hema Xiansheng and Yonghui Superstores' YH Super Species.

Meanwhile, some apparel retailers have also used smart technologies in their operations to enhance customers shopping experience. Fast fashion brand Uniqlo is a case in point. It opened a digitized experiential store in Shenzhen in March 2018 which integrates online and offline experience by connecting real world and virtual experience via smart mirrors and smart screens as well as AR posters on the wall. In May 2018, the brand launched a new AI-driven shopping guide "Xiaoyou" on its WeChat official account. Users can interact with "Xiaoyou" by conducting voice search and text search. Another fast fashion brand, Zara introduced a AR-enabled marketing campaign globally in April 2018 – customers can view the models wearing the latest collections, walking and posting in an AR-setting when they point their phone at designated spots in the store.

In the same vein, advanced technologies have accelerated the growth of unmanned stores in the country. Many retail operators as well as Internet giants such as Lawson, Rainbow, Bingo Box, Alibaba and JD.com have built different types of unmanned stores in the past year. The use of facial recognition technology at the store entrance, RFID-enabled racks and mobile/ facial

payment are commonly seen in these unmanned stores. Recently, apparel retailers such as GUESS have also set up staffless stores. In July 2018, GUESS partnered with Alibaba to launch an AI-equipped apparel concept (pop-up) store in Hong Kong for a short period. The “FashionAI concept store” showcased GUESS’ latest collections together with some latest retail technologies such as smart mirrors, RFID-enabled clothing racks, and smart fitting rooms with real-time notifications. Customers could try-on the clothes physically in-store in the smart fitting rooms or virtually via the smart mirrors. They could purchase the clothes online via the Tmall app.

The use of retail technologies not only enables retailers to provide better shopping experience for customers, but also enhance operation efficiency with better forecasting ability and inventory management. In particular, technologies such as AI, cloud technology and big data analytics allow retailers to better estimate consumers’ preferences based on their previous shopping history, purchase records and shopping routes in the store, and also help them to better manage inventory, improve the efficiency of supply chain operation and reduce costs.

6. Pop-up retailing comes on the scene

Over the past few years, pop-up retailing has seen rapid growth in China. According to Chinese commercial property research agency RET, pop-up stores have proliferated in China with a compound annual growth rate of over 100% since 2015; and the number of pop-up store are projected to exceed 3,000 by 2020. Pop-up stores are becoming increasingly popular as they can serve different purposes — selling products, enhancing brand awareness, and gaining market insights. One of the major advantages of pop-up retailing is that the set-up costs are far lower than for permanent stores with long-term leases.

Recently, some brands have opened pop-up stores backed by innovative marketing content to promote products and raise awareness. Chanel, for instance, launched a pop-up store in the format of game center at K11 Shanghai in April 2018, following its previous debut in Tokyo, Seoul and Taipei. The COCO Game Center offered mainly cosmetics products and perfumes, and featured racing games, game machines, game booths and claw machines. The gamified pop-up store successfully attracted huge traffics to K11 Shanghai. Some customers had to wait for two hours to get inside the pop-up store.

Pop-up stores are also becoming increasingly a popular channel for e-commerce operators and online retailers without bricks-and-mortar presence to connect with customers in a more direct and dynamic way. Some also use the pop-up format to test new technologies, concepts and collections, and to gain market insights. Both Alibaba and JD.com have opened technology-powered pop-up stores to showcase their online products. These stores adopt numerous “black technologies” which can help them better engage with customers and draw offline traffics to online. Alibaba, for instance, set up smart Tmall pop-up stores in collaboration with different brands inside different shopping malls nationwide in recent months. In these pop-up stores, interactive technologies such as digital shopping wall, magic mirror, facial recognition, cashless

payment method, gamified discounts, etc. are commonly seen. Similarly, during March to May 2018, JD.com launched several types of pop-up stores under the name of “Joy Space” – for example, a Joy Space pop-up supermarket was launched in Guangzhou, a Joy Space store selling only cosmetics products of L’Oreal was opened in Shanghai, and a Joy Space pop-up store featuring products of various fashion brands was set up in Beijing. All of these Joy Space stores were equipped with interactive devices including AR mirrors, smart speakers, facial recognition systems, smart screens and smart shelves, as well as an automated check-out aisle.

In May 2018, apparel e-tailer Handu launched a pop-up store outside Intime Shopping Mall in West Lake, Hangzhou in collaboration with Keyring Studio, which created the popular Korean cartoon “Spookiz”. The store only opened for four days; it is the first time Handu launched a physical touchpoint to interact directly with customers. Crossover products of Handu and Spookiz were displayed in the pop-up store and customers could order online. The pop-up store also added some technology-driven entertainment elements such as motion-sensing games and VR games with an aim to enrich consumer shopping experience.

7. Chinese government pushes forward with policies to boost consumption

Recognizing consumption will continue to be a major growth driver in China in the years ahead, the Chinese government has striven to establish an effective mechanism for expanding domestic consumption. In the past year, it has issued a number of policies to promote consumption and facilitate the development of domestic trade. In September 2018, the General Office of the Central Committee of the Communist Party of China and the State Council issued *the Several Opinions on Improving the Mechanism for Promoting Consumption and Further Stimulating Residential Consumption*. The Opinions stress that improving the mechanism for promoting consumption and enhancing the basic role of consumption in economic development is conducive to optimizing the ratio between production and consumption, and is beneficial to the mutual promotion of demand-led and supply-side structural reforms. The Opinions also state the need to create mature segmented markets to stimulate consumption growth, to establish quality standards and credit mechanism, and to create a trustworthy environment for consumers.

Earlier in July 2018, the MOFCOM promulgated the *Opinions on Promoting the Mechanism for Consumption and Further Encouraging the Consumption Potential of Residents*. The Opinions highlight some major tasks to boost consumption, including the construction of the “15-minute community service circle” to promote urban and rural consumption; expanding imports and making full use of platforms such as China International Import Expo, and enriching domestic supply of goods and services; and creating a safe and secure consumer environment through promoting the construction of traceability systems for important products such as edible agricultural products and food, and actively promoting the construction of a business credit system.

Meanwhile, to encourage domestic consumption while promoting imports, the State Council announced in May 2018 that the country will slash import tariffs on a range of consumer goods including apparel, cosmetics, cleaning products, home appliances, fitness products, and some healthcare products. The tariff cuts went into effect on 1 July, 2018. Later in September 2018, the State Council unveiled plans to cut tariffs for products including machinery, electrical equipment and textile products beginning on 1 November, 2018. The overall tariff level reportedly will be reduced to 7.5% in 2018 from 9.8%.

IV. Major challenges

1. China-U.S. trade war hinders overall economic growth

In 2018 and into 2019, the world attention remains fixed on the tit-for-tat trade war between China and the U.S. The trade war will inevitably hinder China's economic growth, which in turn will affect consumer sentiment and consumer spending. The retail sector as a whole will be adversely affected and is expected to see single-digit sales growth.

2. High operating costs continue to hurt profitability

Over recent years, operating costs in China have elevated significantly, largely driven by surging rental and labor costs, as well as higher expenditure on sustainability initiatives. At the same time, adopting new technologies and new business models is a critical part of a successful retail operation. This has forced brand and retailers to increase investments in technologies and data analytics to keep pace with the needs of the rapidly changing environment. All these may further increase the financial burden of businesses and affect their profitability.

3. Changing consumer demand brings new challenges to retailers' supply chain

While consumers become more discerning and demanding, they are also more conservative in their spending. They look for products with affordable pricing, and at the same time, value for money. Moreover, they increasingly demand for personalized products and services, and have a strong desire for convenience and immediacy. To cope with these new demands, a mature supply chain that can react quickly is crucial. However, many operators are still in the early stage of rebuilding their supply chains. Besides, the rise of new delivery and fulfillment options such as "click & collect" and on-demand delivery is also putting a strain on the supply chains of retail operators.

4. Success of business transformation is obscure

Despite the huge investments made in transformation and upgrading of business operations, not many retail operators have obtained satisfactory results; some new business models are unprofitable and unsustainable. Indeed, many retailers have put overwhelming emphasis on hardware upgrading and excessive investment in in-store retail technologies, but have neglected the needs to improve merchandise mix, provide personalized services and unique brands and products to attract customers.

V. Concluding remarks

2018 is a transformative and challenging year for China's retail sector. Internally, the retail landscape has evolved drastically in accordance with changes in consumer new buying preferences. Chinese consumers today are more knowledgeable, inquisitive and tech-savvy, and demand convenience and seamless shopping experience with multiple shopping channels – bricks-and-mortar stores, online, mobile, and social media. Against the new retail backdrop, brands and retailers need to be innovative and bold to embrace change; they have to come up with new business models that can satisfy the new needs of customers and enrich their buying experience. Externally, the escalating China-U.S. trade war inevitably will affect China's economy and affect consumer spending. We expect the negative impact of trade war will drive demand for many commodities and services down in the coming year. China's retail sector is expected to see single-digit retail sales growth in the coming years. Businesses are advised to further broaden their business scopes and income streams, while looking for opportunities in other countries.



Spotlight on China Retail – Issue 2

E-commerce

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

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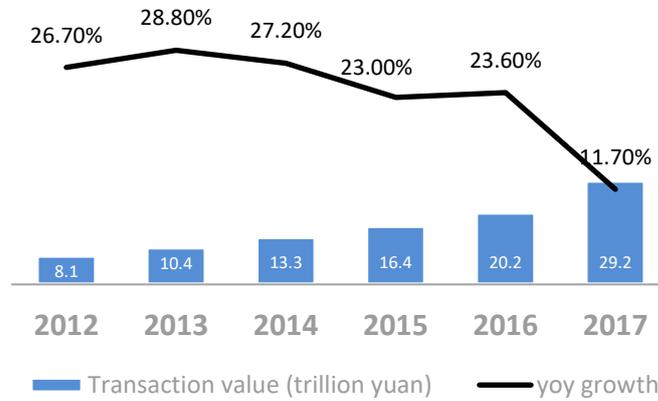
China's e-commerce sector has and will continue to attract the world's attention with its explosive growth and transformative effect on the retail landscape. Changes in consumer preferences and the emergence of innovative technologies and new business models have provided a strong impetus for the growth of the sector. In recent years, e-commerce is increasingly intertwined with physical retailing. Many retailers and brands have ventured into omnichannel retailing or online-to-offline (O2O) integration. Physical retailers have ramped up efforts to improve their digital platforms, while growing numbers of online retailers and e-commerce players have opened offline stores or partnered with offline retailers to provide better shopping experience. At the same time, new e-commerce business models are quickly evolving to cater the new consumer demand.

I. Market overview

1. China's e-commerce market scales up

The e-commerce market in China has continued to grow rapidly and became a major growth driver of China's economy. According to the Ministry of Commerce (MOFCOM), the total transaction value of China's e-commerce market reached 29.2 trillion yuan in 2017, up 11.7% year-on-year (yoy) (Exhibit 1).

Exhibit 1: Transaction value of China’s e-commerce market, 2012 – 2017

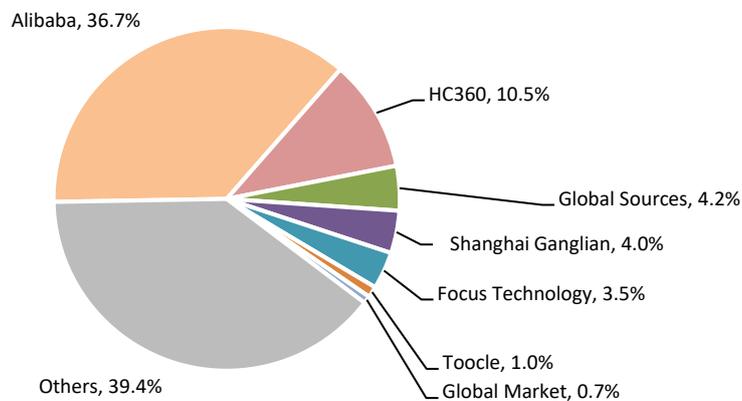


Source: MOFCOM; compiled by Fung Business Intelligence

2. SME’s B2B represents the lion’s share of total transaction value of China’s e-commerce market; Alibaba remains the most popular SME’s B2B platform

Small and medium-sized enterprise (SME)’s B2B platform plays an important role in connecting manufacturers and industrial buyers and sellers online. It offers a more convenient and time-saving way of conducting business for many SMEs. According to 100ec, among the SME’s B2B platform players, the most popular ones include Alibaba, HC360, and Global Sources, accounting for 36.7%, 10.5%, and 4.2% of the total market share respectively in 2017 (Exhibit 2).

Exhibit 2: Market share of China’s major SME’s B2B operators by revenue, 2017



Source: 100ec; compiled by Fung Business Intelligence

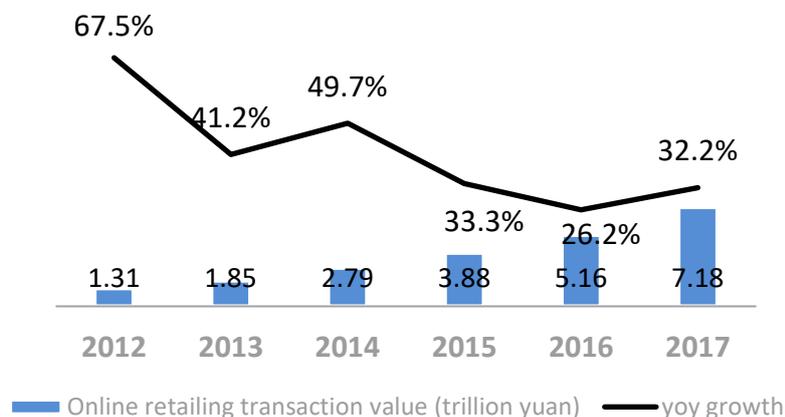
With the competition among SME's B2B platforms getting tougher, it is increasingly difficult to stand out from the competition by solely providing matching services for buyers and sellers. Hence, many SME's B2B platforms are actively moving from purely matching businesses to providing value-added services such as logistics, payment, and financial services. Some SMEs are also collaborating with searching engines, social media platforms, third-party payment providers, etc. to create a one-stop solution along the supply chain. Pursuing mobile strategies has been one of their focuses in recent years.

3. B2C and C2C markets continue growth momentum

Transaction value of online retail market enjoys resilient growth

China's online retail market, which comprises the B2C and C2C segments, is the largest in the world; it has shown resilient growth despite the slowing economy. According to the National Bureau of Statistics of the PRC (NBS), the transaction value of China's online retail market increased 32.2% yoy to reach 7.18 trillion yuan in 2017 (Exhibit 3). Of this transaction value, the online retail sales of goods amounted to 5.48 trillion yuan, up by 28.0% yoy, accounting for 15.0% of the total retail sales of consumer goods.

Exhibit 3: Transaction value of China's online retailing market, 2012 – 2017

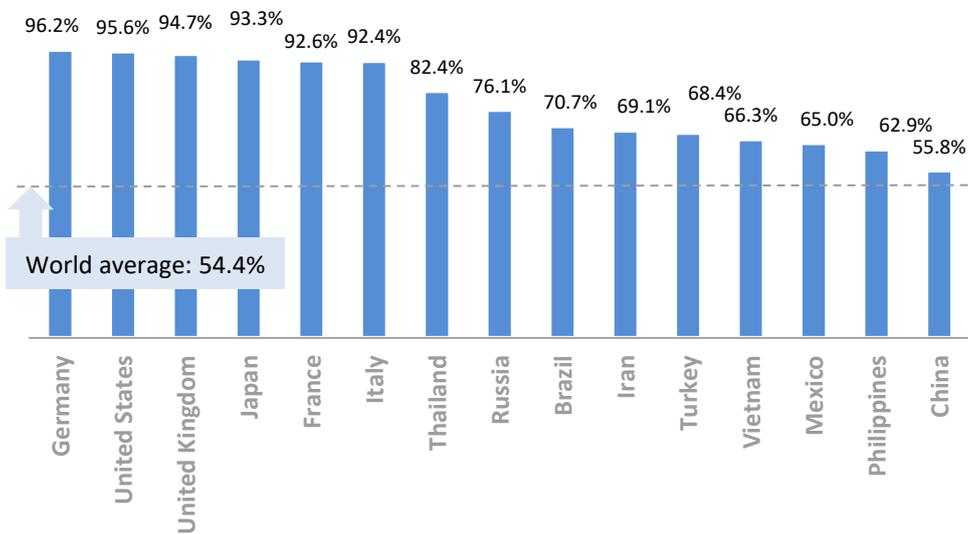


Source: National Bureau of Statistics of the PRC, Ministry of Commerce; compiled by Fung Business Intelligence

China’s huge Internet population drives online sales growth

The fast growth of the online retail market is attributable mainly to China’s large population of Internet users and the early adoption of online shopping by Chinese consumers. China has the world’s largest number of Internet users and online shoppers, contributing significantly to the phenomenal growth of the sector. As of December 2017, there were 772 million Internet users in China, of which 533 million were online shoppers. Internet penetration rate in China was 55.8% as of December 2017, while Germany, U.S., U.K., Japan, France and Italy have Internet penetration rates of over 90% (Exhibit 4). China still lags behind many countries in terms of Internet penetration, reflecting the high growth potential of the market. The number of Internet users in China further increased to 802 million as of June 2018, with 569 million online shoppers; while 788 million people use mobile phones to access the Internet; of these, 557 million are mobile online shoppers.

Exhibit 4: Internet penetration rates of selected countries, December 2017

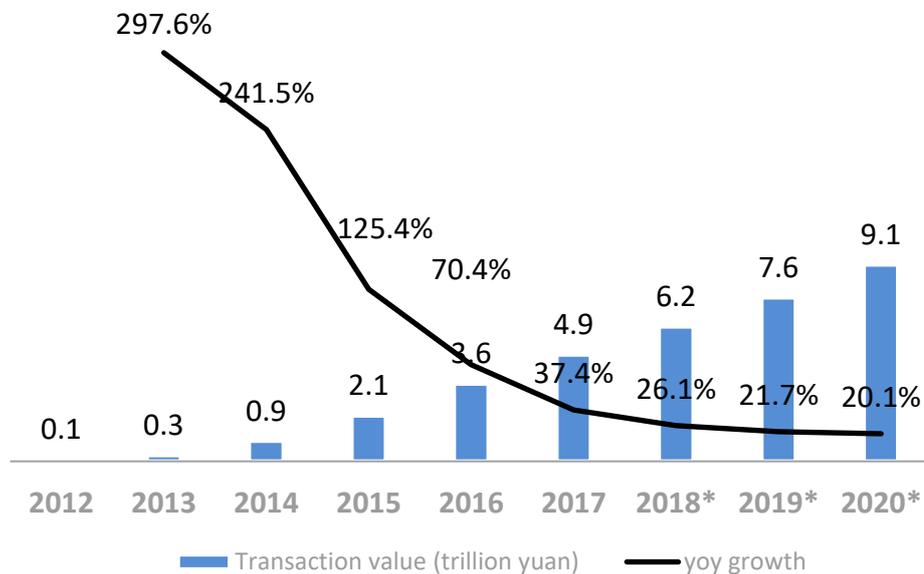


Source: Internet World Stats; China Internet Network Information Center; compiled by Fung Business Intelligence

M-commerce takes the lead

Chinese consumers have been overwhelmingly using mobile devices to access the Internet. According to the China Internet Network Information Center (CNNIC), 788 million people use mobile phones to access the Internet as of June 2018; of these, 569 million are mobile online shoppers. Penetration rate of mobile shopping increased to 70.7% in June 2018. Mobile commerce (m-commerce) has gained market share at the expense of PC-based transactions over recent years. The rise of budget smartphones, such as Huawei, Oppo, and Vivo, has brought mobile connectivity to most parts of China. With the aid of mobile devices, consumers can have real-time interactions with retailers, and enjoy convenient shopping experience anytime and anywhere. The mobile platform is now a highly significant sales and market channel. 81.3% of the online shopping transactions were made on mobile devices in 2017 and total transaction value of mobile shopping reached 4.9 trillion yuan (Exhibit 5). The total transaction value of mobile shopping is estimated to exceed 6 trillion yuan in 2018.

Exhibit 5: Transaction value of mobile shopping, 2012 – 2020 (estimates)



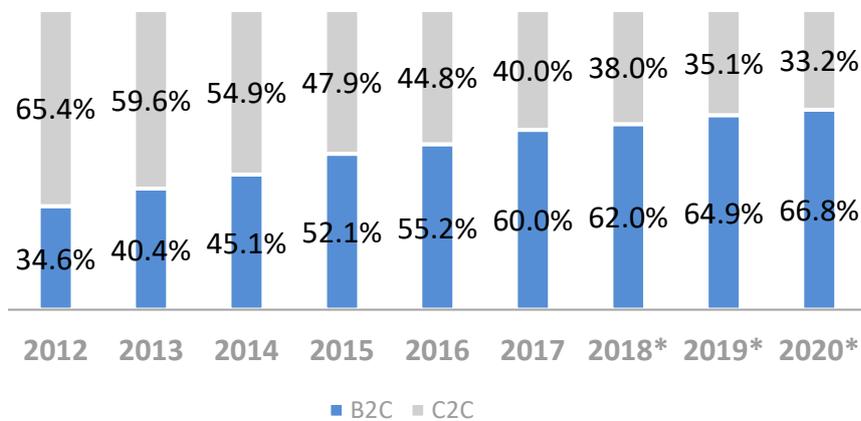
Source: iResearch; compiled by Fung Business Intelligence

* Estimated figures

Share of B2C segment increases steadily; Tmall remains the market leader

According to iResearch, the B2C segment has exceeded the C2C segment in terms of market share. In 2017, B2C and C2C segments accounted for 60.0% and 40.0%, respectively, of the total transaction value of online retailing in China (Exhibit 6).

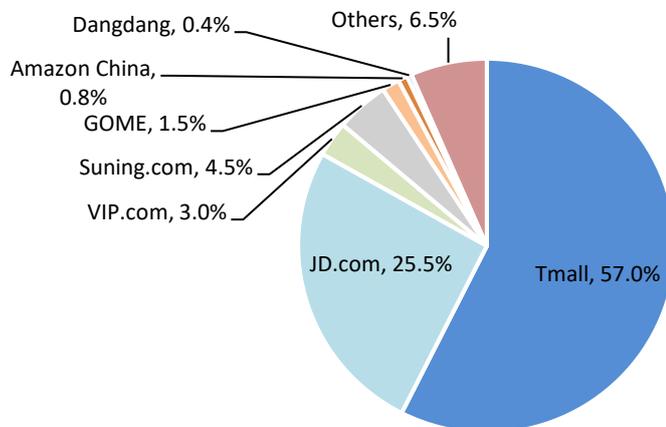
Exhibit 6: Market structure of online retailing in China: C2C vs B2C, 2012 – 2020 (estimates)



Source: iResearch; compiled by Fung Business Intelligence
 * Estimated figures

In 2017, Tmall remained the leader in the B2C market; accounting for 57.0% of the total market, followed by JD.com with 25.5% market share (Exhibit 7).

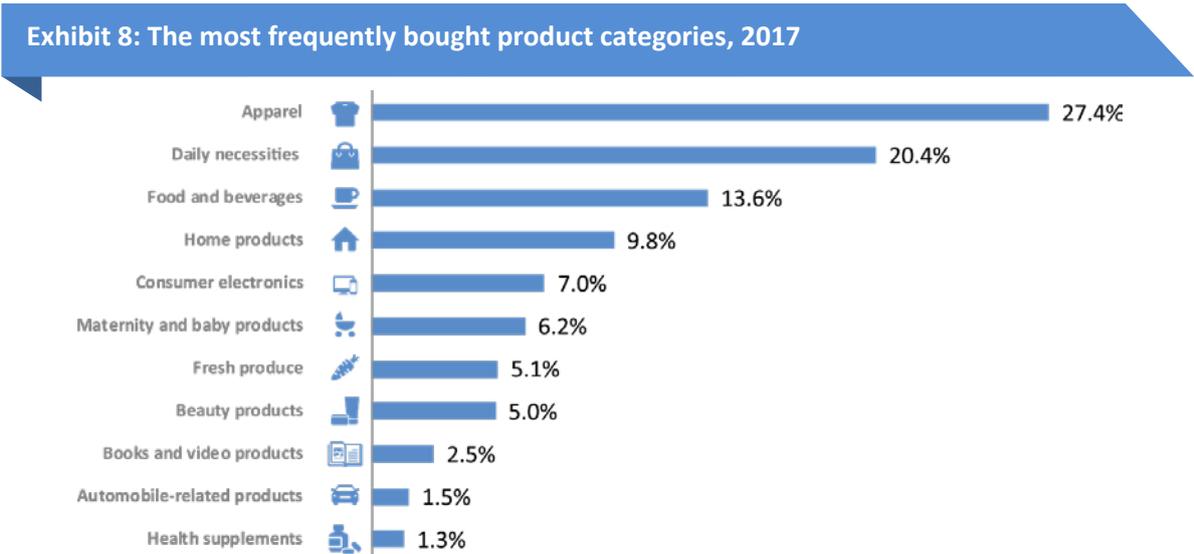
Exhibit 7: Market share of top B2C players, 2017



Source: MOFCOM, iResearch; compiled by Fung Business Intelligence

Apparel and daily necessities are the most frequently categories bought online

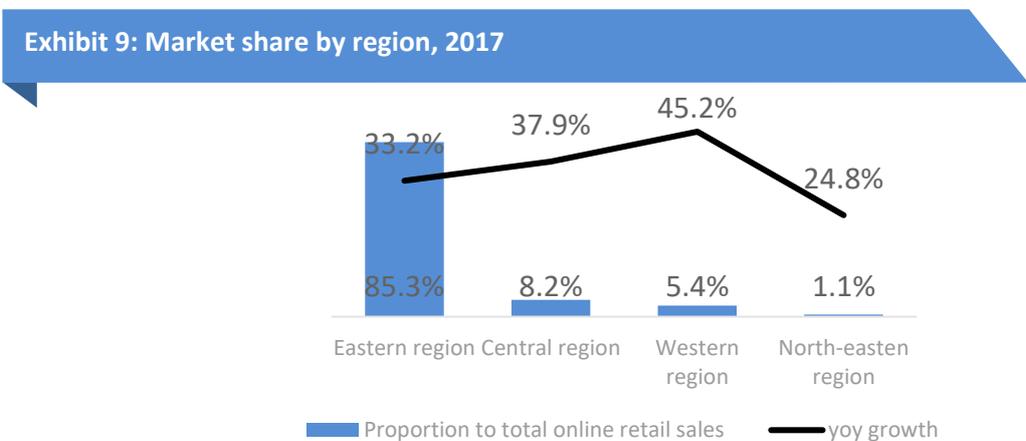
According to iResearch, apparel and daily necessities were the two most frequently bought categories online in 2017, accounting for 27.4% and 20.4% of the market share respectively, followed by food and beverages (13.6%) and home products (9.8%) (Exhibit 8).



Source: iResearch; compiled by Fung Business Intelligence

Eastern China dominates in terms of online transactions made

According to the MOFCOM, Eastern China accounted for 85.3% of the total online retail sales, much higher than Central China (8.2%), Western China (5.4%) and Northeast China (1.1%). Among the provinces in Eastern China, online transactions made in Guangdong, Zhejiang, Shanghai, Beijing and Jiangsu accounted for 74.8% of the total. (Exhibit 9).

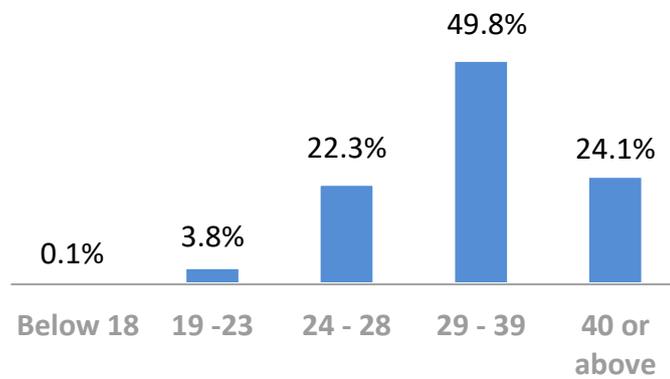


Source: MOFCOM; compiled by Fung Business Intelligence

Young consumers are the major driving force for the e-commerce market

Online shopper aged between 19 and 39 accounted for over 70% of the total in China (Exhibit 10). They grew up with the Internet and embraced the Internet more wholeheartedly than the older generations.

Exhibit 10: Online shoppers by age group, May 2018

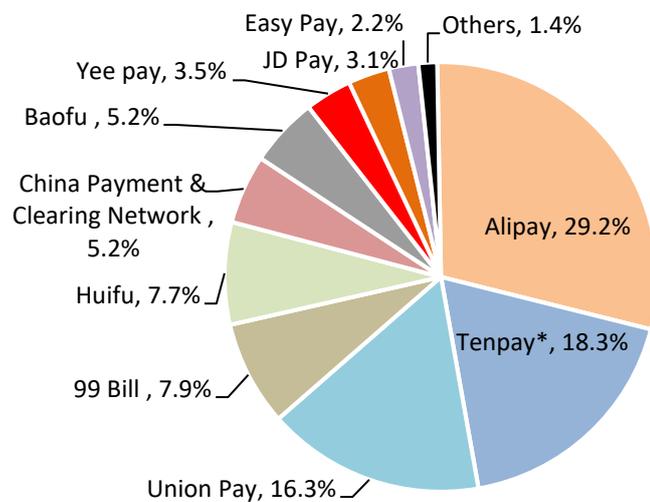


Source: iResearch; compiled by Fung Business Intelligence

4. Widespread use of third-party online payment and mobile payment drives the growth of e-commerce market

The widespread use of third-party online payment and mobile payment has driven the growth of China's e-commerce market. In 2017, third-party online payment services in China achieved a total transaction value of 15.5 trillion yuan, soaring 44.3% yoy from 2016 according to iResearch. There are three major categories of third-party payment companies, including (1) Internet companies' online payment channel (e.g., Alipay, Tenpay); (2) companies from traditional financial institutions (e.g., UnionPay Online); and (3) pure third-party online payment companies (e.g., Yeepay). Currently, the third-party payment market in China is dominated by Alipay¹, followed by Tenpay² and UnionPay Online³ (Exhibit 11). According to a research by Tencent and Ipsos Research in August 2017, more than 52% of Chinese use cash for only 20% or less of their monthly consumption.

Exhibit 11: Market share of third-party online payment services, 3Q17



Source: iResearch; compiled by Fung Business Intelligence

* Note: includes WeChat Pay and QQ Wallet

II. Key trends and developments

1. E-commerce giants strive to increase offline presence and expand their ecosystems

With the rise of omnichannel retailing, on the one hand, bricks-and-mortar retailers are pursuing digital expansion to provide seamless shopping experience for customers; on the other hand, e-commerce giants are actively penetrating offline retailing with the idea of perfecting their physical networks and further expanding their business ecosystems.

Recently, Alibaba and JD.com, in particular, have accelerated the pace of their offline expansion by merging with or acquiring physical retailers. Both Alibaba and JD.com hope to build an all-encompassing business ecosystem that fully blends online and offline channels so as to become ubiquitous and indispensable in the daily life of all Chinese consumers.

Alibaba

Alibaba Group is the largest online and mobile commerce company in the world in terms of gross merchandise volume (GMV), reaching 3,767 billion yuan in 2017. Alibaba has started to make sizable investments in China's physical retail sector in 2015, when it took a 19.99% stake in electronics retailer Suning.com. Thereafter, the company unveiled the "New Retail" concept that calls for the seamless integration of online and offline retail to better serve customers through digital and mobile technology. Since then, Alibaba has invested billions in companies around the world – home appliances chains, grocery chains, shopping malls and home products industry, covering almost every retail formats. Nowadays, Alibaba Group is composed of dozens of business entities, including online payments, cloud services, mobile apps, mobile operating systems, maps, retail outlets, group buying, cloud storage, mobile messaging, car service, music streaming and much more (Exhibit 12).

JD.com

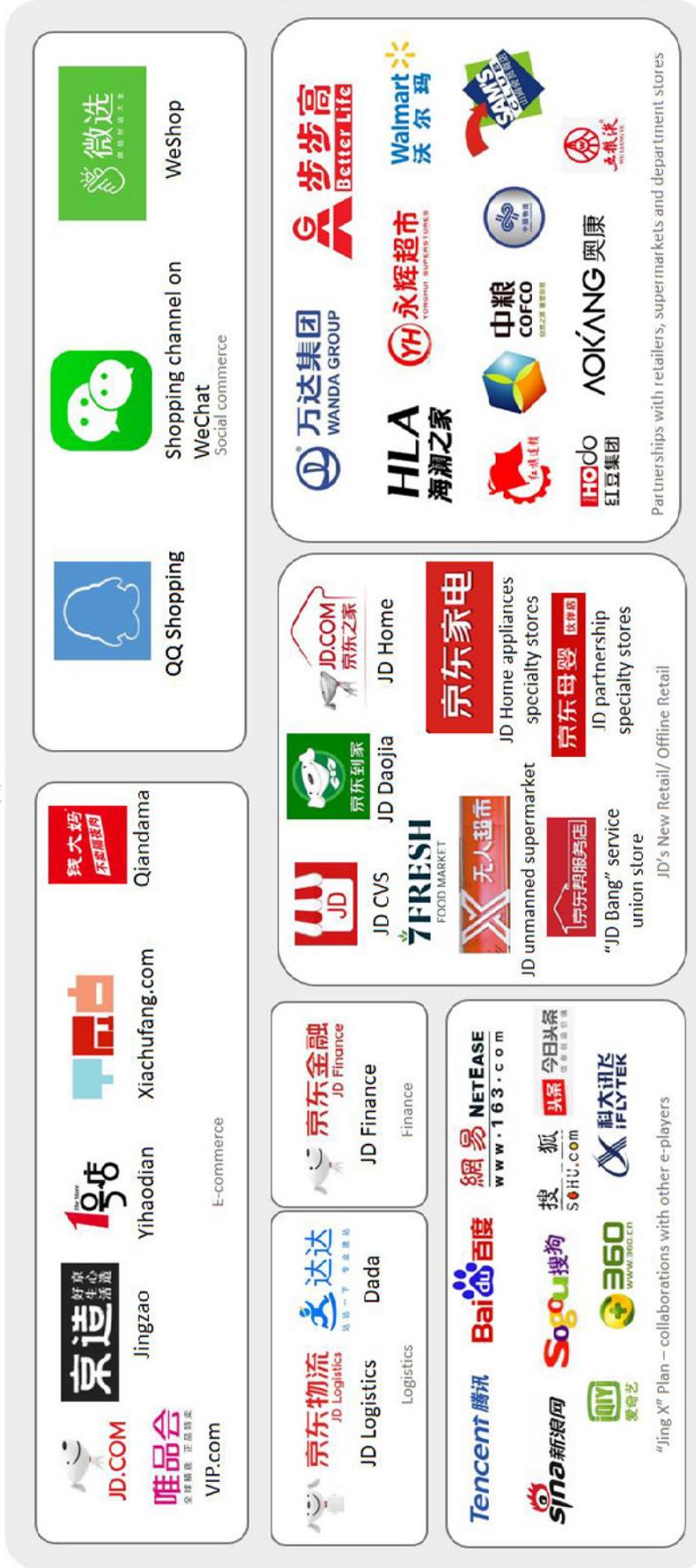
Taking a similar approach as Alibaba, its biggest rival JD.com is also pursuing a similar strategy under the banner of "Unbounded Retail". JD.com has also been aggressively expanding its scope of business and ecosystem through forming partnerships with companies in various sectors. For instance, through in-depth cooperation with different media platforms such as Tencent, Baidu and NetEase, JD.com hopes to capture more customers and obtains big data of consumers from the new access points of the popular media channels. Besides, JD.com has launched 7FRESH, JD Unmanned Supermarket, JD Convenience Store, etc. as part of its bricks-and-mortar and smart retail strategy. Through its collaboration with Tencent, JD.com has also tapped into the social e-commerce arena. Besides, it has partnered with VIPshop and Yihaodian for resources integration, and formed alliances with apparel brands such as HLA and Hodo Group to build an apparel ecosystem (Exhibit 13).

Exhibit 12: Alibaba's ecosystem (key selected business arms and units)



Source: Fung Business Intelligence

Exhibit 13: JD's ecosystem (key selected retail entities under JD.com)



Source: Fung Business Intelligence

2. Social-commerce becomes increasingly popular, especially in lower-tier cities

Social commerce has come into China's e-commerce scene in recent years. Eying the high level of consumer penetration by social media platforms such as WeChat, Weibo, various live-streaming and short video platforms, brands and retailers are trying to sell via these social media channels and transform shopping into a much more entertaining and recreational experience. In recent years, many brands have set up stores on WeChat Mini Program to promote and sell their products. Carrefour China revealed that the number of Carrefour WeChat Mini Program users has exceeded 8 million in August 2018, and is set to continue to grow rapidly.

Meanwhile, the online group-buying market – which mainly leverages on spending via social media platforms – has gained increasing attention in recent years. Pinduoduo, a popular social commerce/ group-buying platform, is a case in point. Founded in September 2015, Pinduoduo reaches out to customers via its own app and WeChat Mini Program. It provides group buying offers at reduced prices through its unique “team purchase” model; shoppers can join or initiate a team purchase, and invite their friends on WeChat to join to enjoy lower prices and further discounts. Pinduoduo's unique social approach to e-commerce has underpinned its growth, especially in lower-tier cities and rural areas. According to eMarketer, as of April 2018, it has risen to become the third largest e-commerce player in China with 5.2% market share, following Alibaba (58.2%) and JD.com (16.3%). Pinduoduo was listed on NASDAQ Stock Market on 26 July, 2018, raising US\$1.63 billion. The deal is one of the largest Chinese tech IPOs of the year in the U.S.

JD.com also set up a group buying platform “JD Pingou” in June 2018, allowing individual merchants to set up stores to sell their products. At present, the categories that have been opened to individual merchants include apparel and underwear, sportswear, footwear, jewelry, watches, home textiles, and home furnishings. JD Pingou aims to leverage group-buying and social-selling among merchants on JD.com to drive more foot traffic and generate sales. Alipay also launched a group-buying function on Alipay's homepage in August 2018. It offers group-buying deals within limited time, and the deals will be changed regularly. The goods from the group-buying offers come from different Taobao merchants, covering more than ten categories including daily necessities, food, and apparel. Prices for the group-buying offers are generally lower than the prices on Taobao; some of the offers may have discounts as low as 50%. Consumers can either initiate a group-buying deal and ask their friends to join, or they can simply join the deals that are set up by others. Taobao will also recommend deals to users according to their purchasing behavior on the platform.

3. Short video platforms facilitate digital marketing

Short video streaming platforms have become an increasingly popular channel for marketing. For instance, Suning launched its short video streaming platform “Touhao Maijia” in August 2018. The new channel is an exclusive channel for customized products, with different themes for buyers periodically. By integrating resources of brands and retailers, media, and veterans into one single platform, Internet KOLs and individual sellers can recommend products through video streaming, while viewers can share easily among their friends. The channel will cover various product categories including beauty, home products, baby and maternity products, FMCG and home appliances. Taobao also launched its short video app “Luke” in September 2018. Luke is a short video app focusing on customers’ sharing of their shopping experience, which in turn will inspire others to discover new and innovative products, people and things. It offers shopping guidance for users and supports real-time interaction between users and their viewers. Users can post questions in their short videos, viewers can answer the questions or they can share the questions to other viewers. The short videos on the platform are usually 15-20 seconds long; some of them may direct the viewers to the Taobao shopping websites.

At the same time, some brands are leveraging popular third-party short video platforms such as Douyin to market their products. Douyin is now available in over 150 countries and regions; it has become one of the most popular short video apps among the youngsters globally especially in Asian countries such as Thailand, Japan, Indonesia, India and Vietnam. To reach out to more young consumers, brands are collaborating with Douyin to promote and market their products. Many renowned global brands such as Michael Kors, Adidas neo and Dior have launched marketing campaigns on Douyin. For example, in November 2017, Michael Kors initiated a “City catwalk” hashtag challenge by sharing videos of its brand ambassadors Yang Mi and Mark Chao, as well as three Douyin in-house KOLs doing a catwalk with Michael Kors products. It is estimated that more than 30,000 users had posted their own 15-seconds catwalk videos using the hashtag, generating more than 200 million views and 85 million “likes” from the viewers.



Michael Kors launches “Hashtag challenge” campaign (Photo source: digitaling.com)

4. E-commerce players and Internet giants launch their own private labels

Along with the trend of consumption upgrading, more and more e-commerce companies and Internet giants have taken bold initiatives to launch their own private labels in order to offer consumers quality, premium and personalized products and services. Key players such as NetEase, Alibaba, JD.com, Tencent, Xiaomi, Mia.com and Suning.com have launched their private labels one after another, while some of them have even set up physical stores to sell their own private labels. Many of these private labels focus on lifestyle products, targeting mainly young consumers who look for high quality products with good design and value. They often market their private label products as made by manufacturers of big brands via the ODM (Original Design Manufacture) model.

NetEase Yanxuan is a prime example. It is an e-commerce private label launched by Internet company NetEase in 2016. With a slogan of “a better life doesn’t have to be costly”, NetEase Yanxuan is dedicated to help build a more affordable yet quality life to young consumers. Its portfolio now covers over 10,000 products across ten categories, ranging from home products, home textiles, kitchen ware and household appliances to daily life consumption products such as body & hair care, basic items of apparel, among others. NetEase adopts the ODM model through which it partners with big manufactures to design and produce the products.

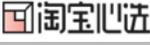
Similarly, Alibaba launched its own private label retail site Taobao Xinxuan in 2017 and opened its first offline concept store in Hangzhou in April 2018, the second store in Shanghai in June and the third one in Wenzhou in August. The stores sell mainly lifestyle and functional daily necessity goods and travel accessories. JD.com also rolled out its own private label platform under the Jingzao brand in January 2018. But neither company has come close to Yanxuan in terms of scale of the private labels. Another example is leading smartphone company Xiaomi. It launched an e-commerce marketplace Youpin by Xiaomi in April 2017 to offer Mi-branded products as well as other high-quality products curated and sourced by the company. Exhibit 14 shows selected examples of private labels launched by e-commerce players and Internet giants and Exhibit 15 summarizes their business models and key features.

Exhibit 14: Selected examples of private labels launched by e-commerce players and Internet giants



Source: Fung Business Intelligence

Exhibit 15: Key business models and features of private label businesses of selected e-commerce operators (As of September 2018)

	 Yanxuan	 Taobao Xinxuan	 Jingzao	 Youpin by Xiaomi
Launched by	NetEase	Alibaba	JD.com	Xiaomi
Launched date	April 2016	May 2017	January 2018	April 2017
Number of offline stores	1	3	Dedicated sales areas inside 1,000 JD Home and JD Home Appliance stores	1
Store locations	Hangzhou	Hangzhou, Shanghai, Wenzhou	Nationwide	Nanjing
Business models	ODM	Self-operated platform + C2M business model	ODM	Third-party platform + Investment (companies within Xiaomi's ecosystem)
Product sources	Manufacturers serving top brands	Sourced by Alibaba	Trusted manufacturers from different sectors	Mi-branded products; products from companies in Xiaomi's ecosystem; third-party brands
Brand owner	Yanxuan	Taobao Xinxuan	Jingzao	Encourage independent development of third-party brands, with brand names clearly marked on products
Product features	High-quality, value for money lifestyle products	Low price lifestyle products	High-quality and good value products and mass products with good quality	Value for money, tech-focused, stylish products
Product categories	Over 10,000 SKUs covering 10 categories (e.g. home products, kitchen products, apparel, electronic appliances, personal care products)	Over 100 SKUs covering 6 categories (e.g. home products, kitchen products, personal care products)	7 categories including home products, apparel, home electronics, kitchen products, personal care products, food and beverage	2,000 SKUs covering 15 categories (e.g. smartphones, home products, kitchen products, smart products, personal care products)
Logistics	SF Express; JD Logistics	Cainiao	JD Logistics	SF Express; JD Logistics

Source: 100ec; modified and compiled by Fung Business Intelligence

5. E-commerce players on expansion spree overseas

In a move to expand their global presence, some large-scale Chinese e-commerce players are actively investing in overseas markets. Recently, JD Central (<https://www.jd.co.th/>), a joint venture between JD.com and Thailand's Central Group, was launched on June 2018, marking the formal entrance of JD.com into the Thai market. It is reported that JD.com will soon cooperate with other ACMECS countries (Thailand, Laos, Vietnam, Cambodia and Myanmar) to operate e-commerce platforms. The five ACMECS countries are located in the center of southern Asia and possess abundant labor resources and high-quality specialty products. JD.com said that it plans to share its knowledge in running online platforms, logistics and financial services to all ACMECS countries over the next two years.

Besides serving overseas consumers, JD.com has also been working on the sourcing side to import more high-quality overseas products into China. In September 2018, JD Worldwide established offices in Tokyo and Seoul. The offices are responsible to maintain cooperation with overseas brand owners and JD Worldwide; it will also find more overseas brands which would like to sell in the China market. JD Worldwide's sourcing capacity in Japan and South Korea is expected to increase after the establishment of the overseas offices.

Similarly, Alibaba has also stepped up overseas investment. In May 2018, Alibaba acquired DARAZ, the Pakistan e-commerce website owned by the European Internet incubator company Rocket Internet. The acquisition allows Alibaba to gain a foothold in the rapidly growing South Asian consumer market and further its expansion overseas. Alibaba said that after the completion of the acquisition, Daraz will continue to maintain the operation with its original brand name. Daraz was established in 2012 and has now become Pakistan's most popular online shopping platform. Earlier in March 2018, Alibaba injected a further US\$2 billion into Lazada as part of the group's ongoing effort to accelerate Southeast Asia's e-commerce development and to deepen Lazada's integration into the Alibaba ecosystem. This brings Alibaba's total investment in Lazada to US\$4 billion in total. In 2016, Alibaba acquired control of Lazada with an investment of US\$1 billion; it further boosted its stake to 83% in 2017 with another investment of US\$1 billion. Lazada is a Southeast Asian online shopping giant which operates in Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam. In terms of logistics, Alibaba's logistics arm Cainiao is connected to near 300 warehouses in 224 countries and regions and is able to deliver packages to Russia, France, Spain, the Netherlands and many South-East Asia countries within 72 hours.

6. Rural e-commerce continues to thrive

China's rural e-commerce has become a new growth engine for e-commerce in China with the near saturation of urban e-commerce. In June 2018, the number of Internet users in the rural area rose to 211 million, accounting for 26.3% of the total Internet population, down from 27.0% in December 2017, according to CNNIC. The decrease in rural Internet population was due to the continual urbanization process in China. According to the China e-Business Research Center, the transaction value of rural online market is estimated to reach 1,245 billion yuan in 2017, up 39.1% yoy. Of which, online sales of physical goods accounted for 62.9% of the total, reaching 782.66 billion yuan, up 35.1% yoy; online sales of services accounted for 37.1% of the total, reaching 462.2 billion yuan, up 46.6% yoy. There are over 9.856 million rural online shop by end-2017, up 20.7% yoy.

The growth potential of the rural e-commerce market relies critically on the development of rural logistics and infrastructure. In recent years, some leading e-commerce players and Internet companies have increased efforts to expand their distribution network in rural areas. For instance, Alibaba launched its Rural Taobao initiative in October 2014 to create a network of e-commerce service centers in rural areas to provide services that enable villagers to purchase goods online, as well as sell their goods. As of July 2017, Rural Taobao already covered over 700 counties. Alibaba announced in June 2018 that it aims to expand the coverage of Rural Taobao to 1,000 counties and 150,000 villages across China in the next three years. JD.com, on the other hand, announced in June 2018 that in the next five years, it targets to open 1 million JD Convenience Stores, of which half of them will be in rural areas.

The government has been very supportive of the development of rural e-commerce. In May 2018, the Ministry of Finance issued the *Notice on launching comprehensive demonstration work of e-commerce in rural areas in 2018*. The Notice states that the government will continue to support the development of rural e-commerce by injecting more capital, as well as nurturing various leading counties as demonstration base to lead the development of rural e-commerce nationally. It is expected that rural e-commerce will continue to be a focus of the government in the coming years.

7. Internet and e-commerce players resort to IPO to raise capital

Several leading e-commerce players have sought IPO outside China to raise fund for expansion and product development. Exhibit 15 shows some prominent examples. Other IPOs in the pipeline include Alibaba-backed parenting online portal Babytree Inc. and leading fashion e-commerce platform Meili Inc. The former has filed for an IPO in Hong Kong in June 2018, and the latter Meili Inc. has also submitted confidential filings to the U.S. Securities and Exchange Commission in the same month for an IPO that could raise up to US\$500 million.

Exhibit 16: Selected IPOs of Chinese Internet and e-commerce players, 2018

Company	Date	Capital raised	IPO location	Details
Xiaomi	9 Jul, 2018	US\$4.7 billion	Hong Kong Stock Exchange	Xiaomi will use the proceeds to invest into its ecosystem in certain product areas, support global expansion and promote research and development. Currently, Xiaomi is the world's fourth-largest smartphone company, achieving over 100 billion yuan in annual revenue in 2017.
Pinduoduo	26 Jul, 2018	US\$1.63 billion	NASDAQ	The deal is one of the largest Chinese tech IPOs of the year in the U.S. The funds raised will be used mainly to expand the company's business operation, promote research and development, and enhance its technology infrastructure.
Meituan-Dianping	20 Sep, 2018	Around US\$48.3 billion	Hong Kong Stock Exchange	Meituan-Dianping will use around 35% of the funds raised from the IPO to upgrade its technology, around 35% to develop new products and services, 20% to make acquisitions and investments, and 10% for general operation.

Source: Internet resources, compiled by Fung Business Intelligence

8. China's first E-commerce Law launches

On 31 August, the National People's Congress (NPC) Standing Committee passed the E-commerce Law, which is to take effect on 1 January, 2019. The E-Commerce Law is formulated to safeguard the legitimate rights and interests of all parties involved in e-commerce, regulate e-commerce practices, maintain the sound order of the market, and foster the further development of e-commerce in a manner that is sustainable and healthy. The E-Commerce Law includes seven chapters with a total of 89 articles, which specifies regulations concerning e-commerce operators, contracts, dispute resolution and legal responsibilities involved in e-commerce operation.

The law puts more emphasis on the duties and obligations of e-commerce operators, while strengthening protection for consumers. In particular, e-commerce platform operators are required to assist with real-name registrations of intra-platform operators, to ensure cybersecurity, to guard the safety of the person and property of consumers, and to protect intellectual property, among other responsibilities. The law bans e-commerce operators with dominant market positions from excluding or restricting competition. Platform operators who unreasonably restrict transactions on their platforms may face a penalty of 500,000 yuan, or up to 2 million yuan in serious cases. A penalty of the same range may also be applied to platform operators if they fail to take necessary steps against IPR infringement by merchants on their platforms that they are aware of or should be aware of.

In terms of consumer protection, the law stipulates that e-commerce operators must follow related laws and regulations when collecting and using consumers' personal information. For instance, when sending advertisements to consumers, e-commerce operators shall abide by relevant provisions in the Advertising Law of the People's Republic of China. E-commerce operators are prohibited from fabricating reviews to deceive or mislead consumers. They must clearly point out tie-in sales to consumers.

To support the sound and sustainable development of the e-commerce sector, the law states that operators engaging in cross-border e-commerce (CBEC) should abide by laws and administrative regulations regarding import and export, given the rising numbers of complaints related to CBEC transactions. The law also touches upon green consumption; it says that the State Council, local governments at or above county-level as well as related departments should take measures to support and promote environmentally friendly packaging, storage and transportation in e-commerce.

III. Concluding remarks

China's e-commerce sector is growing very fast compared to most of the rest of the world. The explosive development is driven largely by its mobile-first consumer base, fast adoption of new technologies and new business models, and prevalence of mobile payment in the country. This will continue to provide tremendous opportunities for players in the sector.

E-commerce in China is intertwined greatly with physical retailing as O2O integration is at the heart of many e-commerce operators and Internet giants. Increasing numbers of players are investing heavily in merging the online and offline world, while relentlessly building their ecosystems. Many of them are actively expanding their offline reach by partnering with physical retailers. The O2O trend is set to continue and shape the development of the sector moving forward. Meanwhile, the ongoing consumption upgrading among rural consumers will produce ample opportunities for rural e-commerce businesses. We expect e-commerce operators to further increase their presence in the fast-growing rural market.



Spotlight on China Retail – Issue 3

Department stores

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

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Against the backdrop of China's supply-side structural reforms coupled with the unprecedented growth of e-commerce over the past years, the department store sector has made relentless efforts to transform and adjust to keep pace with China's economic and social changes, be it hardware and stores upgrade, merchandise and service refinement, supply chain integration, business models and operation system restructuring. In the past year, the sector as a whole has started to reap the benefits of business upgrading and transformation. Sales of some leading players have improved, while the emergence of new retail formats have been welcomed by customers.

I. Market overview

1. Stable sales of department store operators

China's department store sector witnessed a positive and stable growth in the past year. According to the National Bureau of Statistics of the PRC (NBS), the retail sales of department stores of retail units above a designated size (enterprises with annual sales of 5 million yuan or above and with employee strength of 60 or more) increased by 4.6% yoy in 1H18. Statistics from the Ministry of Commerce (MOFCOM) also show that the yoy growth of 5,000 key retailers reached 4.6% in 1H18, with department stores accounting for 4.5% yoy.

A report by Linkshop shows that the department store sector as a whole has started to reap the benefits of business upgrading and transformation. Sales of some leading players improved significantly in 2017, while the emergence of new retail formats have been welcomed by customers. Linkshop's study, based on the 2017 financial statements of 56 listed department store operators in China, shows that the listed department store operators

achieved an operating income of 484.655 billion yuan in 2017, and the total net profit attributable to shareholders of the listed companies was 15.838 billion yuan. Overall, 36 out of the 56 listed companies saw rising revenue; 33 companies recorded an increase in net profit, of which 24 companies recorded increase in both revenue and net profit, and 10 companies recorded decline in both revenue and net profit. As shown in Exhibit 1, eight out of the top 10 best performing department store operators experienced different degrees of positive operating income growth (Exhibit 1).

Exhibit 1. Top 10 best performing department store operators in terms of operating income in 2017

Rank	Department store operators	Operating income in 2017 (billion yuan)	yoy change (%)
1	 Shanghai Bailian Group Co.	47.18	0.22
2	 Chongqing Department Store Co., Ltd.	32.92	-2.75
3	 CCOOP Group Co., Ltd.	27.79	91.52
4	 Dashang Group Co., Ltd.	26.74	-4.79
5	 Wangfujing Department Store (Group) Co., Ltd.	26.09	11.09
6	 Rainbow Department Store Co., Ltd.	18.54	7.31
7	 Wuhan Department Store Group Co., Ltd.	18.12	2.44
8	 Nanjing Xinjiekou Department Store Co., Ltd.	17.96	5.68
9	 Golden Eagle Retail Group Ltd.	17.23	5.10
10	 Shanghai Yuyuan (Group) Co., Ltd.	17.11	9.39

Source: Linkshop; compiled by Fung Business Intelligence

According to the survey conducted by the China Commerce Association for General Merchandise (CCAGM), 64.71% of the 85 surveyed department stores enjoyed positive yoy sales growth in 2017, while 35.29% witnessed a drop in sales revenue. Among those who have registered positive sales growth, 4.71% of the operators enjoyed exceptional sales growth of more than 20% yoy in 2017 (Exhibit 2).

Exhibit 2. Yoy changes in sales revenue of 85 surveyed department store operators, 2017

Yoy changes in sales revenue	Accumulated number of department store operators	Cumulative percentage
(i) >0%	55	64.71%
>20%	4	4.71%
>10%	9	10.59%
>5%	28	32.94%
(ii) <0%	30	35.29%
<-10%	24	28.23%
>-10%	6	7.06%
TOTAL (i) + (ii)	85	100.00%

Source: CCAGM; compiled by Fung Business Intelligence

2. New store openings continue

According to Linkshop's statistics on the store opening and closing patterns of 80 chain stores in China over the past two years, the number of newly opened department stores was still slightly more than that of department stores which were closed or revamped. In 2017, 46 department stores were closed down. These store closures happened mostly in the eastern region (15 stores), southwest region (11 stores) and northern region (seven stores). 55 department stores (including 2 non-chain department stores) were newly opened. Of which, 42 were located in the parent company's self-built shopping mall.

From a regional perspective, the new department stores opened in 2017 were mainly concentrated in the northern region and tier-4 and 5 cities. Tier-1 cities, on the other hand, due to matured economies and versatile consumption patterns, saw many department stores undergoing upgrading and transformation. Many key department stores operators such as Intime Retail (Group) Co. Ltd., Golden Eagle Retail Group Ltd., Liaoning Xinglong Big Family Business Group, Wangfujing Department Store (Group) Co., Ltd., Shanghai Bailian Group Co., and Parkson Retail Group Ltd. have put more focus on the development of shopping centers and outlets, and less on department stores. For example, Intime added seven shopping centers but only one new department store last year.

3. Transformation efforts have started to pay off

Against the backdrop of China's supply-side structural reforms coupled with the unprecedented growth of e-commerce, over the past year, the department store sector has made every effort to transform and adjust to keep pace with China's economic and social changes, whether through the upgrade of hardware and stores, the refinement of merchandise and services, supply chain integration, or the restructuring of business models and operating systems. The sector as a whole has started to reap the benefits. Some leading players such as Wangfujing Group and Rainbow Department Store recorded double digit growth in revenue and profit margins; while premium and high-end department store Beijing SKP achieved record-breaking sales proceeds in 2017, reaching 12.5 billion yuan, ranked second among the department store sector in the world. Despite facing keen market competition and rapidly changing consumer behaviors and spending mindsets, the department store sector has achieved remarkable progress in carrying out upgrading and transformation.



Beijing SKP Department Store (Photo source: Fung Business Intelligence)

4. Domestic players lead the department store sector

China's department store sector is dominated by domestic players. As shown in Exhibit 3, the top 10 department store operators in terms of total sales revenue are all domestic department store operators.

Exhibit 3: Top 10 department store operators among the Top 100s, 2017 (Ranked by retail sales)

Rank	Name of company	Sales, pre-tax (million yuan)		Number of stores	
		In absolute terms	yoy change (%)	In absolute terms	yoy change (%)
1	 欧亚集团 Changchun Eurasia Group Co., Ltd.	42,446	8.6	133	24.3
2	 武商集团 Wuhan Department Store Group Co., Ltd.	37,513	5.5	88	-1.1
3	 步步高 Better Life Co., Ltd.	37,094	15.4	645	9.3
4	 王府井百货 Wangfujing Department Store (Group) Co., Ltd.	33,720	21.7	56	5.7
5	 中百集团 ZHONGBAI GROUP Zhongbai Holdings Group Co., Ltd.	33,194	5.3	1130	10.1
6	 大商集团 DASHANG GROUP Dashang Group Co., Ltd.	31,289*	-4.8	148	-11.4
7	 北国百货集团 Shijiazhuang Beiguo Renbai Group Co. Ltd.	30,008	5.9	68	4.6
8	 RAINBOW 天虹 Rainbow Department Store Co., Ltd.	26,481	5.3	76	7.0
9	 利群 LIQUN Liqun Commercial Group Co., Ltd.	24,917	4.2	585	0.7
10	 家家悦 JIAJIAYUE Jiajiayue Group Co., Ltd.	24,900	4.5	681	5.7

Source: China Chain Store and Franchise Association; modified by Fung Business Intelligence

II. Key trends and developments

1. Pursuing omni-channel retailing

Omni-channel digitalization becomes mainstream

Nowadays in China's retail market, pursuing full online-to-offline (O2O) integration has become a leading trend for sector players. Many department store operators have been leveraging advanced technologies such as mobile Internet, big data, the Internet of Things (IoT) and even artificial intelligence (AI) to achieve omni-channel integration, namely seamless integration across physical stores, online platforms and mobile terminals, along with digital transformation.

Rainbow Department Store is the forerunner in business innovation and O2O model transformation. Since 2013, Rainbow has started to carry out business model innovation and put forward three strategic directions – "full O2O integration", "experiential consumption" and "vertical integration of value chain". Rainbow's O2O strategies emphasize on the seamless integration of the online and offline channels, and data sharing across marketing, payment and logistics systems. Rainbow has strategically implemented digitalization across all physical stores, while upgrading and remodeling its supply chain. Its inventory system, CRM system and merchandise system are managed on a centralized digital platform that is led by big data analytics. Since last year, Rainbow Department Store has put further emphasis on digitalization of their business model. In April 2017, the e-commerce division of Rainbow Department Store changed its name to Digital Business Center. According to Rainbow, by 1H18, it had more than 13.93 million online members; sales of "Rainbow Daojia" (Rainbow Home Delivery), a platform that provides express delivery service for products offered by Rainbow, increased by 280% yoy.

More customer-focused – master accurate customer data to achieve targeted marketing

Today, Chinese consumers are becoming increasingly sophisticated and highly connected. They demand increasingly convenient shopping options both on their smartphones and in physical stores. In order to offer customers a more efficient and flexible retail experience, many department store operators use data and technologies to accurately predict consumer needs and provide relevant products and services accordingly. They consider big data analytics and digitalization of operation management as crucial elements for success.

In recent years, Intime Retail Group has put considerable efforts in strengthening its membership system, aiming to master more accurate consumer data for better satisfying the needs of customers. In August 2017, Intime launched a paid membership program aiming to establish an interactive membership system, which collects customer data on both online and offline channels. Members enjoy discounts when shopping at Intime Department Stores. Based on

customers' purchasing history in-store, on Intime's mobile app and or its online store on Tmall, Intime could identify customers' needs and preferences, thus providing more personalized product recommendations and services. Meanwhile, Intime also rolled out promotional activities which are exclusive to members, discount offerings, customization service for members, etc.; all these initiatives allow the company to easily collect consumer data and carry out targeted marketing.

Leveraging technologies to enhance customer experience

The rising middle class and the growingly influential Chinese millennials have high aspirations for a better life. They have strong desire for premium products and services, as well as convenience-driven shopping experience. With China entering a "New Consumption" era, many department store operators have shifted their focus towards customers, and regarded satisfying consumers' demand for unique and engaging experiences as one of the most important factors to succeed. Meanwhile, more department store operators have leveraged advanced technologies to enhance consumer experience.

Intime Retail Group is a case in point. In May 2017, Intime's Ningbo Dongmen branch was closed for renovation. The store has been upgraded and transformed in all aspects, including the exterior design, interior decoration, floor layout, etc. Apart from placing strong emphasis on upgrading the hardware and software of the store with better shopping facilities and lifestyle offerings, Intime has also increased the proportion of experiential elements substantially. For instance, it had added a 3D fitting room with the support of "black technologies" such as augmented reality (AR) and virtual reality (VR), as well as an "unmanned supermarket".

Partnering with leading Internet companies and e-commerce players to deepen O2O integration

Increasing numbers of department store operators have realized the importance of forming strategic alliances with Internet or large-scale e-commerce companies in order to stay competitive. As such, department store operators can leverage the huge traffic resources, big data as well as logistics capabilities of the Internet or e-commerce companies, so as to roll out O2O initiatives more easily and effectively.

Selected examples of strategic partnerships between department store operators and Internet companies or e-commerce players are shown in Exhibit 4.

Exhibit 4. Selected examples of strategic partnerships or alliances between department store operators and Internet companies or e-commerce players (as of September 2018)

Time	Department stores	Internet companies/ e-commerce players	Details of the strategic partnerships or alliances
April 2018	Rainbow Department Store Co., Ltd.	Tencent	The two companies launched the “Rainbow & Tencent Smart Retail Laboratory” as their first cooperation project. It will focus on innovative technology applications and sustainable development models in technology, channels, big data, supply chain, business management, etc.,
March 2018	Liqun Commercial Group Co., Ltd.	Tencent and IBM	Liqun and IBM will jointly work on the company’s smart supply chain information management upgrading project. This cooperation is the extension of the collaboration agreement signed between Liqun and Tencent on 9 March in the area of smart retailing.
January 2018	Zhongbai Department Store Co., Ltd.	Dmall.com (an integrated O2O retail platform for daily consumer goods)	Dmall’s O2O business will be fully launched in 43 Zhongbai stores in Wuhan.
January 2018	Parkson Retail Group Ltd.	Secco.com (Asia’s largest online integrated upscale products and services platform)	The two parties will integrate their resources to construct a fully integrated online and offline sales and service network. They will jointly explore the application of “smart retail”.
January 2018	Xinhua Department Store Co., Ltd.	Dmall.com	Dmall will provide merchandising and O2O services to Xinhua Department Store through Dmall’s app.
November 2017	New World Department Store (China)	Wanda Feifan (an O2O e-commerce platform)	15 stores of New World Department Store will cooperate with Feifan for “click and collect” service.
March 2017	Nanjing Pacific Department Store Co., Ltd.	Fanli.com (one of China’s largest e-commerce platforms)	All stores of Pacific Department Store in Shanghai will provide promotions and daily discounts on Fanli.com.
February 2017	Shanghai Bailian Group Co.	Alibaba Group	Under the agreement, the two companies will develop new technologies and take advantage of each other’s user data to integrate offline stores, logistics and payments to boost efficiency. They will also jointly develop new technologies for retail applications such as AI, the IoT and big data.
January 2017	Intime Retail (Group) Co., Ltd.	Alibaba Group	Intime Retail Group received a proposal for privatization from joint offerors. Both parties would collaborate in big data analytics and implement more comprehensive O2O strategies so as to optimize customer experience, improve inventory turnover, and increase operation and supply chain efficiencies.

Source: Various Internet sources; compiled by Fung Business Intelligence

2. Diversifying retail formats and tapping into other business sectors to achieve synergy

Actively engaging in multiple retail formats, particularly shopping malls, supermarkets and convenience stores

Competition in China's department store market is fierce, and the single format model has gradually faded out as it lost its competitiveness in the rapidly changing marketplace. To adapt to the changing needs of consumers, more and more department stores have sought to expand their scope of business and engage in multi-format, multi-sector operations (Exhibit 5). For example, in recent years Golden Eagle Retail Group has launched a new G · LIFE series and developed six business units in 2017 including G · MART (boutique supermarket), G · TAKAYA (bookstore), G · QUTE (pet store), G · BEAUTY (beauty store), G · HEALTH (healthcare products), G · BABY (mother-and-baby products) to meet the discerning needs of middle class consumers.

Meanwhile, a number of department store operators changed their company name to show their eagerness to transform into multi-format and integrated retail enterprises. In January 2018, Liqun changed its name from “Qingdao Liqun Department Store Group Co., Ltd.” to “Liqun Commercial Group Co., Ltd.” to better reflect its evolving business nature as the company continued to expand and strengthen their core retail competencies in the operation of shopping centers, supermarkets, home appliances, convenience stores and fresh community shops. During the same period, Xinhua Department Store under Wumart Group also changed its name to “Wumart Xinjiekou Plaza” to highlight its positioning. In March 2017, Rainbow Department Store Co., Ltd. decided to change its tracking stock name on the Shenzhen Stock Exchange to “Rainbow Shares”, hoping to better align with the company's omni-channel and multi-format strategies.

Exhibit 5. Selected department store operators that have tapped into shopping malls, convenience stores, supermarkets and other business sectors (as of September 2018)

Department stores	Shopping mall format	Convenience store format	Supermarket format	Other formats
 王府井百货 Wangfujing Wangfujing Department Store (Group) Co., Ltd.	<ul style="list-style-type: none"> Wangfujing Shopping Center 	<ul style="list-style-type: none"> Wangfujing I Believe 	<ul style="list-style-type: none"> Wangfujing Sofly (community-based fresh food-focused supermarket) Guan Park (an independent supermarket brand by Wangfujing) Wangfujing Jixuan Supermarket (a supermarket brand jointly established with third-party supermarkets) Wangfujing self-owned supermarkets 	<ul style="list-style-type: none"> Wangfujing Factory Outlet
 RAINBOW 天虹 Rainbow Department Store Co., Ltd.	<ul style="list-style-type: none"> Rainbow Shopping Center Dreams-On 	<ul style="list-style-type: none"> Rainbow O2O Store Well Go (unmanned CVS) 	<ul style="list-style-type: none"> Sp@ce (lifestyle supermarket) Self-owned supermarkets 	<ul style="list-style-type: none"> Rain & Co (multi-brand stores) Rainbow app (e-commerce platform) Rainbow Finance (consumption finance)
 新世界百货 NEW WORLD DEPARTMENT STORES New World Department Store (China)	<ul style="list-style-type: none"> Ba Li Chun Tian Shopping Mall 	<ul style="list-style-type: none"> N+ Convenience Store 	<ul style="list-style-type: none"> N+Baby (children's themed-supermarket) Self-owned supermarkets 	<ul style="list-style-type: none"> Xinshuo (multi-brand store) LOL Lifestyle Concept Store N+ Natural Taste Plus (bakery) Peter's Meadow (F&B) Aza Aza! (F&B)
 银泰商业 Intime Retail Intime Retail (Group) Co., Ltd.	<ul style="list-style-type: none"> Intime City In Series 	/	<ul style="list-style-type: none"> Self-owned supermarkets 	<ul style="list-style-type: none"> Onmine snack store (partnered with Alibaba)
 PARKSON 百盛 Parkson Retail Group Ltd.		/	<ul style="list-style-type: none"> Parkson Supermarket 	<ul style="list-style-type: none"> Parkson Beauty (beauty & skincare specialty store)
 利群 LIQUIN Liquin Commercial Group Co., Ltd.	<ul style="list-style-type: none"> Liquin Shopping Center 		<ul style="list-style-type: none"> Liquin Supermarket "Liquin ·Fuji Farm" (fresh community store) 	<ul style="list-style-type: none"> Liquin Home Appliance
 CQEST 重庆百货 Chongqing Department Store Co., Ltd.		/	<ul style="list-style-type: none"> Self-owned supermarkets 	<ul style="list-style-type: none"> Chongqing Alliance Trading Company Chongqing Car Trading Company Mashang Consumer Finance Co. Ltd.

Source: Various Internet sources; compiled by Fung Business Intelligence

In China, small-format stores represented by convenience stores is gaining popularity. According to the MOFCOM, the yoy growth of 5,000 key retailers reached 4.6% yoy in 1H18, of which, the growth of the convenience store (CVS) sector was the fastest among all retail formats, reaching 7.6% yoy. More and more department store operators have extended their footprint into the CVS sector in order to expand revenue streams and business ecosystems.

Wangfujing Group is a case in point. It tapped into the CVS business since 2017. In March 2017, Wangfujing Group and Henan convenience store chain “I Believe” formed a chain convenience store franchise under a joint venture arrangement. The joint venture company announced the opening of 106 stores in Beijing in June 2017. The two companies will jointly transform and upgrade all existing stores of I Believe, invite the mom-and-pop stores in Beijing to be franchisees, and provide O2O services to consumers in Beijing.

Another example is Rainbow Department Store. It launched the unmanned convenience store “Well Go” in 2017. The first Well Go was opened in Nanshan District, Shenzhen in August 2017. The store uses RFID radio frequency identification technology, intelligent equipment control system, remote monitoring system and other IoT technologies. To enter the store, consumers can simply scan the QR code by WeChat app. According to the company’s plan, the total number of Rainbow convenience stores will exceed 800 shops by 2020.

New World Department Store also tapped into the convenience store sector last year. It opened the first “N+ Convenience Store” in the Chongwenmen branch, Beijing in November 2017. N+ Convenience Store’s target customers are working people aged 18-40 and surrounding office crowds. In terms of merchandise, N+ Convenience Store provides mainly fresh food, as well as beverages, daily necessities sourced from New World Department Store. In addition, N+ Convenience Store also provides other value-added services for consumers such as express delivery, free mobile phone charging, free toolbox, free medicine, free water, etc. According to the company’s plan, more N+ Convenience Stores will be opened nationwide in the future.

Going “fresh and experiential”; self-operated boutique supermarkets and fresh food become new growth points

In the past year, “fresh” and “experience” became the new focuses of the fast-moving goods and grocery markets. Increasing numbers of department store operators have transformed and upgraded their existing supermarkets, and stepped up efforts to provide more fresh food, catering service, and select premium and unique products from all over the world in response to the ever-growing consumer demands for higher quality of life.

For example, in January 2017, Rainbow Department Store opened the first Sp@ce supermarket in Shenzhen. The new store was previously an ordinary Rainbow Supermarket and has been transformed and upgraded into the first store of the new brand. Consumers can make online

purchase with Rainbow's official app "Rainbow Scarf"; their products will be delivered directly to their home within 2 hours through the "Rainbow Daojia" service. Sp@ce also supports the "self-check-out" function; customers can pay by WeChat Pay, Alipay and also by credit cards. Rainbow aims to open 100-150 Sp@ce supermarkets in the coming three years.

Exploring new models, new formats and new concepts

Over the past few years, China's retail market has seen an unprecedented evolution with rapid emergence of various new retail models and formats. Many department store operators are actively exploring new business models, developing new retail concepts and targeting more specific groups of customers.

In August 2017, Rainbow Department Store debuted a new retail format named "Global In Select" at its Houhai Branch in Shenzhen. With an operating area of 1,500 sqm, Global In Select houses six sections with a mix of merchandise from different categories, including beauty and cosmetic, maternity and baby, products from Australia and New Zealand, food products, specialty products from Europe and the U.S., and wine. By leveraging RFID technologies, Global In Select supports self-checkout service. The system can recognize the product categories, volume, total price, discounts, etc. all by itself without human touch. Customers can use Rainbow's app to scan the QR code displayed on the screen to complete the payment process.

Another example is RISO – a new fresh food-focused supermarket launched by Bailian Group in Shanghai in June 2017. Located in Pudong New District, RISO occupies two floors and has a total floor space of 4,500 sqm. RISO sells mainly grocery and fresh products and features a large catering area, restaurants and café, book section, as well as art exhibition. RISO exemplifies the concept of "future store", one of Bailian's recent focuses, by integrating catering into the selling of fresh products, together with books, arts and music. It aims to offer a one-stop relaxing shopping experience to consumers, and promote a unique and natural lifestyle. Moreover, RISO also introduces a great variety of imported premium products, as well as exclusive items to enhance attractiveness of the store. As part of its O2O initiatives, RISO has also launched a mobile app and provide 1-hour delivery service for consumers who live within a 3-km distance from the store.

Last year, Intime Retail launched a new snack food store "Onmine" together with Alibaba Group in order to test the "New Retail" concepts and innovation in format integration. The first store was opened in Hangzhou Zhongda Intime City in June 2017. The store has a snack display area and a leisure experience area, covering an area of 300 sqm. It sells about 800 types of products, of which imported snacks accounted for around 80%. The new Onmine retail concept snack store indeed symbolizes the official entry of Intime Retail into the concession food industry.

3. Offering additional sales channels to enhance product uniqueness and gross profit margins

Enriching and expanding direct-merchandise sales business for products and services differentiation

Having experienced the drawbacks of the concessionary model such as homogenization of merchandise and concessionaire brands, thin profit margin, and bringing less foot traffics, etc. many department store operators have expedited the expansion of direct sales business, taken even bolder steps by developing their own private labels, and operating buyer (multi-brand) shops with unique and exclusive brands from overseas in order to enhance product and services uniqueness, provide customers with a differentiated shopping experience and satisfy the increasingly sophisticated consumer demand under the trend of consumption upgrading.

Wanda Department Store is a case in point. In September 2017, Wanda Department Store made its first attempt to set up buyer (multi-brand) store by launching the first "Wanda Select" shop in Wanda Department Store, Tongzhou branch in Beijing. As a buyer shop, "Wanda Select" operates in "shop-in-shop" and "pop-up shop" models. All products are sourced from overseas by Wanda's buyer's team, with categories covering fashion, jewelry, footwear, skin care products, food, etc. "Wanda Select" can leverage Wanda Department Store's massive product categories and sourcing capability to reduce operating cost and enhance supply chain efficiency, thereby providing a better shopping experience for consumers.

In the same month, Bailian Group launched a multi-brand shop "the balancing" inside Bailian's Orient Shopping Center in Xujiahui, Shanghai. All of the products sold in the store are purchased from overseas, from brands buy-out or via in-depth cooperation with local and foreign designer brands. The balancing's buyer team tends to choose some "exclusive" designer and lifestyle brands to enhance the uniqueness and strengthen the competitiveness of Bailian's merchandise portfolio. Currently, it houses more than 150 international fashion and lifestyle brands, including Jil Sander, Masion Margiela, Nina Ricci, Victoria Beckham, Brunello Cucinelli, Paul Smith, and 3.1 Philip Lim.

Stronger efforts in developing private labels

Today's new generation of consumers long for more unique and personalized products. As such, some leading department store operators actively develop their own private labels, which cover a large array of categories from cosmetics, apparel, home products, to food, etc. By launching private labels, department store operators can impose control and oversee the manufacturing and supply chain of their merchandise, and hence enjoy long-term competitive advantages and ensure better profit margin.

Developing private labels is one of the key strategies of New World Department Store China in

recent years. Following the launch of its own private labels "LOL" (Love • Original • Life) Concept Shop, "n+ Natural Taste Plus", a high-end bakery brand of the group and "Luis Home Bake", a DIY baking studio for children, in June 2017, it launched another new private label apparel brand "Xin Shuo" in its Shanghai Wujiaochang Branch. "Xin Shuo" targets mainly the younger generation; its products have unique styles, similar to those created from a mix of designer brands and niche brands. In 2017, sales of goods for merchandise direct sales accounted for 31.8% of total revenue of New World Department Store China. This reflected that great importance of merchandise direct sales to the company.

Another example is Wangfujing Group. In April 2017, Wangfujing Group opened the "Wangfujing Dream Factory" store, which sells creative traditional Chinese cultural and ethnic products. Most of the products are designed by Wangfujing Group's own design team and manufactured by their own partner manufacturers or sourced from local craftsmen for further processing.

4. Improving supply chain management and focusing on the basics of retailing

In response to the consumption upgrading phenomenon and consumers' aspirations for quality products and services, many department store operators have devoted tremendous efforts on revitalizing and restructuring the supply chain, and accelerating the digital transformation process in order to promote product and services upgrades. Increasing numbers of traditional department store operators now realize the weak relationship with upstream suppliers and brands have led to supply chain inefficiency; some operators have sought to harness resources in the best way possible, and improve the supply chain management with digitalization approach, which largely simplified procedures and supply chain system, optimized resources and reduced costs.

Bailian Group is one of the department store operators who put huge emphasis on supply chain expansion. With "i-Bailian" O2O shopping platform as the backbone, on the one hand, Bailian Group has actively built and controlled resources in the supply chain by extending towards the upstream. On the other hand, Bailian has promoted the expansion of sales channels horizontally. For offline channel, Bailian has actively rolled out new convenience stores, shopping malls and factory outlets nationwide, and strengthened its global supply chain organizational capabilities.

III. Concluding remarks

To capitalize on the opportunities arising from consumption upgrading and the trend of younger generations becoming the mainstream of consumption, the department store sector should keep abreast of the latest market trends, optimize operations models and strive to create a stronger merchandise portfolio which aligns with the new lifestyles and spending habits of the dominating consumer group. Emphasis should be placed on strengthening and covering a wider scope of in-demand spending categories related to consumption upgrading, such as children and education, healthcare, tourism, cultural and creative products, etc. Department store operators should gear their business reform direction towards offering high quality products and services with better shopping experience to meet the increasingly sophisticated consumer demand.

Regardless of how the retail formats change and how the business models evolve; ultimately, the essence of retail business lies in the ability to provide desirable goods and services to a specific target market. Going forward, department store operators should strive to optimize the composition of “customers, merchandise, and physical settings” elements in their businesses. They should also focus on the basics of retailing by redefining an operational framework that integrates online and offline businesses, engaging in multiple businesses, enriching product offerings, and enhancing shopping ambience.

Last but not least, department store operators should take proactive initiatives to optimize operational efficiency in order to be well-prepared for the uncertainties that may arise in the “new consumption” era. Some companies have started to change organizational structure and create new departments to serve growing markets, streamline administrative processes.



Spotlight on China Retail – Issue 4

Shopping Malls

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

October 2018

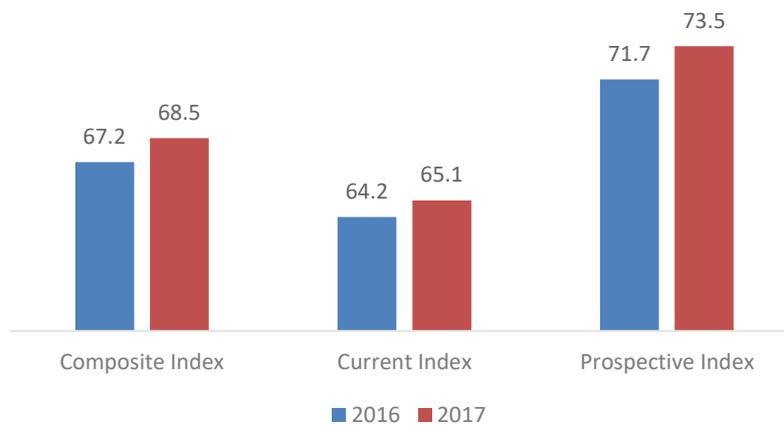
China's shopping malls sector has enjoyed robust development over recent years. Key shopping mall operators have shown improving occupancy rates with satisfactory retail sales growth. In the “New Consumption era”, shopping malls have increasingly become places for consumers to look for lifestyle experience and bond with family and friends. Mall developers and operators have strived to reconstruct the value of their malls and offer differentiated shopping experience to customers powered by Internet technology and data. Increasing numbers of mall operators have already begun to evolve and optimize the composition of the core business elements namely properties, tenants and customers.

I. Market overview

1. Shopping mall sector maintains robust development

China's shopping mall sector has enjoyed robust and healthy development over the past year. This can be reflected in the “China Shopping Center Development Index”ⁱ released by the China Store & France Association (CCFA). The overall shopping mall index was 68.5 in 2017, up 1.3 yoy, 18.5 pts above the 50-point threshold that separates the expansion and contraction status, indicating that the shopping mall sector was in a healthy state of development. The “prospective index” was 73.5, which was 8.4 pts higher than the “current index”, reflecting that most shopping mall owners were optimistic about the market development (Exhibit 1).

ⁱ Commissioned by the Ministry of Commerce (MOFCOM) to the CCFA since 2017, the China's Shopping Mall Development index mainly evaluates the performance of shopping malls in China from the four dimensions – macro market, leasing activity, operational performance, and cost control. The index is measured on a scale of 0 to 100, 50 being the threshold which separates contraction from expansion; a higher number indicates stronger confidence in the market, and vice versa.

Exhibit 1. The China Shopping Center Development Index, 2016 – 2017

Source: MOFCOM; compiled by Fung Business Intelligence

2. Sales of major large-scale shopping malls in China register positive growth

In 2017, most large-scale shopping malls in China delivered positive sales performance. According to iziRetail, the total sales of 190 large-scale shopping centers across 51 cities in China reached 441.3 billion yuan in 2017, up 11.3% yoy (Exhibit 2). Of all the 190 surveyed shopping centers, 148 of them recorded positive sales growth, 27 registered a decline in sales and eight remained flat in sales performance. 33 shopping malls have a yoy growth of over 20%, of which 21 are luxury-oriented shopping malls.

Exhibit 2. Total sales of 190 large-scale shopping centers, 2016 – 2017

Source: iziRetail, compiled by Fung Business Intelligence

According to Linkshop, the top 20 shopping malls in China all achieved positive yoy sales growth in 2017 (Exhibit 3). Among them, 16 shopping malls achieved double-digit sales growth.

Exhibit 3. Sales performance of top 20 shopping centers in China, 2017

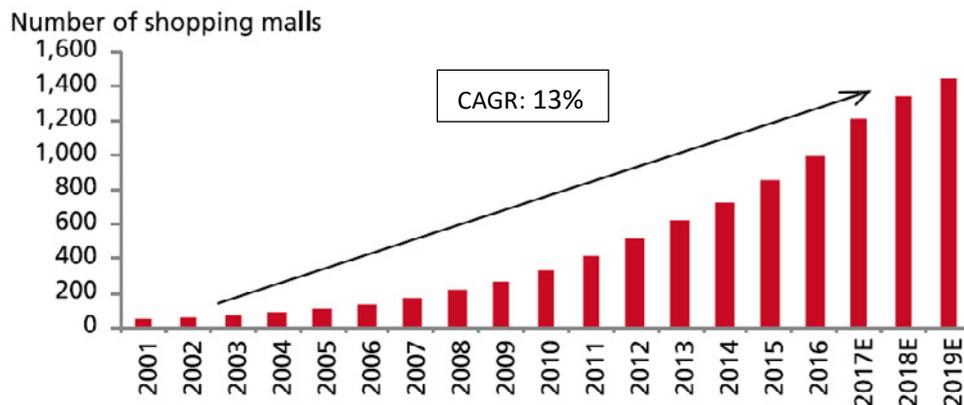
Rank	Cities	Shopping malls	Developers	Sales in 2017 (billion yuan)	Growth rate (yoy)
1	Nanjing	Deji Plaza	Deji Group	9.0	17.5%
2	Wuhan	Wuhan International Plaza	Wushang Group	8.7	135.9%
3	Beijing	China World Mall	CWTC	7.9	40.8%
4	Shenzhen	MIXc World	China Resources Land Ltd.	7.7	16.1%
5	Shanghai	Shanghai ifc	Sun Hung Kai Properties	7.0	16.6%
6	Guangzhou	Teemall	TEEM Group	6.0	9.1%
7	Xi'an	Saga Mall	Xi'an Saga Group	5.8	30.0%
8	Guangzhou	Grandview Mall	Zhengjia Group	5.8	5.4%
9	Guangzhou	Taikoo Hui	Swire Properties	5.0	27.2%
10	Chengdu	Chengdu IFS	Wharf Group	4.9	28.9%
11	Shanghai	Plaza 66	Hang Lung Properties	4.8	25.9%
12	Chengdu	Sino-Ocean Taikoo Li Chengdu	Swire Properties and Sino-Ocean Group	4.3	48.2%
13	Beijing	Joy City Chaoyang	Joy City Property Holdings	4.2	21.1%
14	Beijing	Joy City Xidan	Joy City Property Holdings	4.1	0.7%
15	Shenyang	MIXc Mall	China Resources Land Ltd.	4.0	33.3%
16	Nanning	MIXc Mall	China Resources Land Ltd.	3.7	21.6%
17	Hangzhou	Intime in77	Intime Retail	3.7	12.1%
18	Beijing	Taikoo Li Saniltun	Swire Properties	3.5	4.4%
19	Shenzhen	Coastal City	Coastal Group	3.4	14.1%
20	Zhengzhou	David Plaza	Dennis Group	3.3	86.4%

Source: Linkshop; compiled by Fung Business Intelligence

3. Number of shopping malls in China continues to grow

As of 2016, there were more than 4,000 shopping centers operating nationwide. 323 large-scale projects (with commercial area larger than 80,000 sqm) were opened in 2017. Based on data from commercial properties consultant Jones Lang LaSalle (JLL), the total number of malls (with gross floor area over 10,000 sqm and not operating on a strata titled basis) in China's top 30 cities is expected to increase at a compound annual growth rate (CAGR) of 13% to 1,445 in 2019 (Exhibit 4).

Exhibit 4. Number of shopping malls in China, 2001 – 2019 (estimates)



Source: Jones Lang LaSalle IP, Inc; DBS Vickers

II. Key trends and developments

1. Shopping mall operators shift to more consumer-centric business models

In response to the rapidly evolving retail landscape, the threat imposed by e-commerce and the change in consumer behavior, mall operators in China are taking bold initiatives to reinvent themselves. Increasing numbers of mall operators have changed their mindset and transformed their operations and business models by adopting a more consumer-centric approach. They regard customers as the focal point of their business, set their strategic goals to engage consumers and connect them with retail tenants and the mall.

Historically, the relationship between shopping malls and tenants was a simple, straightforward landlord-tenant relation as tenants represent a direct source of income to the malls. But nowadays, retail tenants have turned into important business partners of shopping malls. For many mall operators, the values derived from the tenants are not just income (from both rental turnover and sales turnover) but also brand value of the tenants, and other positive impacts

from their marketing efforts. Malls and tenants now share the common goal to attract patronage and enhance customer shopping experience. Landlord-tenant cooperation and sharing of information, particularly analytics of customer data have become a hot topic for the industry (Exhibit 5).

Exhibit 5. Shopping mall operators shift to more consumer-centric business models

Mall operators have changed their mindset to become more customer-centric and place customers at the heart of a centers strategic direction

	In the past... Asset-centric		At present... Consumer-centric
Role of landlord	Developers, landlords	➔	Developers, landlords and multifaceted lifestyle service providers, incubators of retail brands or startups
Anchor tenants	Traditional retailers, department stores, supermarkets	➔	Retail, service or entertainment
Role of retail shops	Tenants	➔	Business partners
Role of technology	Powering the system	➔	Connecting the shops, consumers and the mall to improve customers experience, to empower big data analytics through digitalization

Source: Fung Business Intelligence

2. Shopping centers’ strategies to adapt to evolving consumer behavior

Asset enhancement and physical upgrading

To meet the current and future market needs, many existing shopping malls have endeavored to strengthen their physical assets in all aspects including upgrading hardware and facilities, reconfiguring unit layouts, refining tenant mixes as well as enhancing in-mall service facilities. For some well-established traditional shopping centers at the key shopping districts in China, after many years of operation, their physical environment and shopping mall layout have either become outdated or lack of customer service facilities. In order to offer an all-encompassing lifestyle experience for shoppers, increasing numbers of traditional shopping centers have commenced large-scale renovation and asset enhancement programs to optimize the shopping environment. In Shanghai, for instance, large numbers of shopping malls have undergone a series of renovation and upgrading projects in recent years (Exhibit 6).

Exhibit 6. Selected retail malls in Shanghai that have undergone renovations in recent years

Shopping Mall	Opening Year	Re-opening Year
Plaza 66	2001	2017
Wanda Plaza Wujiaochang Store	2006	2017
Changfeng Joy City	2011	2017
No.1 Department Store Old Building	1949	2018
No. Department Store New Building	2007	2018
Oriental Nanjing East Road Department Store	2005	2018
Oriental Yangpu Department Store	2007	2018
Shanghai Shimao Plaza	2004	2018
Changning Cloud Nine Shopping Center	2005	2018
Shui On Plaza	1997	2018
Shanghai Central Plaza	1999	2018
Mall 818	2009	2018
Citic Square	2000	2018
Grand Gateway 66	1999	2019

Source: *Knight Frank Research; compiled by Fung Business Intelligence*

Wujiaochang Wanda Plaza in Shanghai is a case in point. In 2017, Wanda Properties executed a major asset enhancement program at the Shanghai Wujiaochang Wanda Plaza, which has been in operation for about 11 years. In this transformation exercise, Wanda has allocated more than 10,000 sqm of commercial rental space to public space in order to create a good shopping atmosphere for consumers. The façade and interior of the shopping mall have been upgraded, anchor tenants have been readjusted, and the basement area has been transformed into a themed catering area with a collection of popular eateries and restaurants.

Refining and reshuffling tenant mixes to optimize mall portfolio

Nowadays, China’s shopping mall operators are responding swiftly to consumers’ needs by providing more interactive features in the mall, including entertainment, leisure activities, a variety of food options and unique concepts that differentiate their offerings. They set to reposition themselves as consumer destinations and social places, rather than merely big boxes with a collection of retail stores. Some forward-thinking mall operators are incorporating value-added elements that attempt to recast the malls as community and cultural hubs as well as

providing customers a venue for art exhibition, concerts, social events, etc. Shanghai K11's strategy of "art museum retail" is one of the earliest successful examples of experience-based retail. Back in 2014, its Claude Monet art exhibition attracted more than 350,000 visitors. Thereafter, many shopping centers, such as Joy City Chaoyang, Taikoo Li Sanlitun and Chengdu IFS, etc. also held large-scale art exhibitions to draw traffics to the mall and enhance the overall mall image.

On the tenant mix front, innovative malls are strategically reshuffling tenants to enhance mall positioning and optimize rental yield. They are increasingly welcoming retailers who can bring fresh elements to their properties. Many shopping malls are introducing unique flagship stores as their anchor tenants, with a hope to differentiate themselves from their competitors. In some cases, these flagship stores are the first and largest of its kind in the city or the nation. WF Central in Beijing which was opened in November 2017, provides a good illustration. Positioned as a world-class retail, fine dining and hospitality hub in Wangfujing, the mall introduced many brands which debuted in Beijing for the first time, including a Victoria's Secret flagship store set over three floors; a global flagship store for Pandora; and a China flagship store for British contemporary fashion brand Superdry. The mall also welcomed Links of London's debut store to Beijing as well as a number of renowned restaurants such as The Cheesecake Factory, the Michelin-starred Kanpai Classic, Café Landmark, etc.

Taikoo Li Sanlitun in Beijing is another case in point. For example, it houses the world's largest adidas store, the first Apple store in Mainland China, and a 1,597-seat Megabox cinema. In 2017, Kiehl's Coffee Shop and Popcorn General Store opened their first Mainland China stores in Taikoo Li Sanlitun South. Examples of selected new brands introduced by Taikoo Li Sanlitun during 2016-2017 are shown in Exhibit 7.

Exhibit 7. Selected new brands introduced by Taikoo Li Sanlitun to Beijing or to China for the first time during 2016 – 2017

Brand	Description	Brand	Description
Taoyuan Village	1 st store in Beijing	Heytea	1 st store in Beijing, the 1 st Black Platinum Store in Northern China
The Simpsons	1 st store in China	Honor23	1 st store in Beijing, the only store in China
Juicy Couture Black Label	1 st Black Label store in China	Home Thai	1 st store in Beijing
MAG MODE	1 st store in China	G-Shock Store	1 st store in Beijing, 2 nd store in China
Evisu	Flagship store in Beijing	Kiehl's Coffee House	1 st store in mainland China
CASIO Exilim TR	1 st store in Beijing, the only store in China	YE's by YESIR	1 st store in China
POP MART	The first IP concept store in Beijing	GGDB	1 st store in China
Avirex	1 st store in Beijing, the only store in China	Cinker Space	1 st store in China
Kiss The Tiramisu	1 st store in Beijing	Bad Farmers & Our Bakery	1 st store in China
Debrand	1 st store in Beijing	Philipp Plein	1 st store in Beijing
MSGM	1 st store in Beijing, the only store in China	Gentle Monster	1 st store in Beijing, the only store in China
Lululemon	1 st store in Beijing, the only store in China	KLERM	1 st store in Beijing
Philipp Plein	1 st store in Beijing, the only store in China	Anchoret Temp Store	1 st store in Beijing
Infrarouge by Bar Rouge	1 st store in Beijing, the only store in China	Infrarouge by Bar Rouge	1 st store in Beijing
Meso Skinlab	1 st store in China	Comme Moi	1 st store in Beijing
Softree	1 st store in China	Thom Browne	Flagship store in Beijing
Roberto Cavalli	1 st flagship store in China	Any Shop Concept Store	1 st concept store
Off-White	1 st store in Beijing	Les Hommes	1 st store in China

Source: Swire Properties; compiled by Fung Business Intelligence

The mix of retail tenants is hence changing – historically, supermarkets, fashion and accessories tenants tended to occupy the largest retail space in a shopping mall; they started to lose store space to other tenants, particularly eateries, leisure facilities, entertainment, kids-related categories and services tenants. For instance, Printemps Paris Huaihai branch in Shanghai completed its renovation in 2016, with nearly 40% of its floor space allocated to F&B tenants. Data from Savills Research shows that in 2016, space occupied by kids-related tenants increased by 11%; leisure tenants increased by 8% and home & lifestyle tenants increased by 7% in Shanghai. By the same measure, F&B increased by 3% while apparel decreased by 5%.

Shopping malls breed the explosive growth of pop-up retailing

Over the past few years, pop-up retailing has experienced explosive growth in China. According to Chinese commercial property research agency RET, pop-up stores have proliferated in China with a CAGR of over 100% since 2015; and the number of pop-up stores are projected to exceed 3,000 by 2020. Pop-up stores have become popular as the interesting designs and new concepts can attract customer attention and provide a unique retail space for retailers to engage and interact with customers. Pop-up stores can serve different purposes— selling products, enhancing brand awareness, and gaining market insights. For shopping mall landlords, pop-up stores of sought-after retail brands, luxury brands or online brands with unique concepts and exclusive products provide new attractions to the mall. For brands and retailers, especially those who are new to the market and want to test the waters, launching pop-up stores is an ideal option as they do not need to commit to an expensive long-term lease but can enjoy the marketing services provided by shopping mall operators.

Recently, some luxury brands have set up pop-up stores that coupled with innovative marketing contents inside shopping malls to promote their products; this is an effective strategy for branding, promotions and marketing. Chanel, for instance, launched a pop-up store in the format of game center at K11 Shanghai in April 2018, following its previous debut in Tokyo, Seoul and Taipei. The COCO Game Center offered mainly cosmetics products and perfumes, and featured racing games, game machines, game booths and claw machines. The gamified pop-up store successfully attracted huge traffics to K11 Shanghai. Some customers had to wait for two hours to get inside the pop-up store.

It is observed that increasing numbers of pop-up stores now adopt technologies to enhance in-store experience. Some online players such as Alibaba and JD.com have opened technology-powered pop-up stores to showcase their online products. These stores feature a number of “black technologies” which can help them better engage with customers and draw offline traffics to online. Alibaba, for instance, has set up smart Tmall pop-up stores in collaboration with different brands inside different shopping malls nationwide. In these pop-up stores, interactive technologies such as digital shopping wall, magic mirror, facial recognition, cashless payment method and gamified discounts are usually found.

Introducing new types and formats of shops

Shopping mall operators seek to provide special experience to shoppers by introducing new and innovative concept stores. In many cases, anchor tenants that drive traffic are still key, but a new emphasis has been placed on a curated mix of unique stores that add a sense of novelty to the mall offering. New categories with experiential elements such as augmented reality (AR)/ virtual reality (VR) gaming centers, indoor escape gaming centers, haunted houses, indoor bowling and art & musical theatres. have become new types of tenants in some shopping malls in recent years. For example, in September 2016, Aegean Shopping Mall in Kunming launched the first ever mall-operated equestrian training school at the rooftop of the shopping center. Hopson One, Beijing, which was opened in end of 2017, has introduced a number of retail and lifestyle-focused tenants with shop formats and trade categories that are new to the market such as an indoor ski center, Le Ski which houses large-scale ski training equipment with electronics simulator to simulate the snow effect in reality; an indoor roller skating center for children; a large-scale indoor playroom for children; and a kung fu learning center. These new types of tenants can help differentiate the mall from other players in the market.

On the other hand, some shopping mall operators have strategically brought in new types of tenants, such as popular character themed shops, hoping to leverage the popularity of these characters to attract customers. For instance, Line, an outstanding online social networking brand opened its “Line Friends” retail shops and café in different cities in China, including Shenzhen, Guangzhou, Beijing, and Shanghai. Featuring the cute original characters of Line Friends, each of the grand openings has received overwhelming responses by shoppers and fans with long queues waiting to enter the shop/café.

3. Exploring new development concepts

Shopping mall operators in China have actively been exploring new development concepts. A trend is emerging of “shopping mall + shopping precinct” (or “streetscaped”) malls, with Sanlitun Taikoo Li as a successful forerunner, followed by Chengdu Taikoo Li, and the recently opened MIXc World and UpperHills in Shenzhen. The new concept features a combination of indoor and outdoor elements, with a shopping center plus a pedestrian area that has shops and restaurants – all within a landscaped environment. It can create a unique ambiance for shopping and bring consumers a special experience. Exhibit 8 lists selected examples of shopping malls which adopt the “shopping mall + shopping precinct” concept.

Exhibit 8. Selected examples of shopping malls which adopt the “shopping mall + shopping precinct” concept

City	Shopping mall	Opening year	Developer	Size	Description
Beijing	Sanlitun Taikoo Li	2008	Swire Properties	The total project area is 54,000 sqm and the total floor area is 172,000 sqm	Sanlitun Taikoo Li splits into southern and northern zones and altogether comprises 19 buildings. It features youthful and fast-fashion international and local brands, covering fashion, sports, home furnishings and lifestyle brands as well as around 30 restaurants and bars.
Chengdu	Sino-Ocean Taikoo Li Chengdu	2012	Swire Properties and Sino-Ocean	Gross floor area of over 269,000 sqm	Sino-Ocean Taikoo Li Chengdu is a retail-led mixed-use development surrounding the Daci Temple, and consists of an open-plan, lane-driven mall, a boutique hotel with serviced apartments and a Grade-A office tower.
Shenzhen	MIXc World	2017	China Resources Land Limited	Gross floor area of over 230,000 sqm	MIXc World has nearly 300 stores, housing over 1,000 brands and 12 standalone flagship stores. There is also a 2,000 sqm indoor kids' playground and a food court that opens 24 hours a day.
Shenzhen	UpperHills	2017	Shum Yip Group	Gross floor area of over 1.2 million sqm	UpperHills is a mixed-use development project that comprises shopping mall, hotel with serviced apartments and a Grade-A office tower. There are around 80 stores and a first-ever Muji Hotel.

Source: Various Internet sources; compiled by Fung Business Intelligence

Example 1: MIXc World, Shenzhen

MIXc World is located at Shennan Boulevard, Nanshan District in Shenzhen. Opened in September 2017, it is China Resources Land's second commercial property in Shenzhen under the MIXc brand following the opening of MIXc Shenzhen in 2004. MIXc World is positioned as a mid-to-high-end streetscaped commercial project with an area of around 230,000 sqm; it has nearly 300 stores, housing over 1,000 brands and 12 standalone flagship stores – including Zara, Zara Home, Under Amour, Uniqlo, COS, Urban Revivo, I.T, Massimo Dutti, Xiaomi, Starbucks, etc. Among all tenants, 30% are brands made their foray into Shenzhen market for the first time. Unlike traditional large-scale shopping centers which have an enclosed format, MIXc World takes a hybrid approach with both indoor and outdoor components, and integrates elements such as humanities, art, and socialism into such a large-scale commercial project.

Using the "one street, one lane and five squares" layout plan, the whole project is connected through two core pedestrian streets, namely High Street (Fashion Street) and In Street (Restaurant Street), five major squares (Time Plaza, Water Plaza, Flagship Plaza, Architecture Plaza, W5 Art Space) and other public spaces and facilities (Exhibit 9).



Shopping precinct, MIXc World, Shenzhen



Alfresco dining, MIXc World, Shenzhen



High Street (Fashion Street), MIXc World, Shenzhen



In Street (Restaurant Street), MIXc World, Shenzhen

(Photos source: Fung Business Intelligence)

(Example 1 Cont'd)

Exhibit 9. Layout plan of MIXc Shenzhen



Source: MIXc World, modified by Fung Business Intelligence

Example 2: UpperHills, Shenzhen

UpperHills has a gross floor area (GFA) of over 1.2 million sqm. It is a mixed-use development project with 170,000 sqm of high-end luxury apartments, 330,000 sqm of office towers, 100,000 sqm of LOFT office spaces for SMEs, a shopping mall and a hotel. The project is designed and positioned as top tier city complex. Different from that of a traditional shopping center, UpperHills adopts a “Luxury Street + Shopping Mall+Town” concept. These three components are divided but closely linked. UpperHills also houses Muji Hotel, MUJI’s first hotel in the world, MUJI flagship store and MUJI Diner restaurant.

“The Luxury Street” spans across two floors and houses a number of international brands. It is connected to the shopping mall at L2. “The Shopping Mall” spans across five floors. 42% of brands are new to Southern China. Examples include Southern China’s first Nike Beacon Store, China’s largest new concept flagship store of Purcotton, and the only Sony flagship store in Shenzhen. “The Town”, which is named as “Loft Town”, is located on L3. It comprises about 10 low-rise and colorful blocks and is positioned as a commercial and cultural hub. It features a number of creative brands, designer shops and unique restaurants with origins from Europe, Japan, Hong Kong, China and Taiwan.

With an innovative retail development concept, UpperHills has successfully created a unique shopping ambiance which set a new benchmark to the shopping mall sector in China.



Shopping Mall, UpperHills Shenzhen



Town, UpperHills Shenzhen



Luxury Street, UpperHills Shenzhen

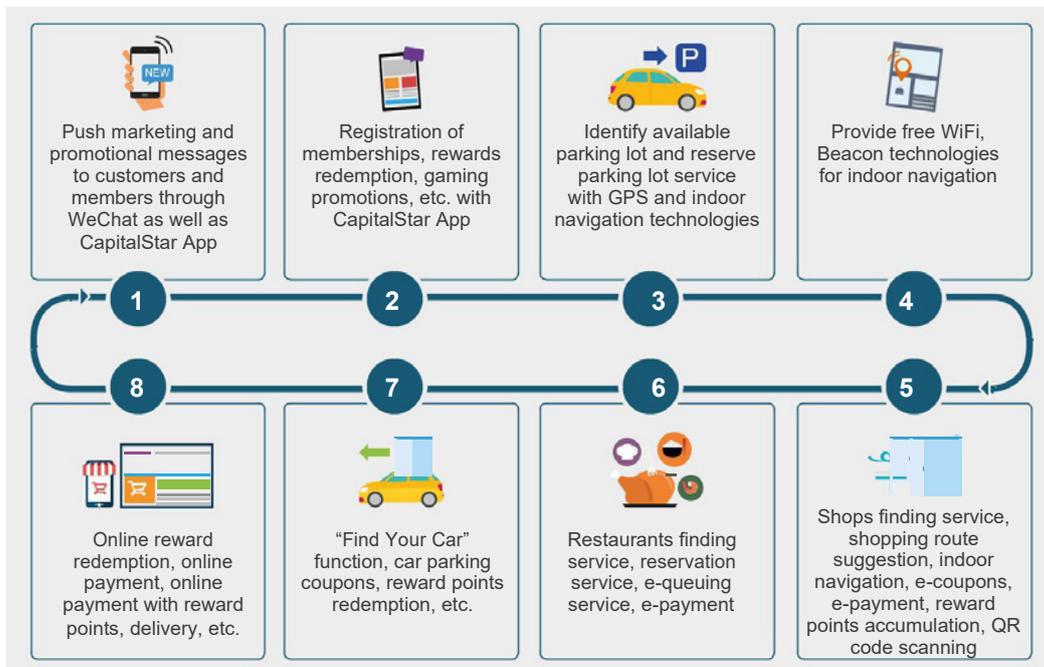
(Photos source: Fung Business Intelligence)

4. Leveraging technologies and multichannel strategies to transform the mall experience

Use of in-mall technologies and O2O platforms to enhance shopping experience

Many shopping mall operators realize that the best way to deal with rapid technological changes is to embrace it. They are utilizing digital capabilities to take the shopping experience to the next level. Beyond providing basic services such as free WiFi, accepting mobile payments and running different promotions to encourage social media engagement, mall operators are adopting in-mall technologies such as AI-powered services to improve the omni-channel experience and strengthen relationships with consumers. For example, increasing numbers of shopping centers have introduced AI-powered services and digitalized operation initiatives. Aegean Shopping Mall, for instance, has collaborated with Microsoft to gauge the satisfaction level of customers in the mall as well as recommend relevant products to respective customers with the help of facial recognition technology. Aegean has also formed partnerships with Meituan-Dianping and Koubei for in-depth cooperation to drive online customers to the mall. Another example is CapitaLand’s “Smart Mall model”. CapitaLand opened the group’s first smart mall, CapitaMall Xinduxin, in Qingdao in 2016. The mall offers integrated O2O experiences through CapitaStar, the company’s digital platform. CapitaLand’s Smart Mall aims to optimize customer experience in their entire shopping journey from eight perspectives. Please see Exhibit 10 for details.

Exhibit 10. CapitaLand’s “Smart Mall” model



Source: CapitaLand; modified and compiled by Fung Business Intelligence

Big data analytics

Technology can help shopping mall operators gather real-time data and immediate feedback to enhance customer experience. The use of big data can help operators figure out market trends and tailor features that suit the needs of shoppers. Getting deeper insight into consumer needs and behavior is the first step to reinforcing shopping centers and making them truly customer-led. To precisely capture market and consumer trends, existing shopping malls in China have different tools – such as live customer feedback, social media/big data analytics, mystery shoppers, exit polls, surveys in catchment areas and retail analytics provided by a number of IT solutions. All these would provide useful insights for mall operators to provide well-designed facilities, improved customer care and services tailored to the customers' lifestyles and preferences.

Some forward-thinking market leaders such as Aegean Shopping Mall have even built a complex and highly interconnected big data ecosystem that connects and integrates its entire business operation. The big data ecosystem has a powerful multidimensional database which is backed by big data analytics. With this big data ecosystem, the mall can perform targeted marketing and provide precise and accurate services to customers.

5. E-commerce giants make forays into shopping mall sector

Recently, the shopping mall sector in China has seen the emergence of a new competitive landscape with the entrance of e-commerce giants. The opening in April 2018 of the Alibaba Group's first bricks-and-mortar shopping mall in Hangzhou, is a major step by the Group towards achieving its goal of blending digital prowess with a footprint in the physical world. With a floor area of 40,000 sqm, the 5-storey shopping center houses many Alibaba's new retail concepts, such as Hema Xiansheng supermarket, Tmall Global Experiential Store, "Tmall Fairy Pavilion" (which focuses on AI products and technology products), etc. and the first bricks-and-mortar store of Taobao – "Taobao Xinxuan". As of April 2018, the shopping center has 52 retail and F&B brands; over 40% of the floor space are allocated to F&B and around 10% of floor space are allocated to shops with New Retail concepts. As part of the e-commerce giant's push into real-world retail, the entire mall is connected with Alibaba's online channels, big data system and logistics network. The mall also features a number of black technologies, including facial recognition technologies for membership registration, unmanned registration counters that accept Alipay mobile payment service, magic mirrors for makeup-trial and virtual fitting rooms.

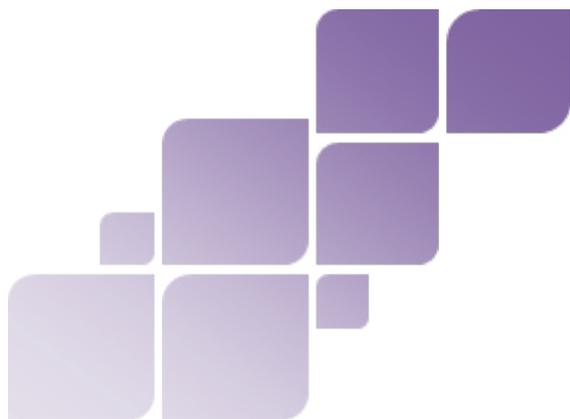
III. Concluding remarks

In our view, under the “New Consumption” era, the combination of omni-channel shopping and consumer experience is an inevitable trend for future retail development. Shopping mall operators will need to be consumer-centric and evolve with both consumers and brands in order to stay relevant and competitive. Developing new concepts, introducing new store formats and ensuring a dynamic mix of tenants will certainly provide shoppers with new and innovative retail experience. Constant reinvention of retail space, effective promotions, high-quality customer service and well-executed customer loyalty programs will altogether provide a way-out for shopping mall operators to sustain and stand out.

On the other hand, technology will continue to be a significant disruptor in the sector. We believe that shopping malls must embrace technology as an integral part of the mall operation, be ready to compete in the digital era by incorporating technologies such as big data and machine learning to drive growth and boost efficiency. Forward-thinking shopping mall operators who keep exploring ways to collect and leverage data in their sales, marketing, customer service, and operations will continue to thrive.

In fact, many researches indicate that people still love to see and touch the real products they intend to buy. Bricks-and-mortar stores are irreplaceable and in-store shopping experience remains dominant in the retail sector. We believe that the shopping mall sector will continue to maintain a high level of development in the coming years, and no longer be a place purely for shopping but a one-stop destination for shopping, lifestyle and social experience.

Nonetheless, to maximize rental turnovers while shifting the leasing focus to lifestyle, entertainment and F&B tenants mix has always been a dilemma for mall owners. Besides, how to keep abreast of changing consumer habits and translate consumer data into useful information, sustain foot traffics, maintain high occupation rate, control costs spending and ensure positive return on investments are some of the key issues that mall owners need to work hard to solve.



Spotlight on China Retail – Issue 5

Hypermarkets/ Supermarkets

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

October 2018

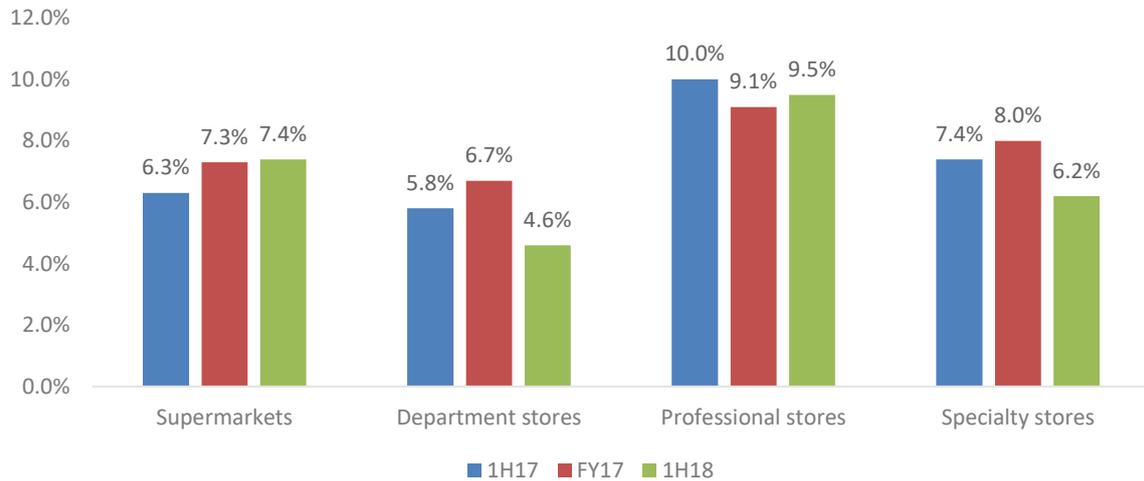
In recent years, the hypermarket and supermarket sector has faced fierce competition from the fast-growing e-commerce sector as well as from smaller-scale retail formats such as convenience stores, community stores and specialty stores. To better compete in the marketplace, many hypermarket and supermarket operators have revamped their operations by tapping the online market, offering fast delivery, adding on-site catering services, as well as providing more value-added services.

I. Market overview

1. Hypermarket and supermarket operators see improvement in sales growth

Over recent years, hypermarket and supermarket operators in China have been facing fierce competition and witnessing slower growth compared to online retailing and professional stores. That being said, many hypermarket and supermarket operators have stepped up efforts to revamp their operation to cater the changing needs of Chinese consumers. Their efforts have paid off with solid improvements in sales performance. According to the National Bureau of Statistics of the PRC (NBS), the retail sales growth of supermarkets above designated size (enterprises with annual sales of 5 million yuan or above and with employee strength of 60 or more) was 7.4% year-on-year (yoy) in 1H18, up from 6.3% yoy in 1H17 (Exhibit 1).

Exhibit 1: Yoy sales growth by retail formats, 1H17 – 1H18



Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Most of the top hypermarket and supermarket chain operators in China achieved a better performance in 2017 than in 2016, thanks both to new store openings and format expansion. The FMCG chain operators in the Top 100s achieved total sales revenue of 1,062 billion yuan in 2017, an increase of 7.3% yoy, up significantly from 4.1% yoy and 4.2% yoy in 2015 and 2016 respectively (Exhibit 2).

Exhibit 2: Yoy sales growth of FMCG chain operators among the Top 100s in China, 2012–2017

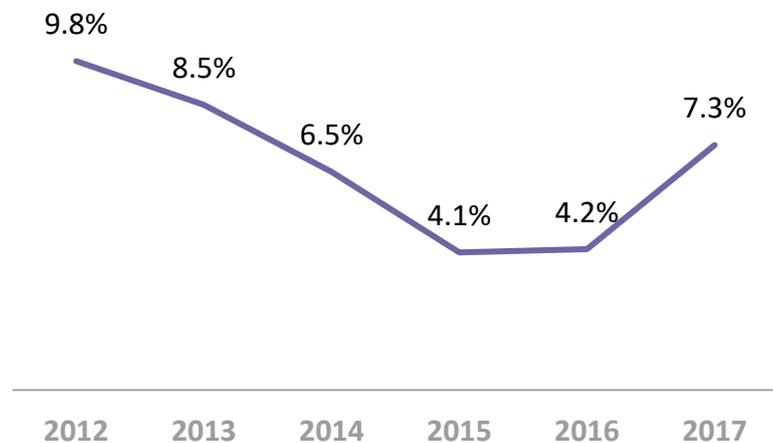


Exhibit 3 shows the performance and major developments of selected major hypermarket and supermarket chains in China in 2017.

Exhibit 3: Performance and developments of selected hypermarket/ supermarket chains in China, 2017

Name of company	Performance
 <p>Walmart China Investment Co., Ltd</p>	<ul style="list-style-type: none"> Walmart China reported the best financial sales performance in China in 2017. In 2017, Walmart China opened 31 new stores. Walmart China invested 300 million yuan to upgrade 62 stores, enlarging the fresh food section to attract more customers. More than 160 Walmart stores are already connected to JD Daojia. In 2018, Walmart China will put more focus on rolling out omnichannel strategy, digitalization and smart retail, building new retail format, enhancing its competitiveness in fresh food, private labels and direct import products; it targets to open 30-40 new stores and upgrade 50 current stores.
 <p>Sun Art Retail Group Ltd.</p>	<ul style="list-style-type: none"> Revenue amounted to 102,320 million yuan in 2017, up 1.9% yoy. Profit for the year grew 14.9% yoy to 3,020 million yuan. Net profit margin increased 0.4 ppt to 3.0%. As of 31 December 2017, Sun Art Retail has 461 hypermarket complexes across China. On 20 November 2017, Auchan Retail International S.A., together with Ruentex Group, a stakeholder of Sun Art Retail, and Alibaba Group established a strategic alliance. Auchan Retail, Alibaba Group and Ruentex now have approximately 36.18%, 36.17% and 4.67% interest in Sun Art Retail, respectively. Sun Art Retail commenced a new venture “Auchan Minute”, an unmanned convenience box with 18 sqm and 500 SKUs. It has rolled out 67 boxes as of December 2017. Its “RT Mart Fresh” app was made available to all RT Mart stores. Customers can make orders via the app and the nearest stores can provide one-hour delivery service to designated address for the consumers.
 <p>Yonghui Superstores Co., Ltd.</p>	<ul style="list-style-type: none"> Total sales revenue reached 58.59 billion yuan in 2017, up by 19.01% yoy, while net profit was 1.81 billion yuan, up by 46.28% yoy. As of December 2017, Yonghui Superstores has 806 branches in 21 provinces. In January 2017, Yonghui launched a new retail format “YH Super Species”, which focuses more on catering and experiential elements while offering fresh produce. It already opened 46 YH Super Species as of June 2018. Its “Yonghui Life” app was made available to all of Yonghui’s retail businesses; the app has 2.89 million registered uses as of December 2017. Yonghui Superstores has actively transformed and upgraded its Yonghui Superstores (Red Label store) to Bravo YH (Green Label store).

 <p>New Huadu Supercenter Co., Ltd.</p>	<ul style="list-style-type: none"> • In 2017, total revenue reached 6.97 billion yuan, up 3.92% yoy. Net loss was 52.44 million yuan. • New Huadu opened a new retail format "Hai Wu Hui" in May 2017 which focuses on fresh food and on-site catering to embrace "new retail". It opened another new retail format with focus on sports goods in December 2017. • As of December 2017, New Huadu operated 125 supermarkets, 7 department stores, and 11 sports stores.
 <p>Lianhua Supermarket Holdings Co., Ltd.</p>	<ul style="list-style-type: none"> • Revenue amounted to 25,225 million yuan in 2017, down 5.4% yoy. The annual loss attributable to the shareholders of the company was 283 million yuan. • Lianhua Supermarket operates in three main retail segments including hypermarkets, supermarkets and convenience stores under the "Century Mart", "Lianhua Supermarket", "Hualian Supermarket" and "Lianhua Quik" banner. Lianhua Supermarket operated 3,421 stores in 17 provinces as of December 2017. • Lianhua Supermarket launched a new retail format named "Century Lianhua Whale-Choice Store" in Hangzhou in 2017 which focuses on offering on-site catering services in supermarkets. • It also proactively optimized its fresh procurement supply chain in 2017.
 <p>C.P. Lotus Corporation</p>	<ul style="list-style-type: none"> • Total revenue was 9,655.2 million yuan in 2017. Profit attributable to equity shareholders of the company was 179 million yuan. • CP Lotus operated 69 stores in China in 2017, 56% of the stores are located in Southern China.
 <p>Better Life Commercial Chain Share Co., Ltd.</p>	<ul style="list-style-type: none"> • Total revenue was 17.25 billion yuan in 2017, up 11.51% yoy. • Better Life launched a new retail format "Fresh Idea" in June 2017 which features an on-site catering area in the supermarket; it has 13 stores as of December 2017. • Better Life operated 267 supermarkets and 51 department stores in China in 2017; more than 50% of the stores are located in Hunan.
 <p>Renrenle Commercial Group Co., Ltd.</p>	<ul style="list-style-type: none"> • Total revenue was 8.86 billion yuan in 2017, down 12.81% yoy.

Source: Company annual reports; compiled by Fung Business Intelligence

2. China Resources Vanguard, RT Mart, Walmart China, Yonghui Superstores, and Lianhua Supermarket rank the top among the hypermarket and supermarket chain operators

According to the annual list of “Top 100 fast-moving consumer goods (FMCG) chain operators in China” released by the China Chain Store and Franchise Association (CCFA), most key chain operators are engaged in hypermarket and supermarket businesses. Topping the list in this category is China Resources Vanguard, followed by RT Mart, Walmart China, Yonghui Superstores, and Lianhua Supermarket. Of which Yonghui Superstores achieved significant yoy sales growth of around 20%, much higher than the average sales growth of FMCG of 7.3% yoy.

Exhibit 4 shows the key FMCG operators by sales revenue among the Top 100s in 2017.

In the past, most large-scale key players in the hypermarket and supermarket sector were nationally focused while many smaller-sized domestic supermarkets and hypermarkets operated regionally. Nowadays, more and more domestic operators are expanding nationally. For example, Yonghui Supermarket has 806 stores nationally as of December 2017 covering 21 provinces. Lianhua Supermarket operated 3,421 stores in 17 provinces in China as of December 2017. Sun Art Retail (which operates hypermarkets and supermarkets under RT Mart and Auchan banner) has 461 stores in 29 provinces as of December 2017.

Exhibit 4: Top 10 FMCG players among the Top 100s, 2017 (Ranked by retail sales)

Rank	Name of company	Sales, pre-tax (million yuan)		Number of stores	
		In absolute terms	yoy change (%)	In absolute terms	yoy change (%)
1	 China Resources Vanguard Co. Ltd. ¹	103,646	0.1	3,162	-1.9
2	 RT Mart ²	95,400	2.3	383	4.6
3	 Walmart (China) Investment Co., Ltd.	80,278	4.7	441	0.5
4	 Yonghui Superstores Co., Ltd.	65,400	20.2	806	65.5
5	 Lianhua Supermarket Holdings Co., Ltd. ³	56,460	-5.6	3,451	-5.4
6	 Easy Joy Convenience Store (Sinopec Group)	51,950	48.0	25,775	0.7
7	 Carrefour China Inc. ⁴	49,796	-1.3	321	0.6
8	 Wumart Holdings ⁵	37,041	5.8	752	32.9
9	 Ccoop Group Co., Ltd.	24,542	114.2	266	7.7
10	 Zhongbai Chain Storage Supermarket Co., Ltd.	22,030	4.4	174	-5.4

Source: China Chain Store and Franchise Association; modified by Fung Business Intelligence

¹Sales of China Resources Vanguard Co. Ltd. included sales of Suguo Supermarket.

²Sales of RT Mart excluded sales of Feiniu.com.

³Sales of Lianhua Supermarket Holdings Co., Ltd. included sales of Carrefour in Shanghai.

⁴Sales of Carrefour included sales in the Greater China Region.

⁵Sales of Wumart included sales of B&Q China Co. Ltd. and Yinchuan Xinhua Commercial Group Co., Ltd..

3. Pace of new store openings picks up; store closures remain significant

In 2017, the pace of hypermarket and supermarket store openings picked up gradually. The number of new stores of the Top 100 FMCG players increased 8.1% yoy in 2017, up from 6.9% yoy in the previous year. Many undertook store revamps and closed unprofitable stores. For example, Lianhua Supermarket closed 492 stores in 2017, but opened only 295 stores. Zhongbai also closed over 100 stores in 2017. Exhibit 5 shows the store closures of selected hypermarket and supermarket players in 2017.

Exhibit 5: Store openings and closures of selected hypermarkets and supermarkets, 2017

Hypermarket/Supermarket	Store openings	Store closures	Total number of stores
Lianhua Supermarket	295	492	3,421
Hongqi	119	93	2,730
Zhongbai	200	107	1,130
Yonghui Superstores	332	3	806
Jiajiayue	68	24	675
Sun Art Retail	18	3	461
Better Life	43	10	318
Jingkelong	13	41	220
Sanjiang	18	7	169
Hualian Supermarket	11	9	156
New Huadu	6	10	143
Renrenle	15	11	125
CP Lotus	8	0	72

Source: Linkshop; compiled by Fung Business Intelligence

Meanwhile, some foreign players exited the China market recently. One significant example is that South Korea's Lotte Group. In April 2018, it agreed to sell 21 Lotte Mart to Wumei Holdings Inc. for about 1.5 billion yuan. In May 2018, it further announced to sell Lotte Mart's 72 stores in Eastern China, including Shanghai and Jiangsu to Liqun Group at 1.67 billion yuan.

II. Key trends and developments

1. Adapting to “New Consumption” era

Over the past year, many traditional hypermarket and supermarket operators have proactively adapted themselves to the “New Consumption” era. Many have used data analytics to link shopper profiles with shopping behaviors as a way to increase store traffic and offer more targeted promotions to shoppers. Some have integrated their inventory and supply chain management system with e-commerce or solutions platforms to improve warehouse management, inventory planning and last-mile delivery. Others have invested in technologies and digitalization to create a better in-store experience.

Embracing retail technologies

“Smart retailing” is the major theme in the retail market in 2018. Hypermarket and supermarket chain operators are embracing technologies in-store to offer consumer better shopping experience. For instance, Carrefour China launched its first Carrefour Le Marché smart store in Shanghai in May 2018. This is Carrefour’s first global initiative in smart retail. Partnering with Tencent, Carrefour Le Marché is equipped with a number of “black technologies” such as “Scan and Go” payment service, facial recognition payment system, self-checkout counters, electronic tags and other interactive entertainment facilities. For any item in the store, customers can scan the price label or product barcode with Carrefour’s Mini Program on WeChat, and add it to the E-trolley. When the customers finish shopping, they can choose to pay online via WeChat Pay and go through a designated passageway to “scan and go”. Customers can also pay with their faces. Customers have to scan their face and register through WeChat Pay before using the facial recognition payment system. When customers finish shopping, they can just smile to the camera to complete the payment process.



Designated passageway to “scan and go” (Photo source: Fung Business Intelligence)



WeChat facial recognition payment system” (Photo source: Fung Business Intelligence)

Meanwhile, JD.com’s fresh food supermarket 7FRESH has also put great emphasis on technologies. 7FRESH was launched in Beijing in December 2017. With a store size of around 4,000 sqm, 7FRESH focuses mainly on fresh food, ready-to-cook packaged food and cooked food. The store also features some advanced technologies, including interactive projector which can display product information, smart shopping cart, and conveyor belt. Of which, the smart shopping cart can automatically follow customers and guide them to the right product shelves to get the products they want. It is reported that 7FRESH plans to open over 1,000 stores in the next three to five years.



7FRESH’s smart shopping cart (Photo source: 7FRESH)

Digitalization of hypermarkets and supermarkets is well underway

Digitalization is one of the major moves of hypermarket and supermarket players. An example is Wumart Group. It has installed electronic shelf labels to replace traditional paper labels in 48 of its hypermarkets in the eastern China region in April 2017. Product information will be displayed electronically to allow for integrated online and offline inventory management. Other benefits of using electronic shelf labels include: saving manpower and increasing efficiency of store operation; improving the accuracy of pricing; and allowing for real-time price adjustment so that online and offline price and discount information can be synchronized.

In June 2018, RT Mart announced that it has completed the digital transformation of 100 stores using Alibaba's new retail technologies. RT Mart and Alibaba aim to upgrade the remaining 300 stores by the end of 2018. The upgraded RT Mart stores offer 1-hour delivery for customers living within a 3-km radius. Orders placed via the mobile app are fulfilled in the closest physical store.

Connecting with third-party O2O local lifestyle service platforms to provide quick delivery

Consumers now want their products as fast as possible. Some hypermarket and supermarket chain operators have partnered with third-party online-to-offline (O2O) local lifestyle service platforms such as JD Daojia and Dmall to provide O2O shopping and speedy delivery services.

Launched in April 2015, JD Daojia is JD.com's grocery delivery platform which provides 1-hour delivery services to customers in most of the tier-1 and tier-2 cities. It merged with a crowdsourcing delivery platform Dada in April 2016. JD Daojia currently works with leading hypermarket and supermarket chain operators such as Walmart China, Sam's Club, Yonghui Superstores Lianhua Supermarket, Better Life Group, CR Vanguard as well as other chains across 370 cities nationwide.

Dmall is a third-party O2O local lifestyle service platform launched in 2015, mainly focusing on FMCG. It partners with various supermarkets to provide 2-hour delivery service to customers who live within a 3-km distance from the store. Wumart is the first partner of Dmall. Recently, Dmall has proactively strengthened cooperation with other supermarket chains including Zhongbai Holdings, Better Life Group, Shenzhen Jiahua Stores, Renrenle and Zhongyanghai Group.

2. Continues to carry out format revamp

In recent years, more and more hypermarket and supermarket chain operators have revamped their stores or launched new store formats to better suit the changing needs of customers. They have also created more spaces for occasion- or experience-based activities (e.g., in-store dining) to improve customer stickiness.

Hypermarket and supermarket operators move to smaller-sized format

Small-sized format has been favored by many hypermarket and supermarket chain operators as small-sized store can better address consumers' increasing demand for convenience, personalization and fast services. For instance, Walmart China re-launched its small-format store "Smart Choice" in Shenzhen in April 2018. With a store size of around 1,200 sqm, less than a tenth of the 15,000 sqm average size of a Walmart hypermarket in China, the store mainly offers fresh food, cooked food, half-cooked food and packaged food. It is connected with JD Daojia, where customers can make their orders on JD Daojia and have the orders delivered to home directly. Walmart hopes the small-format store can satisfy the increasing demand from small households and the singles. It plans to open five more "Smart Choice" stores in Shenzhen, Guangzhou and Dongguan by the end of 2018.

Earlier in August 2017, Wumart launched its first small-format community store in Hangzhou. The store has an operating area of 1,500 sqm, much smaller than other regular hypermarkets. The store features an in-store catering section, where consumers can purchase fresh foods in the store and the chef will prepare the dish real-time, ranging from Chinese style dishes, to French steak, and even sashimi and salad.

Fresh-food supermarkets see rapid growth

The "fresh-food supermarket" phenomenon in China is fast evolving. To meet the constantly changing consumer preferences, many grocery retailers have put more emphasis on fresh food business. Major initiatives include enlarging the proportion of fresh food in their supermarkets and hypermarkets, sourcing directly from farms to offer better price for customers, and importing more unique fresh products overseas. Some players have incorporated various experiential elements to better engage with customers along their shopping journey. According to Chinese information platform Winshang, 12 "fresh-food supermarket" chains have announced plans to open over 200 stores in 2018, and expand rapidly over the next three years. Of which, Alibaba's Hema Xiansheng will open over 100 stores mainly in tier-1 and tier-2 cities; Yonghui Superstore's YH Super Species will launch 100 new stores in 2018, while JD.com's 7Fresh will open over 1,000 stores in the next three to five years; Suning's SU Fresh will open 50 new stores by end-2018 (Exhibit 6).

Exhibit 6: Store opening plans of selected fresh-food supermarkets

Retailer	Launched by	Launched date	Number of stores	Opening plans
Hema Xiansheng	Alibaba	January 2016	67 (August 2018)	100 stores by end-2018
YH Super Species	Yonghui Superstores	January 2017	46 (June 2018)	100 stores by end-2018
SU FRESH	Suning.com	December 2017	7 (May 2018)	50 stores by end-2018
7FRESH	JD.com	January 2018	2 (Feb 2018)	1,000 stores in 3-5 years

Source: *Winshang, compiled by Fung Business Intelligence*

3. Stronger effort into developing private labels

A number of hypermarket and supermarket chains have launched their own private labels in recent years. According to a survey by the CCFA, the total SKUs of private label products increased from 435 in 2016 to 633 in 2017 for the Top 100s. However, sales of private labels accounted for only 6.4% of the total sales in 2017.

CP Lotus reported in its financial report 2017 that it has 42 SKUs of private label products and plans to increase the SKUs to 200 in 2018. In August 2018, Yonghui Supermarket also announced plans to revamp its private label strategy – instead of putting all the fresh produce under the private label “Caishixian”, Yonghui will develop various private labels based on product categories and source of origins.

In April 2018, Walmart China also reorganized its private label business. The company integrated its 13 private labels under three brand names "Great value" (daily necessities), "Marketside" (bakery products) and "George" (apparel). Walmart hopes its sales of private label products will account for around 20% of the total sales in the future.

Indeed, developing private labels is one of the winning strategy for hypermarkets and supermarkets that wish differentiate themselves from their peers and earn higher profit margins. The aforementioned CCFA survey showed that profit margin for hypermarket and supermarket chains with their own private labels was 15% higher than those without their private brands.

4. Forming strategic alliances with Internet giants to drive synergies

To achieve better O2O integration, some traditional grocery retailers have formed partnerships with Internet companies to gain access to payment tools, social media, big data analytics, etc. In turn, Internet companies can leverage the extensive physical store networks of hypermarkets or supermarkets to reach more customers. Selected partnerships between hypermarket and supermarket operators and leading Internet players include:

Alibaba acquires stake in Sun Art Retail Group to explore new retail opportunities

In November 2017, Alibaba Group announced that it has acquired a 36.16% stake in Sun Art Retail Group for HKD\$22.4 billion (US\$2.88 billion) to expand further in the offline retail market. For Alibaba, the deal enables the company to gain access to Sun Art Retail's offline customers via the latter's over 440 hypermarkets and supermarkets in China. Sun Art Retail's store network is unique among its peers in the grocery sector – it spreads across 29 provinces, while others are mostly regional operators; this provides Alibaba a fast route to gain access to the offline grocery market. For Sun Art Retail, it can leverage Alibaba's digital ecosystem and undergo digital transformation in O2O retailing, logistics infrastructure, etc. to provide better shopping experience for its customers.

Tencent and China Resources Group sign strategic cooperation agreement

In April 2018, Tencent and China Resources Group signed a strategic cooperation agreement to jointly work on areas of common interest including smart cities and real estate management, medical and health, cloud computing and big data, as well as smart retail. For smart retail cooperation, China Resources' retail stores will equip with Tencent's Internet tools, big data analytics, cloud platforms, etc. The two companies hope to better connect Tencent's social media traffic with China Resources' physical networks including hypermarkets, supermarkets and coffee shops. In the future, they will consider combining Tencent's cutting-edge technologies such as artificial intelligence and blockchain with related businesses of China Resources.

Walmart China and Tencent reach in-depth strategic cooperation

In June 2018, Walmart China and Tencent jointly announced that they formally entered an in-depth strategic partnership. To upgrade the various consumption scenes, the two companies will have in-depth cooperation on smart retail and digitalization process such as shopping experience enhancement, precision marketing, comprehensive payment services, and membership system enhancement, by fully utilizing their strengths in their respective fields. Earlier in March 2018, Walmart China partnered with Tencent to launch an in-store self-service payment service "Scan and Go" through WeChat Mini Program; customers could complete their payment by scanning the product barcodes and paying with their mobile phone. As of June 2018, Walmart has launched this service in its stores in 28 cities and plans

to extend this service to 400 plus stores in the country during this year.

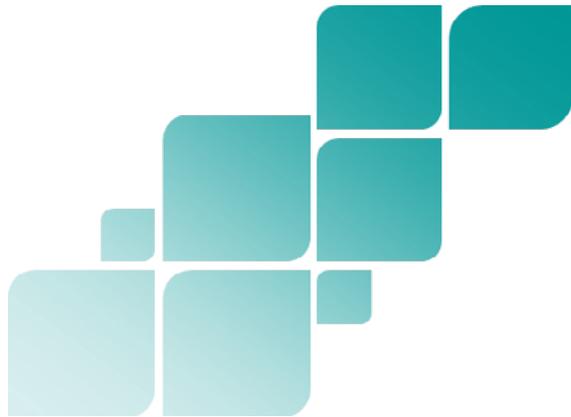
JD.com and Walmart to integrate inventory management

In July 2018, JD.com and Walmart announced that both parties will accelerate the integration of their stores and platforms, inventory and customers. The two companies plan to achieve full inventory integration and roll out a pilot 1-hour delivery service before the end of this year. JD.com said that the company will make sell-out forecast in Walmart stores, adjust inventory according to consumer behavior and needs, reduce invalid inventory, improve the efficiency of supply chain operation, and ultimately achieve cost reduction

III. Concluding remarks

China's hypermarket and supermarket sector has entered a "New Consumption" era of unprecedented changes. To cope with the changes and new developments, many operators are launching new formats, adopting new technologies in their supply chain as well as in their storefronts, trialing new delivery models, developing private labels and forming partnerships with leading Internet players to roll out their O2O strategy.

After all the trial and error in 2016 and 2017, the performance of the hypermarket and supermarket sector is set to further improve in the coming years. We expect to see more new developments as players will continue to come up with new strategies and new ways to operate their business. That said, despite the positive outlook, there remain some challenges facing the hypermarket and supermarket players such as securing investment capital, developing sustainable business model and maintaining profitability while embracing the changes.



Spotlight on China Retail – Issue 6

Convenience Stores

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

October 2018

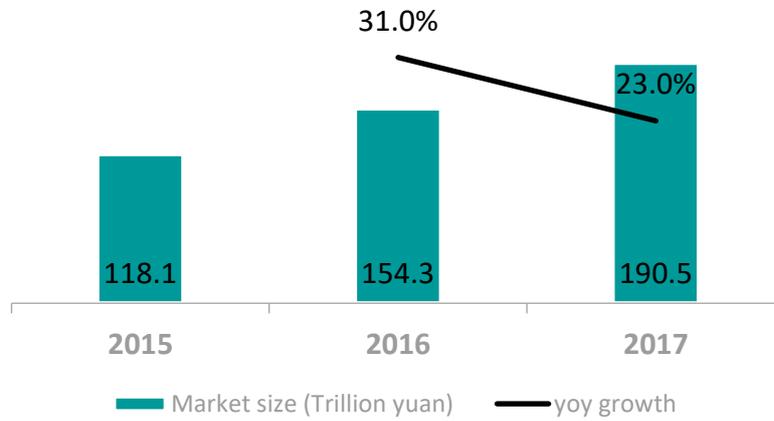
Small format shops, especially convenience stores (CVS) and community stores, have gained popularity over the years as consumers are getting more mature and demanding more convenient shopping experience. As small-scale retailer, CVS has the advantage of being more accessible to customers, while offering quicker services and better experience. As with other retail formats, the CVS sector has undergone rapid transformation and reinvention in the rapidly evolving retail environment. CVS is the pioneer of retail transformation and reinvention, as well as an active participant in online-to-offline (O2O) integration.

I. Market overview

1. China's CVS sector sees rapid sales growth

CVS has been the fastest-growing retail format in China in recent years. According to a report by the China Chain Store and Franchise Association (CCFA) and the Boston Consulting Group (BCG), total sales revenue for the CVS sector (including forecourt stores) reached 190.5 trillion yuan in 2017, up 23% year-on-year (yoy) (Exhibit 1). The growth momentum of CVS is expected to continue, as small retail format continues to gain in popularity in China's retail market. Data from the Ministry of Commerce (MOFCOM) show that the yoy growth of 5,000 key retailers reached 4.6% yoy in 1H18, with CVS recording the fastest growth among all retail formats: 7.6% yoy, compared to 4.5% yoy for supermarkets and 1.6% yoy for department stores.

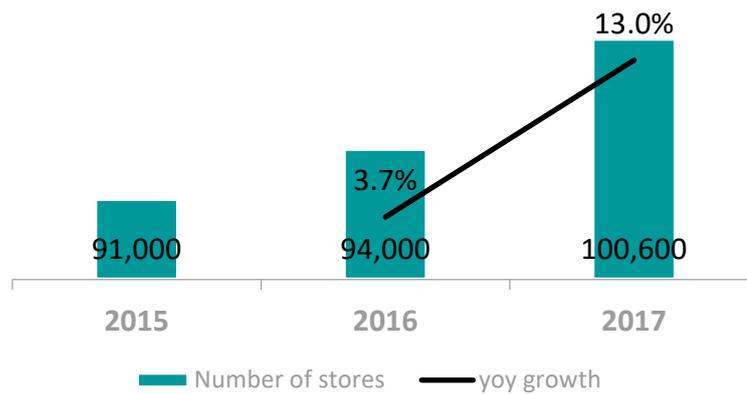
Exhibit 1: Total sales revenue for CVSs, 2015 – 2017



Source: China Chain Store and Franchise Association, BCG; compiled by Fung Business Intelligence

In 2017, the total number of CVS in China increased by 13% yoy to reach over 100,000, up from 94,000 in 2016, indicating that the store opening speed is very fast in the sector (Exhibit 2).

Exhibit 2: Number of stores, 2015 – 2017



Source: China Chain Store and Franchise Association; BCG; compiled by Fung Business Intelligence

2. Overall prosperity index remains stable in 2Q18

According to the “Report on the Prosperity Index of China’s Convenience Stores” released by the MOFCOM, the development of the CVS sector has remained stable and healthy throughout 2017 and 2018. The overall prosperity index of China’s convenience stores was around 70.00 in the previous quarters, much higher than the 50-point threshold (Exhibit 3).

Exhibit 3: Prosperity index of China’s convenience stores, 1Q17 – 2Q18



Source: Ministry of Commerce; compiled by Fung Business Intelligence

3. Domestic CVS players take the lead

Currently, most leading CVS players in China are regionally based. As shown in Exhibit 4, Easy Joy and uSmile¹ have the most number of stores in China, followed by regional players Meiyijia, Tianfu and Hongqi. It is noteworthy that Easy Joy and uSmile operate mainly forecourt stores, thus they have more stores than others. Meiyijia, with 11,659 stores in China in 2017, greatly outnumbered that of local peers Tianfu and Hongqi. Foreign player FamilyMart only came sixth on the list in terms of store numbers.

Recently, it is notable that both foreign and domestic CVS operators are expanding fast around the country. This is different from the past where foreign CVS operators sought to expand nationally, while domestic players focused mostly on regional expansion. As of July 2018, 7-Eleven has 2,244 branches across China, of which over half of them were opened in the past three years. Lawson has 1,642 branches in China as of June 2018, of which 990 of them were

¹ Easy Joy and uSmile operate mainly forecourt stores in China.

opened in the past three years. Meanwhile, domestic player Meiyijia has been actively expanding outside of Southern China into other provinces such as Shanghai, Zhejiang, Guizhou and Hunan.

Exhibit 4: Top convenience store operators by number of stores, 2017

Rank	CVS brand	Parent company	No. of stores
1	 Easy Joy⁺ 汽车生活的驿站	Sinopec Group	25,775
2	 uSmile⁺ 昆仑好客	PetroChina Co., Ltd.	19,000
3	 Meiyijia 美宜佳	Dongguan Sugar & Liquor Group Meiyijia Convenience Store Co., Ltd.	11,659
4	 Tianfu 天福	Guangdong Tianfu Convenience Chain Limited	3,820
5	 Hongqi 红旗连锁	Chengdu Hongqi Chainstore Co., Ltd.	2,730
6	 FamilyMart	Shanghai FamilyMart Co., Ltd.	2,181
7	 Shizu; Zhishang 十足 志之上	C&U Group	2,003
8	 365 365 24 小时便利店	Hebei 365 International	1,700
9	 7-Eleven	Seven-Eleven (Beijing) Co., Ltd.	1,644
10	 Quik 快客	Shanghai Lianhua Quik Convenience Stores Co, Ltd.	1,474
11	 Tangjiu 唐久便利	Shanxi Taiyuan Tangjiu Supermarket Co., Ltd.	1,435
12	 Lawson LAWSON 罗森	Lawson (China) Holdings, Inc.	1,399
13	 Kedi; Alldays 好德 alldays KEDI	Nonggongshang Group	1,300*
14	 Fook Convenience Store 福客便利店	Xiamen Fook Chain Management Co., Ltd.	1,237
15	 Wudongfeng 舞东风 WUDONGFENG	Sichuan Wudongfeng Supermarket Chain Co., Ltd.	1,187

Source: China Chain Store and Franchise Association; modified by Fung Business Intelligence

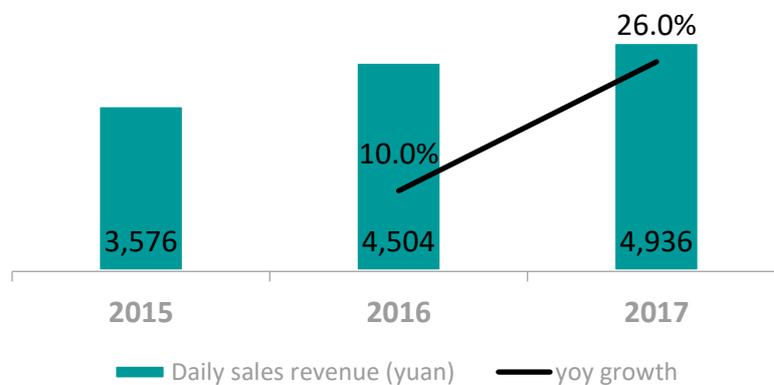
[†]Note: Forecourt retailers

*Note: Estimated value

4. Performance of individual store improves; more players tap the online market

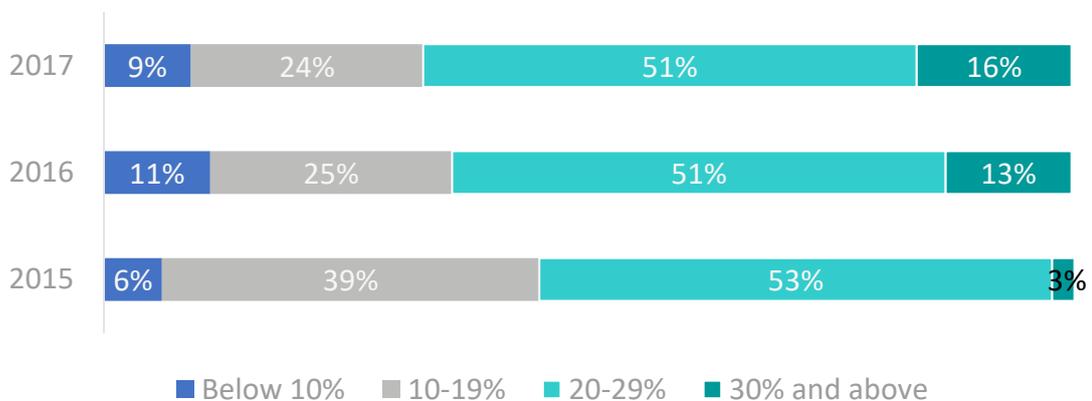
The performance of individual store improved significantly in 2017 with daily sales revenue increased 26% yoy to 4,936 yuan in 2017, according to the report by the CCFA and the BCG (Exhibit 5). As shown in Exhibit 6, 67% of the 55 surveyed companies recorded gross margin of over 20% in 2017, compared to 56% of the surveyed companies in 2015.

Exhibit 5: Daily sales revenue, 2015 – 2017



Source: China Chain Store and Franchise Association; BCG; compiled by Fung Business Intelligence

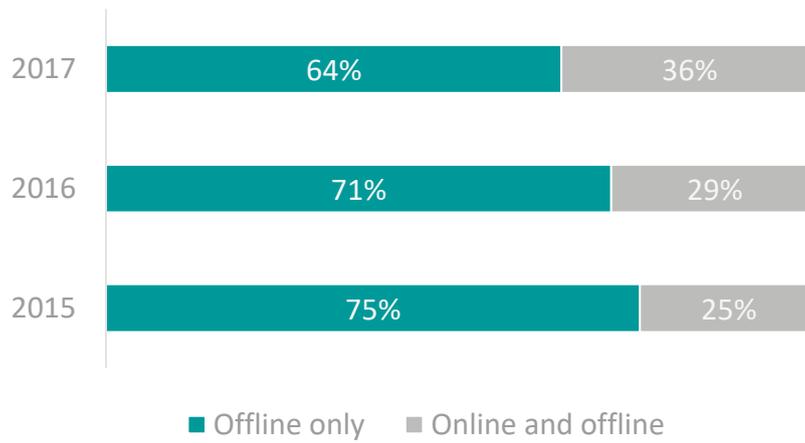
Exhibit 6: Gross margin of the 55 surveyed respondents of CVS, 2015 – 2017



Source: China Chain Store and Franchise Association, BCG; compiled by Fung Business Intelligence

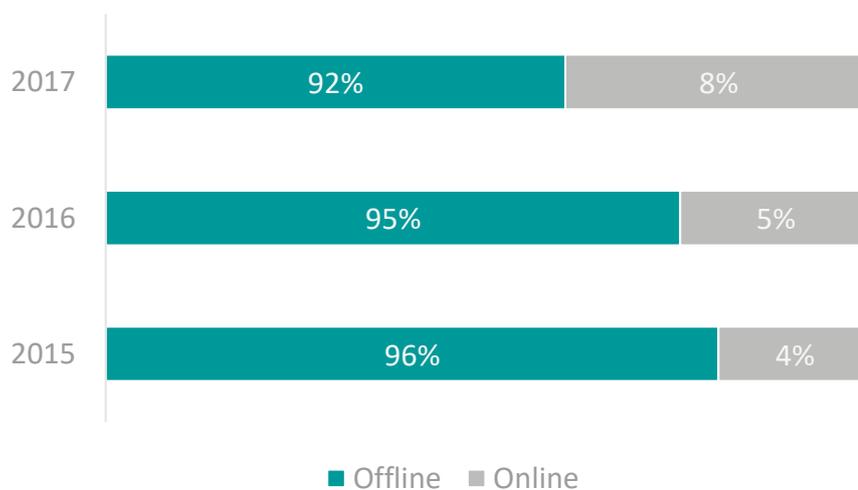
The report also shows that 36% of the surveyed companies have set up online business (Exhibit 7), but online sales accounted for only around 8% of the total sales in 2017, slightly higher than 5% in 2016 and 4% in 2015 (Exhibit 8).

Exhibit 7: Percentage of CVS operator going online, 2015 – 2017



Source: China Chain Store and Franchise Association, BCG; compiled by Fung Business Intelligence

Exhibit 8: Share of online retail sales of the total sales, 2015 – 2017



Source: China Chain Store and Franchise Association, BCG; compiled by Fung Business Intelligence

II. Key trends and developments

1. O2O initiatives remain crucial

Providing pick-up services

To stay competitive in the fast-changing retail market, many CVS operators have drawn up seamless O2O strategies to attract and retain customers. Providing pick-up services in-store is a common strategy adopted by CVS players. Since the beginning of 2017, increasing numbers of CVS chains including FamilyMart, Meiyijia, Tangjiu, and Quik have partnered with e-commerce players to provide in-store pick-up services for online customers. CVS chains can benefit from the potential increase in customer flow, while e-commerce players can offer additional pick-up options for customers and enjoy lower logistics costs.

Partnering with O2O local lifestyle service platforms

Local lifestyle service O2O market in China has developed rapidly over recent years, driven by consumers' increasing pursuit of better quality of life as well as growing demand for convenience. In the past year, many CVS operators partnered with third-party local lifestyle service/ delivery platforms such as JD Daojia, Baidu Waimai, Meituan Waimai to offer O2O services. CVS players can leverage the app of these platforms to reach out to more customers, while providing other O2O services such as delivery. According to JD Daojia, as of July 2018, it has cooperated with over 10,000 CVS branches including leading CVS operators such as FamilyMart, Lawson and 7-Eleven, as well as regional CVS chains such as OurHours, Buddies, Today, Wudongfeng, Meiyijia and Youke to offer O2O services.

In August, Beijing 7-Eleven announced that all of its stores in Beijing have connected with Meituan Waimai platform. Most of the SKUs in 7-Eleven are available on Meituan Waimai platform; customers can order products via Meituan Waimai app and Meituan will provide the delivery services. It is reported that 7-Eleven will further cooperate with other delivery platforms in the future.

2. Differentiated products are the keys to success; players make greater efforts to launch private labels

Nowadays, Chinese consumers look for products that are personalized or even unique. To cater to this demand, some CVS operators have stepped up efforts to launch their own private labels and to offer such products. For instance, FamilyMart has launched its own snack food brand “YUMMY” in China; 7-Eleven has introduced its own private label series “Seven Select”; and CP Fresh Mart has launched a number of private labels for fresh produce, wine, tea, etc. Regional CVS chain Anda Convenience Store has started to sell private label products sourced from NetEase Yanxuan, an e-commerce platform under NetEase. The products are mainly daily necessities such as batteries, data cables, bandages, wet wipes, rags and cloths, bath sponges and slippers.



FamilyMart's snack food private label “YUMMY” (Photo source: Fung Business Intelligence)

It is noteworthy that private label development in China's CVS sector still lags far behind that of equivalent chains in developed countries such as Japan. According to a survey by the CCFA and BCG, over 80% of sampled CVS operators in China reported that sales of their private labels accounted for less than 10% of total sales. By contrast, for many CVS stores in Japan, private label sales account for around 40-50% of total sales. Thus, there is still huge room for private label development in China's CVS sector.

3. Emergence of technology-driven business models

Technology advancement is a significant factor driving the growth of the CVS sector. Since the second half of 2017, there have been significant CVS initiatives involving the adoption of

technologies that can transform retail operations. This had led to the emergence of technology-driven business models including those featuring unmanned/ cashierless CVS, smart shelves and smart vending machines.

Unmanned/ cashierless convenience stores

Increasing numbers of players are tapping the unmanned/ cashierless CVS market by launching staffless CVS, including Internet giants Alibaba and JD.com, as well as several large-scale retailers such as Sun Art, Easyhome, Rainbow Department Store, Sinopec and Lenovo (Exhibit 9). Most of these stores use advanced technologies such as artificial intelligence (AI) to replace manpower in their operations to improve efficiencies and reduce costs. A recent case is Sinopec's Easy Joy membership unmanned store. Sinopec opened its first IC card membership-based Easy Joy unmanned store in Xiangtan city, Hunan province in July 2018. The store reportedly has adopted more than 10 technologies such as facial recognition, smart access control, electronic tags, smart lighting and scan to pay technology. In the same month, Lenovo announced that its first unmanned store has entered trial operation. Located at its own headquarters, the store provides "line-free, cash-free, and wait-free" shopping experience. It has installed devices which can detect customers' expressions and body languages when they pick up the products in-store. It can also trace consumers' paths and their length of stay in front of different shelves. This provides insights for adjusting product assortment and in-store display for a more convenient shopping experience.

Exhibit 9: Selected examples of unmanned convenience stores



Source: Fung Business Intelligence

Smart shelves and smart vending machines

Following the opening of unmanned stores, unmanned shelves and smart vending machines are the next wave of innovations in the CVS sector. For instance, JD Daojia has launched its unmanned shelf “Daojia Go” in tier-1 and tier-2 cities including Beijing, Shanghai, Guangzhou and Shenzhen since October 2017. “Daojia Go” shelves are mostly located in office areas. Each “Daojia Go” is a refrigerator-like box, which is equipped with facial recognition technology. After scanning their faces, customers need to scan the QR code on the “Daojia Go” app to open the shelf door; they can then take the products, close the door and settle payment instantly as the “Daojia Go” app is connected with WeChat Pay or JD Pay.

Another example is Gome. It launched its first 24-hour unmanned shelves in February 2018. Consumers need to register with the palm scanners on the unmanned shelves. Registered users can scan their palm to open the shelf door and choose the products. The system will detect the products taken out and show the product information and prices on screen. Payments will be completed via Alipay once the door of the shelf is closed. Similarly, Suning also launched its first unmanned shelf in January 2018. It is reported that Suning targets to install 50,000 unmanned shelves nationwide in 2018. The first phase will include 79 key cities in China and follow by 134 cities in the next phase.

Smart vending machine comes on the scene

Some CVS players have installed smart vending machines as a way to enhance consumer experience. In May 2018, JD Convenience Store launched a new type of vending machine in its stores across the country. All JD Convenience Store owners can put the vending machine somewhere near their stores such as outdoor sports ground and on the street. The vending machine sells mainly beverages and snacks, as well as other daily necessities, and mobile phone accessories such as power banks and screen protectors. Customers can scan the QR code on the product to complete payment. Launching smart vending machine is indeed a major attempt for JD Convenience Store to implement its “Borderless Retail” strategy – extending the retail scenes and improving user experience.

In a similar attempt to entice shoppers, domestic CVS operator Ccoop launched its first AI smart vending machine in May 2018 in Beijing. The vending machine adopts activity recognition technology and visual tracking technology to identify and detect which products have been taken out and also being put back on the rack. It is reported that the vending machine’s product identification accuracy rate is as high as 99%.

4. Retailers tap the fast-growing fresh food community store market

Launching community stores is a growing trend in the CVS sector. CVS is one of the most relevant formats for serving local communities. Instead of offering standardized products and services, CVS can better accommodate the diverse needs of different communities and provide tailor-made services for them. Specifically, CVS can provide goods and services suitable for the elderly, families, or university students in nearby areas.

Recently, some CVS chains have upgraded and transformed their stores into fresh food community stores, catering to the growing appetite of Chinese consumers for fresh, healthy, quality products. In October 2017, VIP.com launched its first offline fresh food community store “Pinjun Life” in Guangzhou. The store is operated by Pinjun Holdings Ltd., the wholly-owned logistics company under VIP.com. Pinjun Life store offers fresh food, seafood, meat and eggs, groceries, hot meals, bakery products, fast food, frozen food, etc. The store also serves as the pick-up point for online orders placed on VIP app or Pinjun Life app. According to VIP.com, it targets to open 200 Pinjun Life stores in 2018, and 10,000 stores in three years.

Another example is domestic supermarket and CVS chain operator Chengdu Hongqi. The CVS chain has further cooperated with Yonghui Superstores² to upgrade and transform some of its stores into fresh food convenience stores. Supported by Yonghui’s expertise in fresh food supply chain, the stores offer more fresh food including fruits, vegetables, meat and seafood compared to other Chengdu Hongqi stores. Chengdu Hongqi plans to open 300 more similar stores in the future.

5. Many mom-and-pop stores connect with Alibaba’s LST and JD Convenience Store

E-commerce giants Alibaba and JD.com have sought to extend their offline footprints by connecting with tens of thousands of mom-and-pop stores to help them digitalize their operations and increase their gross merchandise volume. Under its New Retail initiative, and to advance its O2O strategy, Alibaba has launched the LST “Ling Shou Tong” system to help mom-and-pop stores embark on digital transformation. The LST system provides digitalization and other business services for mom-and-pop stores in areas such as product procurement, logistics, marketing, and other value-added services. Meanwhile, the system also enables fast-moving consumer goods (FMCG) brands to connect directly with mom-and-pop stores across China that could previously only be reached through multiple layers of sub-distributors. In September 2018, Alibaba announced that it has recruited one million mom-and-pop stores or unchained CVS in China, around one-sixth of the total market, to connect with its LST system to provide

² Chengdu Hongqi signed strategic cooperation framework agreement with Yonghui Superstores in December 2017; the companies will work together in areas including supply chain management, new business expansion, logistics, technology, big data analysis, and poverty alleviation.

“one-stop solution for digital transformation” and offer better services to their local neighborhoods.

JD.com has also rolled out the JD Convenience Store initiative, partnering with owners of CVS across the country, particularly in rural areas, to help them revamp their stores. JD.com provides training, branding and products as part of a large-scale franchise model. The store owners need to pay a deposit to join the program and will retain full ownership of the stores. The JD store owners can source different types of products from JD.com including FMCG, digital products, home appliances, apparel and home furnishings. They can also source products from other retailers. JD.com intends to have 1 million JD Convenience Stores over the next five years.



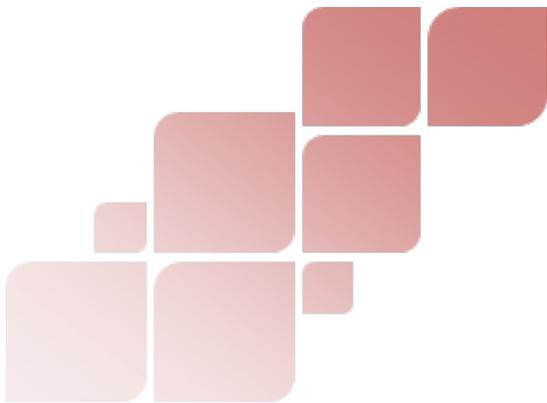
A mom-and-pop store connected with Alibaba’s LST system (Photo source: alibabane.com)



III. Concluding remarks

China's CVS sector has undergone tremendous changes over recent years. Increasing numbers of players have revamped their formats by embracing O2O initiatives, developing private labels, adopting new business models, expanding product and service offerings, and adopting advanced technologies to enhance shopping experience. In our view, the CVS sector is set to continue to transform and grow in the coming years, given its eagerness to innovate and adapt to the changing needs of the market.

The growth of the sector, however, is not without challenges. Some CVS operators reflected that insufficient government support for the development of the sector in some cities has made expansion difficult. In addition, high labor costs, including turnover and training costs, as well as lack of funding remain a significant burden for many CVS players, especially the domestic ones. Meanwhile, the rise of unmanned CVS and smart shelves also pose certain challenges. First, providing excellent services is a key element of retailing; replacing manpower by technologies in unmanned stores may not be able to satisfy consumers' demand for great service. Second, despite the rapid growth of unmanned stores and smart shelves, there have been cases of shutting down of such stores/ shelves due to various reasons. Staffless smart shelf project "Gogo Small" is a case in point. "Gogo Small" reportedly shut down its 500 unmanned shelves in November 2017. According to the company, the closure was due to excessive business expansion as well as wrong choice of shelf locations. Enterprises tapping the market must be careful when devising their expansion strategies.



Spotlight on China Retail – Issue 7

Luxury Market

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

October 2018

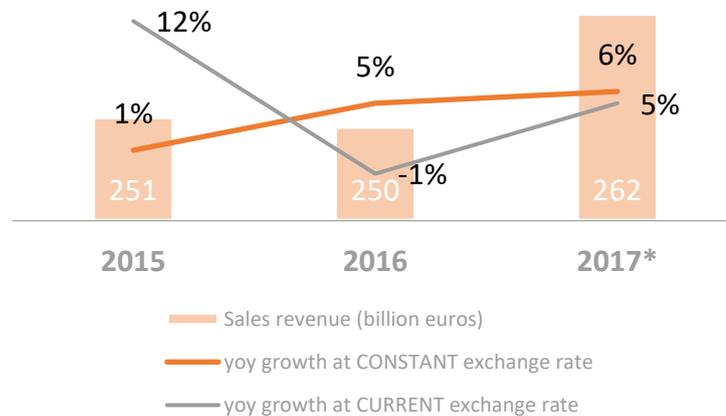
China's luxury market enjoyed robust growth in 2017. Accelerating luxury purchases by millennials, especially those from the fast-growing middle class, coupled with revived consumer sentiment backed by the buoyant domestic stock and property markets have driven the resurgence of luxury purchases by Chinese customers at both home and abroad. Considering the strong spending power of Chinese shoppers, luxury players have also stepped up their digital efforts, widened their product offerings and re-adjusted their pricing strategies in China so as to better suit local tastes and preferences.

I. Market overview

1. China's personal luxury goods market experiences resurgence

Personal luxury goods sales worldwide came in at 262 billion euros in 2017, representing a 5% growth at current exchange rates and a 6% growth at constant exchange rates, according to Bain & Company (Exhibit 1). The remarkable growth was mainly driven by strong luxury consumption across key regions, especially the resurgence of luxury purchases by Chinese customers both at home and abroad.

Exhibit 1: Global personal luxury goods sales, 2015 – 2017

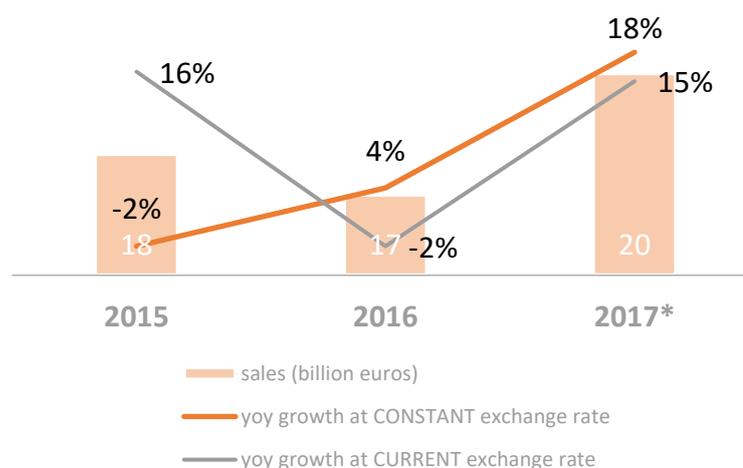


Source: Bain & Co; compiled by Fung Business Intelligence

* Note: Estimated value

In China, sales of personal luxury goods rose significantly to 20 billion euros in 2017, representing a 15% year-on-year (yoy) growth at current exchange rates and a 18% yoy growth at constant exchange rates (Exhibit 2). This notable rebound suggests that the domestic personal luxury goods market has returned to solid growth.

Exhibit 2: Mainland China personal luxury goods sales, 2015 – 2017



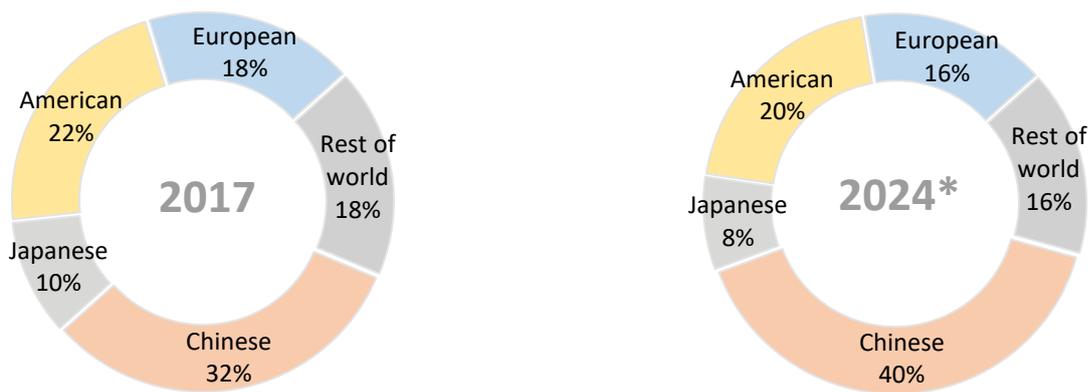
Source: Bain & Co; compiled by Fung Business Intelligence

* Note: Estimated value

2. Chinese millennial consumers continue to drive global luxury growth

In the past year, Chinese consumers increased their luxury purchases abroad. Chinese luxury spending accounted for 32% of global luxury purchases in 2017 (Exhibit 3), up from 30% in 2016. China’s personal luxury goods market is projected to expand by 6% annually through 2024, by then Chinese shoppers will contribute 40% of global luxury sales and drive 70% of global luxury growth, according to Boston Consulting Group.

Exhibit 3: Global personal luxury goods sales by consumer nationality, 2017 and 2024e

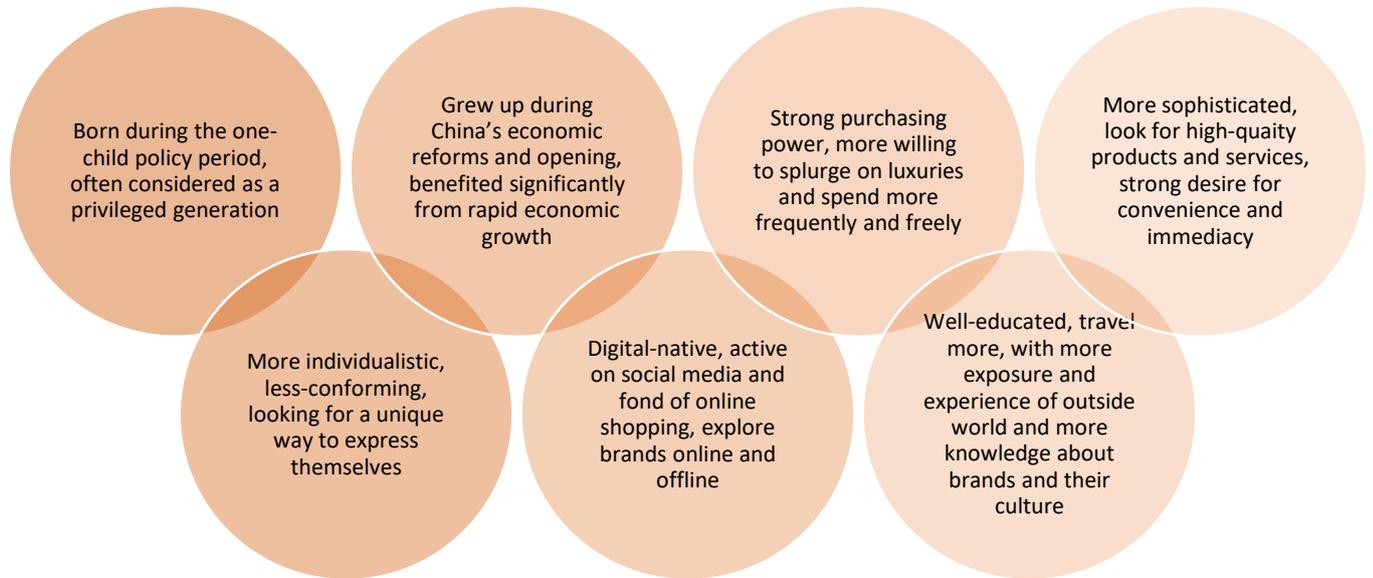


Source: Boston Consulting Group; Altagamma; compiled by Fung Business Intelligence

* Note: Estimated value

The growth of Chinese luxury spending in 2017 was driven by several factors, the major one being millennials accelerating their spending on luxury. Millennials in China, especially those from the fast-growing middle class, have stronger spending power and are more willing to spend than counterparts in other countries. They start purchasing luxury goods at an earlier age – around 10 years younger than those in Europe and 20 years younger than those in the U.S., and buy more frequently and freely compared with the older generation, making them among the major contributors to luxury growth. It is also expected that by 2024, millennials will account for 50% of China’s personal luxury market. Exhibit 4 shows some key traits of Chinese millennial luxury shoppers.

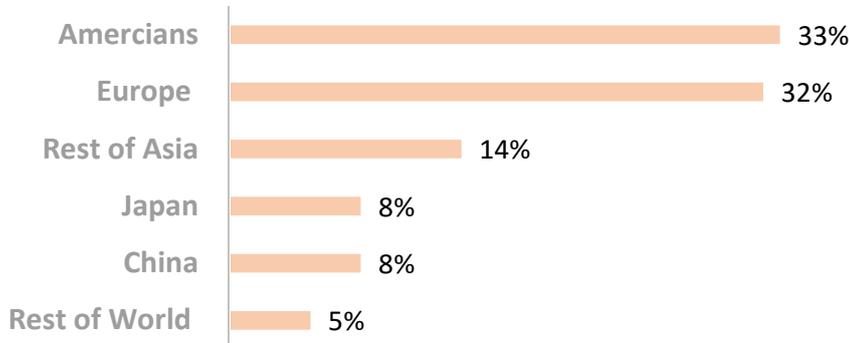
Exhibit 4: Key traits of Chinese millennial luxury shoppers



Source: Fung Business Intelligence

In addition, China's robust economic growth backed by stellar performance in the stock market and real estate market in 2017 has also led to the revival of the luxury market in the country. Meanwhile, the rebound of luxury spending by Chinese consumers also made the country the third largest luxury goods market in 2017, sharing the same rank with Japan, just behind Europe and the U.S. (Exhibit 5).

Exhibit 5: Global personal luxury goods sales by region, 2017



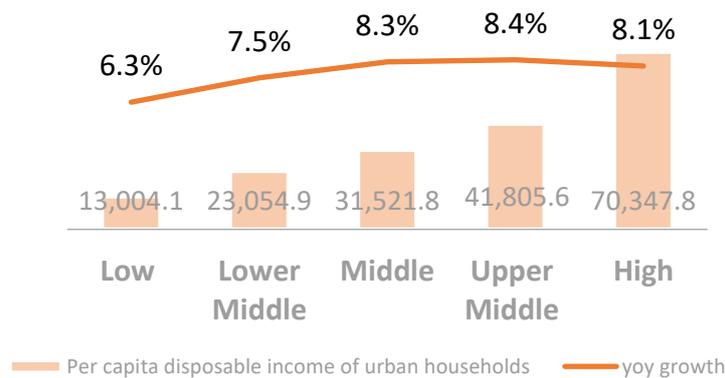
Source: Bain & Co; Fondazione Altagamma; compiled by Fung Business Intelligence

* Note: Estimated value

3. Rapid growth in household disposable income and number of wealthy individuals fuel the demand for luxury goods

Household disposable income in China has grown gradually over the years. According to the National Bureau of Statistics of the PRC (NBS), upper middle income, middle income and highest income segments all registered strong growth at annual growth rates of 8.4% yoy, 8.3% yoy and 8.1% yoy respectively in 2016 (Exhibit 6). These groups of individuals often have a voracious appetite for luxury goods and are the biggest spenders on luxury products.

Exhibit 6: Per capita disposable income of urban households, by income group, 2016

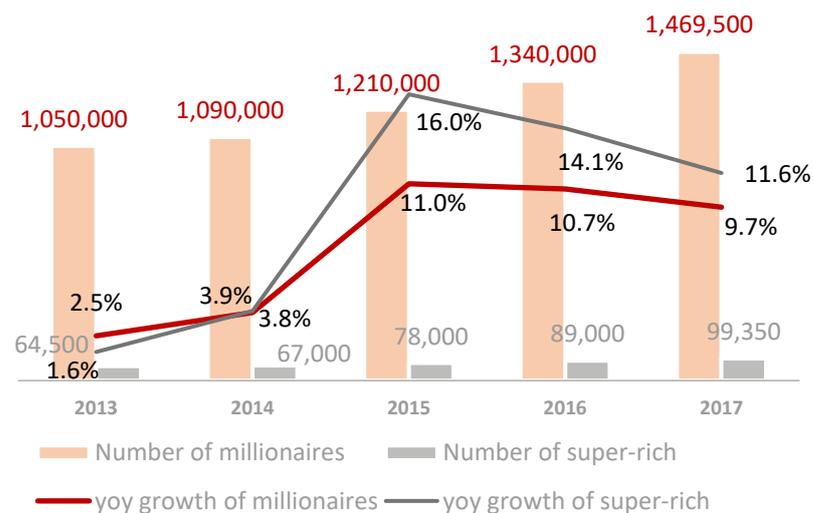


Source: National Bureau of Statistics of China of the PRC; compiled by Fung Business Intelligence

* Note: Estimated value

Meanwhile, there has been a continual increase in the number of wealthy individuals in China over recent years. According to Hurun Wealth Report 2017, there were 1.47 million millionaires and 99,350 super-rich individuals in China as of January 2017, up by 9.7% yoy and 11.6% yoy respectively (Exhibit 7). Among all the regions, Guangdong had the highest number of millionaires in 2017, followed by Beijing, Shanghai, Zhejiang, and Jiangsu (Exhibit 8). Hurun Research Institute also pointed out in its Luxury Consumer Survey 2017 that over 90% of surveyed high net-worth individuals in China feel confident about the economy going forward, with the number of respondents that were “extremely confident” accounting for 28% of the total. Besides, appetite for luxury products by Chinese luxury consumers in 2017 bounced back 20% to return to the level in 2013; the renewed appetite for luxury goods is expected to further drive luxury consumption in the country.

Exhibit 7: Number of millionaires and super-rich individuals in China, 2013 – 2017



Source: Hurun; compiled by Fung Business Intelligence

* Note: Millionaires are defined as individuals with personal wealth of 10 million yuan or more; super-rich are defined as individuals with personal wealth of 100 million yuan or more

Exhibit 8: Number of millionaires in China, by geographic region, 2017

Geographic region	Number of millionaires		Number of super-rich individuals	
	In absolute terms	yoy change (%)	In absolute terms	yoy change (%)
1 Guangdong	268,000	11.7%	15,700	12.1%
2 Beijing	263,000	10.5%	17,400	11.5%
3 Shanghai	230,000	12.2%	14,800	16.5%
4 Zhejiang	176,000	10.0%	12,000	16.5%
5 Jiangsu	109,000	11.2%	7,550	11.9%
6 Fujian	52,700	9.8%	3,600	9.1%
7 Shandong	50,500	7.7%	3,500	9.4%
8 Sichuan	34,600	6.8%	2,650	6.9%
9 Liaoning	31,800	-0.6%	2,100	2.4%
10 Tianjin	25,200	6.8%	2,150	7.5%
11 Henan	25,000	8.2%	1,890	9.9%
12 Hubei	19,600	8.9%	1,640	9.3%
13 Hunan	19,500	8.9%	1,160	9.4%
14 Hebei	18,200	4.0%	1,450	4.3%
15 Shaanxi	18,000	5.9%	1,200	13.2%
16 Shanxi	16,300	1.2%	1,460	1.4%
17 Chongqing	17,000	8.3%	1,240	10.7%
18 Inner Mongolia	13,400	0.8%	860	1.2%
19 Heilongjiang	12,300	-1.6%	800	-3.6%
20 Jiangxi	12,700	7.6%	1,200	8.1%
21 Anhui	12,500	8.7%	1,400	17.6%
22 Jilin	9,800	3.2%	630	3.3%
23 Yunnan	8,700	6.1%	880	8.6%
24 Guangxi	7,800	8.3%	620	8.8%
25 Hainan	5,700	9.6%	260	13.0%
26 Guizhou	4,700	6.6%	490	8.9%
27 Xinjiang	3,900	2.6%	310	3.3%
28 Ningxia	1,200	9.1%	140	7.7%
29 Gansu	900	1.1%	100	0.0%
30 Qinghai	900	5.9%	90	12.5%
31 Tibet	600	9.1%	80	14.3%
Total	1,469,500	9.7%	99,350	11.6%

Source: Hurun; compiled by Fung Business Intelligence

4. Female-related products continue to lead growth in the luxury market

China's luxury market experienced remarkable growth overall in 2017, following four years of lackluster performance and decline. Dominated by female shoppers, a number of categories, including women's apparel, jewelry, cosmetics, perfume and personal care products, which altogether contributed almost 50% of total luxury spending in China, posted more than 20% growth respectively in 2017, fueling the growth in the domestic luxury market. (Exhibit 9).

Exhibit 9: Market share of China's luxury market and growth rates by category, 2017

	Market Share	CAGR			
		2012-2013	2013-2014	2014-2015	2016-2017*
Cosmetics, perfume and personal care products	30%	10%	7%	5%	28%
Watches	20%	-11%	-13%	-10%	13%
Leather goods	15%	5%	0%	-5%	18%
Men's apparel	10%	-1%	-10%	-12%	8%
Jewelry	8%	5%	2%	7%	27%
Women's apparel	7%	10%	11%	10%	24%
Shoes	5%	8%	8%	2%	21%
Accessories	5%	8%	0%	-6%	14%
Total	100%	2%	-1%	-2%	20%

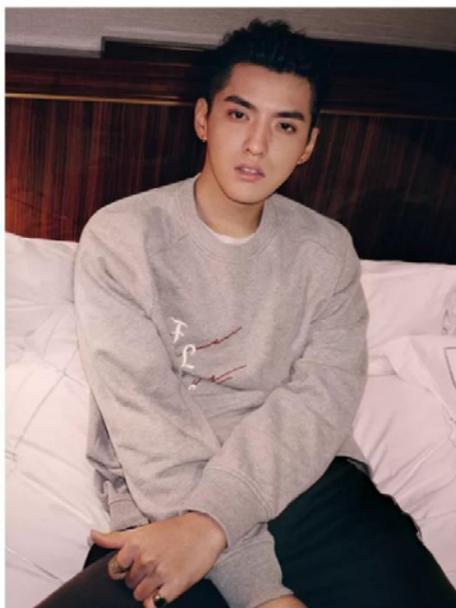
Source: "2017 China Luxury Market Study." January 2018. Bain & Co; compiled by Fung Business Intelligence

* Note: Estimated value

II. Key trends and developments

1. Luxury brands team up with young Chinese celebrities to market their products

Recently, increasing numbers of luxury retailers are ramping up efforts to better engage with millennials, the most powerful consumer group in China’s luxury market today. To woo young shoppers, retailers are turning to young celebrities and influencers to market their products. They are also launching new product lines catering to younger tastes. British luxury fashion house Burberry, for instance, has appointed Kris Wu, one of the most popular millennial idols in China, as its brand ambassador and launched a new collection dubbed the “Burberry x Kris Wu Edit 2017”. The new collection, featuring five specially curated looks of the brand’s classic English-woven cotton gabardine trench coat and sports striped knitwear, has given a new and fresh interpretation of Burberry classic items and brought a youthful touch to the heritage brand, making the brand more appealing to young consumers in China. In April 2017, French luxury brand Christian Dior also appointed Chinese actress Yang Ying, commonly known as Angelababy, as its first brand ambassador in China. Thanks to her 87 million followers on Weibo, Yang succeeded in raising the popularity of Dior among the younger generation in China. Exhibit 10 shows selected examples of international luxury brands appointing young Chinese celebrities as their brand ambassadors.



*BURBERRY X KRIS WU, a limited-edition capsule collection Burberry created in collaboration with Kris Wu in 2017
(Source: Burberry.cn)*

Exhibit 10: Selected examples of international luxury brands appointing young Chinese celebrities as their brand ambassadors

Brand	Celebrity	Announcement of brand ambassador	Number of followers on Weibo (as of September 2018)
Burberry	Kris Wu, born in 1990, a Chinese hip hop star, actor and model	November 2016	39 million
Dior	Yang Ying, Angelababy, born in 1989, a Chinese actress, model, and singer	April 2017	87 million
Bally	Tang Yan, born in 1983, a Chinese actress	June 2017	67 million
Louis Vuitton	Lu Han, born in 1990, a Chinese actor, singer	July 2017	52 million
Michael Kors	Yang Mi, born in 1986, a Chinese actress and singer	September 2017	94 million
YSL Beauty	Z.Tao, born in 1993, a Chinese actor and singer	September 2017	33 million
Fendi	Guli Nazha, born in 1992, a Chinese actress and model	September 2017	16 million
Valentino	Zhang Yixing, born in 1991, a Chinese actor, singer and a former member of South Korean-Chinese pop group EXO	November 2017	38 million

Source: Respective companies' official websites; FDKG; compiled by Fung Business Intelligence

2. E-commerce players crack the luxury market; yet Chinese luxury shoppers still prefer offline

Chinese luxury shoppers have become more accustomed to purchasing luxury goods online. The big data of Alibaba's Tmall shows that more than 100 million consumers have either browsed, bookmarked, or purchased luxury goods online over the past year – this huge potential customer pool is four to five times the number of the current luxury goods' customers in China. Eying the increasing demand for luxury goods online, e-commerce players such as Alibaba and JD.com have set up their luxury e-commerce platforms targeting this segment.

In August 2017, Tmall launched the "Luxury Pavilion", which is an invite-only online platform for premium and luxury brands. The platform is exclusive to a selected number of ultra-rich consumers. It features a wide range of luxury products, including apparel, watches, beauty and cosmetics, and luxury autos. Following the launch of the Luxury Pavilion, Tmall also unveiled "Tmall Space" – an online pop-up luxury retail platform in August 2017. Spanish luxury brand Loewe is reportedly the first luxury brand to use Tmall Space to hold a 24-hour flash sale campaign; it released a limited-edition Barcelona bag tailored for Qixi festival (Chinese Valentine's Day) exclusively on Tmall Space in August 2017.

Similarly, JD.com also launched its first-ever luxury e-commerce platform "Toplife" in October 2017. Toplife is JD.com's independent shopping platform where foreign and domestic brands can set up their official flagship stores on the platform and sell directly to consumers. Apart from displaying and selling products, the platform also shares the brand's design concepts with users. Product delivery will be handled by JD.com's specialized logistics team for luxury products, and air freight shipment will be provided. With all the dedicated services including dedicated warehouse and aircraft, as well as dedicated personnel and vehicle, JD.com is able offer personalized one-stop logistics services to customers.

Despite the enthusiasm of Chinese consumers for online shopping, most still prefer purchasing luxury products at bricks-and-mortar stores. These enable them to see, touch, feel and try out products, as well as to enjoy high-end customer experiences such as refreshments, invitations to private lounges where goods can be previewed, and other customized services. According to a report by Tencent and Boston Consulting Group, in 2017, 95% of luxury purchases were made offline versus merely 5% of luxury purchases done online. Nevertheless, Chinese luxury shoppers tend to research luxury products online before making purchases offline, with over 50% of polled respondents started their luxury purchasing journey through researching on mobile. They are more inclined to discover and learn more about luxury brands and items through various online channels, including celebrities' and fashion influencers' Weibo and WeChat accounts (12%), brand's social media platforms (12%), luxury brands' official websites, apps and mini-programs (11%), luxury brands' digital advertisements (8%) and third-party e-commerce platforms (7%).

When it comes to online shopping, over half of the online luxury purchases in China were made through major e-commerce platforms such as Tmall's Luxury Pavilion and JD.com's TopLife; and almost a quarter of online orders were placed on brands' official e-commerce websites. While social commerce shopping currently makes up merely 11% of online luxury sales volume in China, it is expected that shopping on social platforms will continue to grow considering that major social commerce platforms, such as WeChat and Xiaohungshu, are developing and catching up swiftly.

3. More international fashion brands set up self-operated online stores in China

Apart from selling on major e-commerce platforms, more and more international luxury brands have also ramped up their online presence in China by setting up self-operated transactional websites, as a way to obtain a full control of its online consumer search data and higher profit margin.

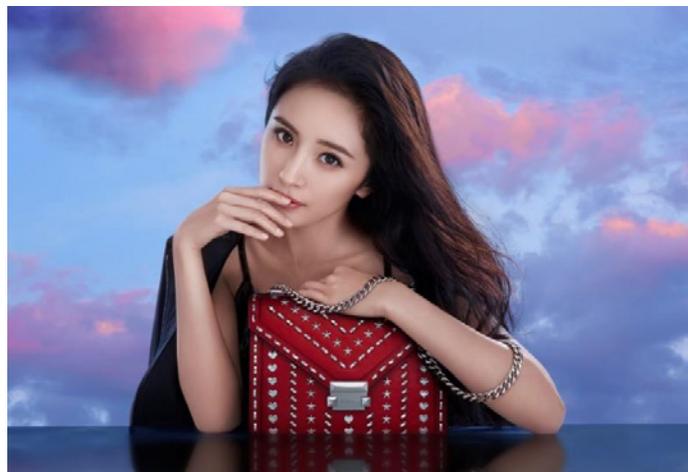
A typical example of luxury brands setting up their own transactional website is Gucci. In July 2017, the Italian luxury fashion house opened a self-managed online store in China. Consumers can order from the online store the full range of products from its current season's collection, including bags, shoes, apparel and jewelry. According to media report, Gucci.cn is currently the only official online store for the brand in China.

Louis Vuitton is also a case in point. In July 2018, the French luxury brand announced the official opening of its self-operated online flagship store in China after a year of trial operation. Contrary to catering to 12 of China's largest cities in the past year, Louis Vuitton has rolled out its online services to all cities in the country, meaning that all Chinese consumers can enjoy the brand's premium services including delivery service and 7-day return policy. In addition, the luxury brand has also extended the product range available online, from leather goods and accessories to footwear, ready-to-wear and fine jewelry. Meanwhile, besides launching self-managed online stores, LVMH's private equity arm L. Catterton has also partnered with JD.com to inject US\$175 million in Secoo, one of largest and fastest-growing luxury e-commerce platforms in China. The investment in Secoo is expected to extend LVMH's e-commerce reach in China, where the French luxury giant has already listed a number of its brands on Secoo's website, including fashion labels Celine, Dior, Fendi, Givenchy, Kenzo and Loewe; fine watch brands Hublot, Zenith and Tag Heuer, and cosmetics brands Guerlain and Fresh.

4. Luxury players scramble to strengthen social commerce presence; WeChat Mini Program is gaining popularity

Considering that social media and word-of-mouth are major sources of information for Chinese consumers, increasing numbers of international luxury players are striving to boost their social commerce presence as a way to market their products in China. For example, in September 2018, Italian luxury menswear brand Ermenegildo Zegna launched a China-only capsule collection “Ermenegildo Zegna XXX”, which was available on the brand’s pop-up store on WeChat Mini Program, an embedded app within WeChat.

During the Qixi festival (China’s equivalent to Valentine’s Day), which in 2018 fell on 17 August, many luxury brands also used the WeChat Mini Program to offer products exclusively for the festival (Exhibit 11). For example, on 3 August, Burberry officially launched its store on WeChat Mini Program, through which the brand released its two new Qixi-themed bags – red “Belt Bag” and red “Pin Clutch” available only in China. It is also the first time that Burberry introduced “China-only” products. Michael Kors, after setting up its store on WeChat Mini Program on 24 July, introduced a limited-edition Whitney purse co-designed with Chinese actress Yang Mi on the WeChat Mini Program store in celebration of Qixi festival.



Michael Kors launched a limited-edition Whitney purse co-designed with Chinese actress Yang Mi on the WeChat Mini Program store to celebrate Qixi festival. (Source: Michael Kors.cn)

Exhibit 11: Selected WeChat Mini Program marketing campaigns rolled out by luxury brands during Qixi festival in 2018

Brands	Details
Marni	On 24 July, the Italian luxury brand started selling its limited-edition “Caddy” bag in celebration of Qixi festival on the brand’s WeChat Mini Program store.
Valentino	On 25 July, the Italian luxury brand launched its Chinese Valentine’s Day campaign “Be My VLTN” and offered its special collection of fashion items co-designed with Chinese actress Zhang Yixing on the brand’s WeChat Mini Program store.
Montblanc	On 26 July, the German luxury brand started selling its Chinese Valentine’s Day collection co-created with Chinese fashion blogger Mr. Bags on the blogger’s WeChat Mini Program store.
Versace	On 27 July, the Italian luxury brand launched a boutique store on WeChat Mini Program, first of its kind store of the brand. Running until 27 August, the store offered a wide range of Versace’s signature handbags with four of them available exclusively on its WeChat Mini Program store.
Dior	On 31 July, the French luxury brand released its “DiorAmour” handbag for sales exclusively on its WeChat Mini Program in celebration of Qixi festival; prior to the new launch, the brand had already published 16 posts to promote the new handbag. With the limited-edition bags sold out in seconds on its WeChat Mini Program store, Dior then opened a pop-up store at Beijing’s SKP shopping mall (from 5-19 August), releasing more “DiorAmour” fashion products to further cash in on the raging demand.
Bottega Veneta	On 31 July, the Italian luxury brand launched its Chinese Valentine’s Day campaign through its store on WeChat Mini Program; a number of the brand’s limited special items were available on the platform, including Catena City Knot handbag and Intrecciato Maze wallet.

(Exhibit 11 Cont'd)

Brands	Details
Michael Kors	On 1 August, the U.S. designer brand introduced its limited-edition Whitney handbag, co-designed with Chinese actress Yang Mi, on the brand's WeChat Mini Program in celebration of Qixi festival.
Burberry	On 3 August, the British luxury brand officially launched its WeChat Mini Program store, through which the brand released its two China-only limited-edition bags – red “Belt Bag” and red “Pin Clutch” to celebrate Qixi festival.
Stella McCartney	On 3 August, the British designer brand's WeChat Mini Program store officially went online, allowing users to place orders directly.
Givenchy	On 5 August, the French luxury brand officially launched its WeChat Mini Program store, enabling Chinese shoppers to order the brand's special GV3 handbag created for Qixi festival.
Gucci	On 6 August, the Italian luxury brand launched its Chinese Valentine's Day campaign along with the release of its WeChat Mini Program store. To celebrate Qixi festival, the brand rolled out limited-edition products, including special “GG Marmont” handbags and “Ace Patch” sneakers exclusively designed for Chinese consumers.
Cartier	On 7 August, the French premium jewelry brand launched its WeChat Mini Program store dedicated to selling the brand's Qixi festival special “Juste un Clou” bracelet.
Berluti	On 8 August, the French luxury leather goods brand released Qixi festival limited-edition “Nino GM” leather document holder, exclusively available on the brand's WeChat Mini Program store.

Source: Ebrun, Jing Daily, China Daily, Fashion Network, Sohu, Vogue; compiled by Fung Business Intelligence

5. Domestic luxury players buy out international players

To exert international influence and enrich their brand portfolios, some leading domestic luxury players and large-scale Chinese companies are actively expanding overseas by investing in foreign luxury brands. For example, in February 2018, Shandong Ruyi Investment Holding, the investment tool of Shandong Ruyi Group, dubbed as the LVMH of China, acquired a majority stake in Swiss luxury brand Bally. Although the two sides have not disclosed any details of the deal, but insiders mentioned the transaction value was about US\$700 million. Previously in November 2017, Shandong Ruyi Group's subsidiary Ruyi Technology Group Ltd. acquired a 54% stake in Israeli menswear group Bagir Group Ltd. for US\$16.5 million, becoming the latter's controlling shareholder. Prior to the takeover of Bally and Bagir, Shandong Ruyi also acquired Parisian high-end fashion labels Sandro, Maje, and Claudie Pierlot, as well as British luxury brand Aquascutum.

Another example is Chinese investment company Fosun International. In February 2018, Fosun acquired a controlling stake in Lavin, one of the oldest luxury fashion houses in France. Following the acquisition of Lavin, Fosun also bought a majority stake in Austrian luxury lingerie maker Wolford for 55 million euros in March 2018. In addition to Lavin and Wolford, Fosun also has purchased stakes in Italian premium menswear brand Caruso and U.S. luxury fashion house St. John Knits.

JD.com has also expedited its push into the luxury sector with a partnership with Farfetch, a London-based luxury marketplace listed recently on the New York Stock Exchange in September 2018. In June 2017, JD.com bought a stake in Farfetch for US\$397 million and became one of its largest shareholders. Under the partnership, JD.com would help Farfetch build a digitized sales and marketing system in China with JD.com's technology and big data. For Farfetch, the partnership allows it to have direct access to the China market. Farfetch consumers can also use JD.com's recently launched premium delivery service, JD Luxury Express, as well as payment service JD Pay and microcredit service JD Baitiao.

6. Luxury retailers lower prices in China in response to tariff cuts by the Chinese government

To encourage domestic consumption while promoting imports, the State Council announced in May 2018 that the country will reduce import tariffs on a range of consumer goods with effect from 1 July 2018. In response, some international brands have marked down their prices in China. For example, Burberry and Louis Vuitton have lowered the prices of some of their products sold in China. Burberry has trimmed the prices of selected apparel and luggage products by 4% in China from 14 July onward, while Louis Vuitton lowered prices of some of its products available on its China's official website and physical stores in end-June, ranging from 300 yuan to 1,500 yuan, which is equivalent to a drop of between 3% and 5%. Gucci also

confirmed that it will adjust retail prices of all merchandise with an average drop of about 5%. This is applicable to all products including new and classic items sold in its directly operated stores in China. Another Italian luxury fashion brand Moncler has also followed suit and cut its product prices by an average of 3.5% in China starting July 2018.

III. Concluding remarks

China's luxury market is expected to maintain stable growth in the coming years. The China-U.S. trade war is set to raise economic uncertainty in China and weigh on domestic consumer confidence. Nevertheless, driven by a number of positive factors such as rising household disposable incomes, increasing numbers of millionaires and super-rich individuals, as well as government's latest tariffs cut to boost domestic consumption, China is set to remain as one of the most lucrative markets for global luxury retailers.

To keep pace with the rapidly evolving needs of Chinese luxury consumers, especially the millennials, global luxury retailers are advised to constantly evaluate their business strategies and marketing plans, keep on innovating and embrace technologies in-store to better engage with customers. In the past year, a few luxury brands have set up pop-up stores that coupled with advanced technologies and innovative marketing contents to promote their products and gain awareness. Chanel, for instance, launched a pop-up store in the format of game center at K11 Shanghai in April 2018. The COCO Game Center offered mainly cosmetics products and perfumes, and featured racing games, game machines, game booths and claw machines. Miu Miu also launched a Miu Miu disco pop-up store in Nanjing Deji Plaza in March 2018. The store was designed with a disco theme; displayed and sold a selection of specially chosen Miu Miu handbags, shoes, jewellery and accessories. These pop-up stores successfully caught shoppers' attention and drove customer traffic.

Meanwhile, as the new generation of consumers are more sophisticated and digital savvy, global luxury retailers should come up with a comprehensive digital strategy to provide seamless shopping experience for customers. The use of social media to promote products and enhance brand awareness is a must in today's digital world.



Spotlight on China Retail – Issue 8

Cross-border E-commerce (Import)

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

October 2018

Cross-border import e-commerce has been expanding rapidly over recent years. Cross-border e-commerce (CBEC) platforms are highly popular among Chinese consumers and have become one of the major channels to buy authentic foreign products. For many brands and retailers, the CBEC channel is a good starting point to test the China market. In the past year, increasing numbers of e-commerce operators and traditional retailers have set up their own CBEC businesses.

The government has been very supportive toward the development of CBEC. It has rolled out a number of favourable policies since 2012 to regularize CBEC, and set up comprehensive e-commerce pilot zones that are designated exclusively for the development of CBEC industry. As of August 2018, there are 35 CBEC comprehensive pilot zones across the country. In March 2016, the government introduced new policies for CBEC to facilitate further growth and development of the CBEC market and balance the impact of CBEC on traditional importers and existing sales channels. The new policies set forth new tax rules for CBEC businesses and new supervision regulations covering new operation procedures, a positive list of permitted imported goods, etc. CBEC operators have been given a transition period until the end of 2018 to adjust their operations and business strategies in relation to the new supervision regulations on CBEC imports.

I. Market overview

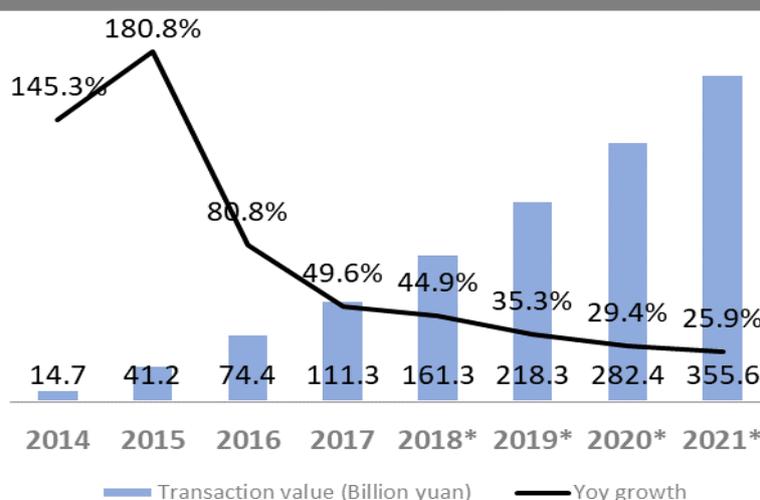
1. CBEC maintains stable development, while growth pace slowing down

China’s CBEC (import) market has maintained stable development in recent years, fueled mainly by individuals upgrading their level of consumption. Chinese consumers are increasingly buying higher quality and unique overseas products via approved CBEC platforms. According to iResearch, the transaction value of the CBEC (import) retail market increased by 49.6% year-on-year (yoy) to 111.3 billion yuan in 2017 and is expected to balloon to over 350 billion yuan by 2021 (Exhibit 1).

Hectic though growth has been for China’s CBEC (import) market, the pace has, in fact, slowed over the past three years. This might be attributable in part to the launch in late March and early April 2016 of new CBEC tax policies and a positive list for permitted imported goods, which might pose uncertainties for the future development of cross-border trade. Also, as the base becomes larger, growth rate would not be as rapid as in previous years.

Please refer to the Appendix for details of the changing states of development of the CBEC (import) market and key policies and regulations related to the market.

Exhibit 1: Transaction value of CBEC (import) retail market, 2014 – 2021 (estimates)

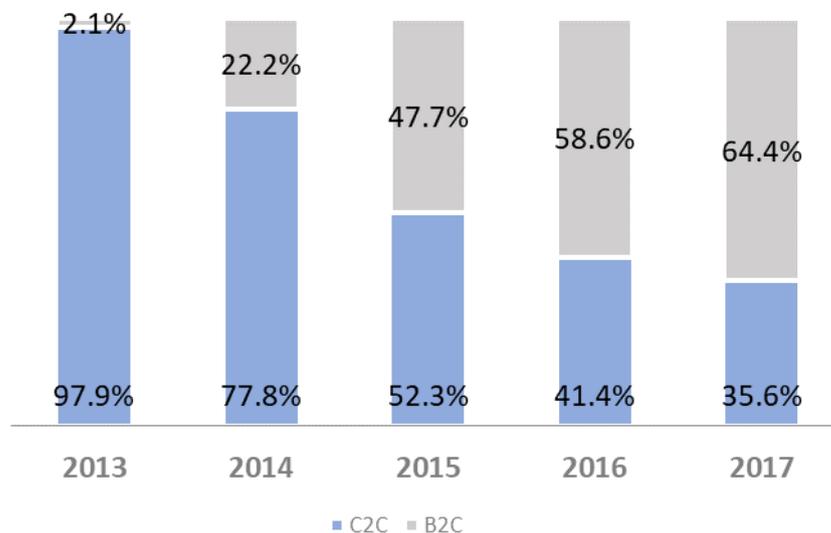


Source: iResearch; compiled by Fung Business Intelligence

2. B2C model accounts for the largest share of total CBEC (import) market

CBEC (import) business can be grouped into B2C and C2C models. According to Moda Data, B2C has exceeded C2C to become the most significant CBEC import model in China. It is estimated that the B2C model accounted for 64.4% of the total CBEC import market in 2017 (Exhibit 2). The B2C model enables regulators to monitor the activities and transactions on the platforms and take the appropriate actions imminently if required.

Exhibit 2: Share of B2C and C2C of CBEC (import) market, 2013 – 2017



Source: Moda Data; compiled by Fung Business Intelligence

3. Two major types of CBEC (import) platforms: integrated and vertical platforms

Currently, cross-border B2C players usually sell on two major types of platforms – integrated CBEC platforms in the form of marketplace platforms, self-operated platforms and hybrid platforms or vertical CBEC platforms which are often a combination of marketplace and self-operated platforms. The former sells a large variety of categories of products, while the latter focuses on a few specialized categories. Selected major CBEC platforms and their major operating models are shown in Exhibit 3.

Exhibit 3: Selected major CBEC platforms and their operating models

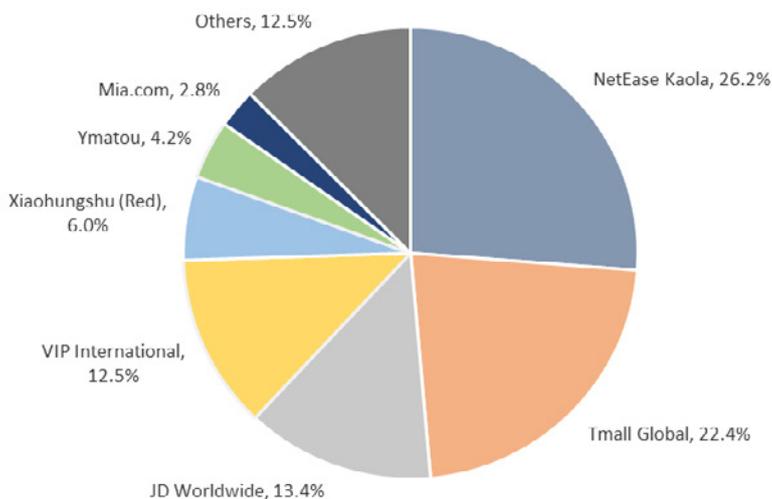
	Integrated CBEC platforms			Vertical CBEC platforms		
Player	Tmall Global	JD Worldwide	VIP Global	NetEase Kaola	Xiaohongshu (Red)	Mia.com
Operating model	Marketplace	Marketplace and self-operated	Self-operated	Marketplace and self-operated	Marketplace and self-operated	Marketplace and self-operated
Core competencies	Wide product choices	Good logistics services	Good after-sale services	Mainly self-operated; authentic products	Content-based and community nature	Specialized in baby and maternity products

Source: *iResearch*; modified by *Fung Business Intelligence*

4. NetEase Kaola, Tmall Global and JD Worldwide continue to top the list among CBEC (import) players

According to domestic consulting agency iiMedia Research, NetEase’s CBEC arm Kaola ranked first in the CBEC market in terms of transaction value with 26.2% market share in 1H18, followed by Tmall Global with 22.4% market share and JD Worldwide with 13.4% market share (Exhibit 4).

Exhibit 4: CBEC (import) players by market share, 1H18

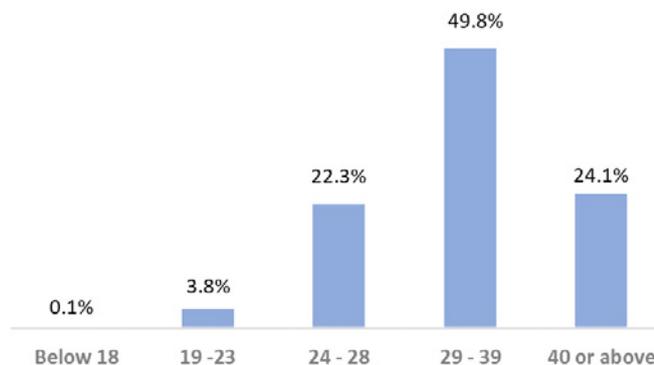


Source: *iiMedia Research*; compiled by *Fung Business Intelligence*

5. Consumers aged 29–39 and those living in coastal regions are core CBEC shoppers

According to a survey released by iResearch in March 2018, more than half of the surveyed CBEC shoppers are aged between 29 and 39 (56.3%); 21.7% of are aged between 24 and 28, and 17.8% are aged 40 and above (Exhibit 5). As shown in Exhibit 6, the majority of CBEC shoppers live in coastal areas. 13.2% of the surveyed shoppers live in Beijing, 10.1% live in Shanghai and 19.0% in Guangdong. Many CBEC shoppers are frequent buyers, with 69.1% make more than one purchase per month.

Exhibit 5: CBEC (import) shoppers by age, March 2018



Source: iResearch; compiled by Fung Business Intelligence

Exhibit 6: CBEC (import) shoppers by region, March 2018

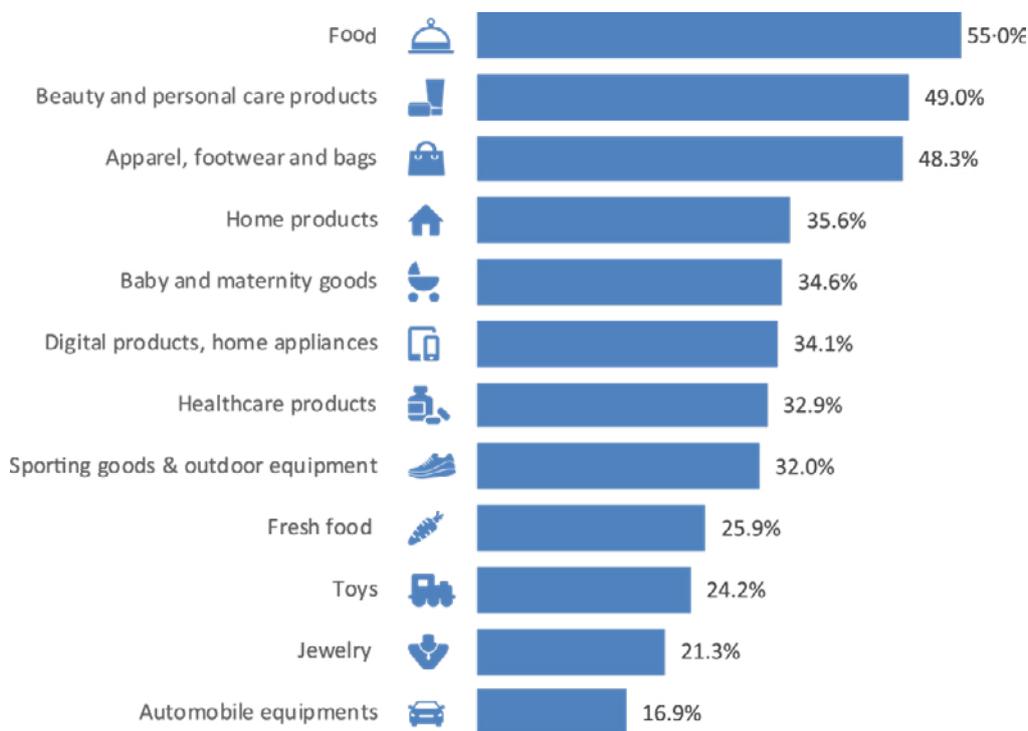


Source: iResearch; compiled by Fung Business Intelligence

6. Food, beauty and personal care products, and apparel, footwear and bags are the best-selling categories for CBEC (import) market

Chinese consumers’ concerns about product safety have driven the demand for imported products which are generally perceived as having better quality than domestically produced goods. Exhibit 7 shows the categories of products purchased by CBEC shoppers on CBEC platforms during March 2017 to March 2018. Food (55.0%), beauty and personal care products (49.0%) and apparel, footwear and bags (48.3%) were mostly purchased by CBEC shoppers during the surveyed period.

Exhibit 7: Categories of products purchased by CBEC shoppers on CBEC platforms, March 2017 – March 2018



Source: *iResearch*; compiled by *Fung Business Intelligence*

As shown in Exhibit 8, CBEC shoppers bought mostly from Japan, the U.S. and South Korea.

Exhibit 8: Top countries of cross-border online shopping, 2017



Source: Ebrun; compiled by Fung Business Intelligence

II. Key trends and developments

1. Government establishes more pilot zones for CBEC

Since 2012, the government has rolled out a pilot program and established pilot zones for CBEC import business. These pilot zones take the lead in setting new standards for CBEC transactions, payment, logistics, customs clearance, exchange settlement, inspection quarantine, etc., and facilitate the development of the CBEC import business. As of August 2018, China has 35 CBEC Comprehensive Pilot Zones (Exhibit 9); 22 of which were approved by the State Council on 7 August, 2018, including pilot zones in Beijing, Hothot, Shenyang, Changchun, Harbin, Nanjing, Nanchang, Wuhan, Changsha, Nanning, Haikou, Guiyang, Kunming, Xian, Nanzhou, Xiamen, Tangshan, Wuxi, Weihai, Zhuhai, Dongguan and Yiwu. The State Council has also urged relevant government departments to support innovation and development in the CBEC Comprehensive Pilot Zones, including streamlining logistics processes and custom clearance procedures, enhancing information sharing, promoting effective regulatory innovation, and pushing forward with international trade liberalization, facilitation and business innovation.

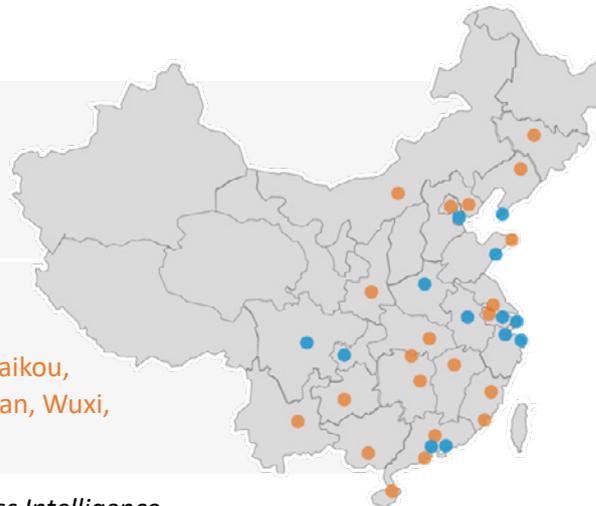
Exhibit 9: CBEC comprehensive pilot zones, as of August 2018

1st batch

Hangzhou, Ningbo, Tianjin, Shanghai, Chongqing, Hefei, Zhengzhou, Guangzhou, Chengdu, Dalian, Qingdao, Shenzhen, Suzhou

2nd batch

Beijing, Hothot, Shenyang, Changchun, Harbin, Nanjing, Nanchang, Wuhan, Changsha, Nanning, Haikou, Guiyang, Kunming, Xian, Nanzhou, Xiamen, Tangshan, Wuxi, Weihai, Zhuhai, Dongguan and Yiwu



Source: *The State Council; compiled by Fung Business Intelligence*

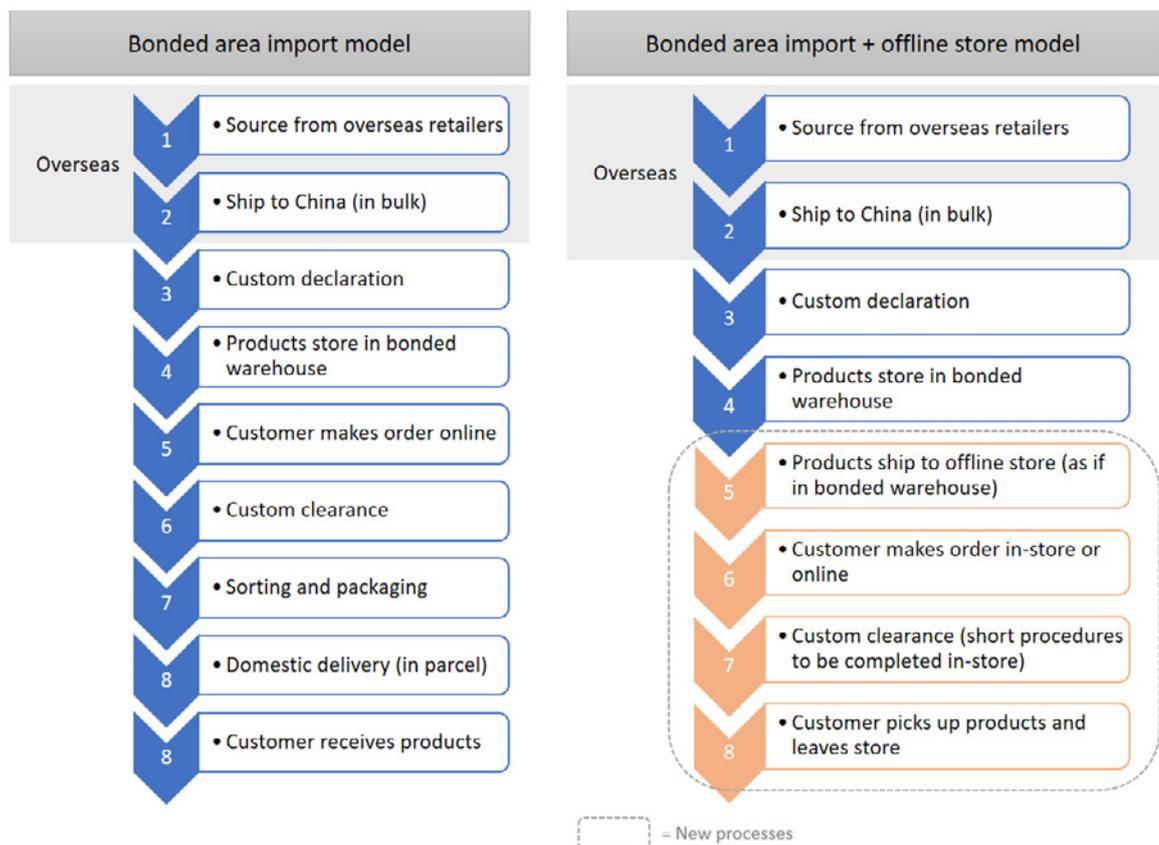
2. CBEC players set up new form of offline stores to sell bonded imported products

In recent years, some CBEC operators have set up offline experiential stores to display overseas products sold on their website and provide a physical touchpoint for customers to see and feel the products before placing orders. Customers still need to buy products online via authorized CBEC platforms and the imported products will be sent to their home by courier.

More recently, some CBEC players, after gaining approval from relevant authorities, have opened a new form of offline stores where customers can purchase and pick-up the bonded imported products directly in the stores (the “bonded area import + offline store” model). The bonded imported products go through customs clearance only after the customers have placed the orders. In February 2018, Kaola.com opened its first offline store in Hangzhou; it then opened the second store in Zhengzhou in August 2018. Customers can purchase bonded imported products directly in the store. After choosing the products they want to purchase, customers can go straight to the cashier, provide their ID card number and telephone number and settle payment; the customs clearance process will then be processed immediately. The process reportedly will take around 4 minutes. Customer will receive a SMS notification if the customs clearance is successful. After showing the cashier the SMS, customers can pick-up the goods directly in the store without the need to wait for the products to be sent to their home.

The offline store is de facto an extension of the bonded area import model whereby overseas products in the bonded warehouse in China can be sold in the approved experiential store, and they will go through customs clearance only after customers have placed orders in-store or via the CBEC website. Exhibit 10 compares the flow of CBEC products via the bonded area import model and the “bonded area import + offline store” model.

Exhibit 10: Flow of CBEC products, bonded area import model vs. “bonded area import + offline store” model



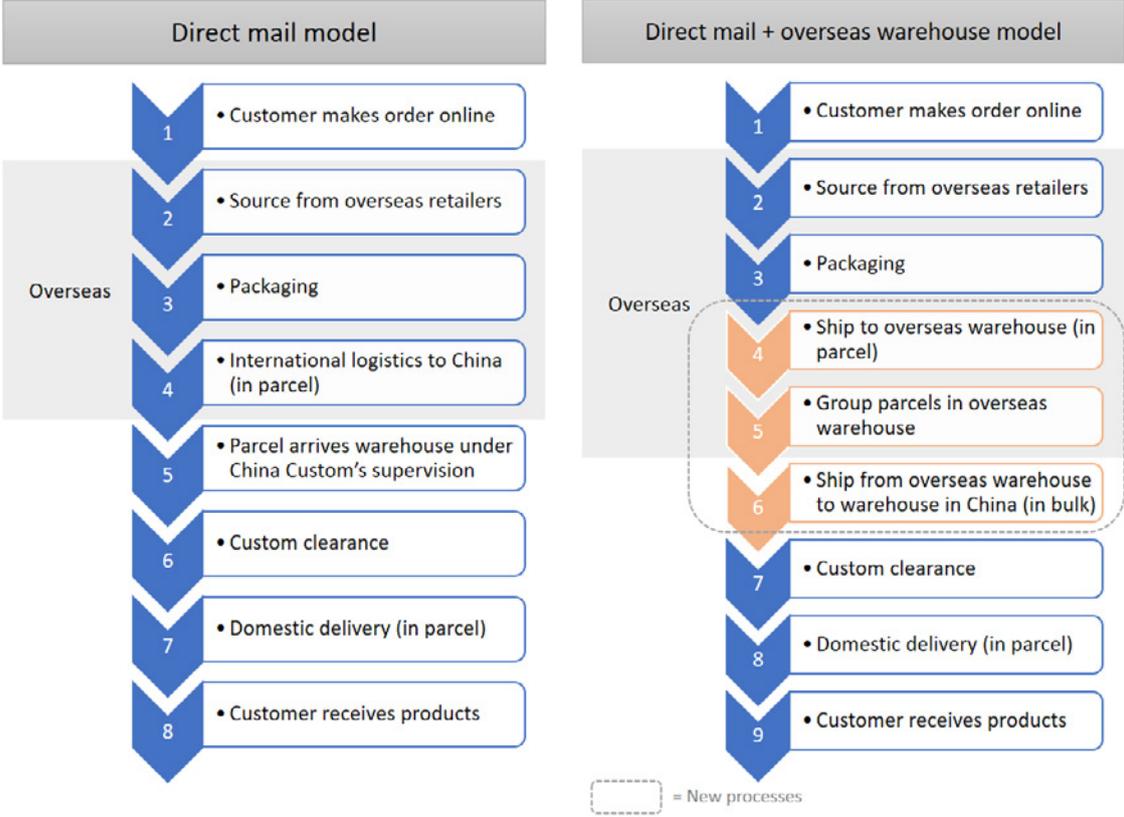
Source: Fung Business Intelligence

3. Building overseas warehouses to improve logistics efficiency

Some leading CBEC players such as JD.com, VIP.com, NetEase Kaola and Xiaohongshu are ramping up efforts to build overseas warehouses to facilitate cross-border shipping. For example, in May 2018, VIP.com announced that its CBEC arm VIP International will cooperate with JD Worldwide in operating CBEC supply chain and overseas warehouses. VIP.com will provide overseas warehousing and logistics services to JD Worldwide, including 12 overseas warehouses (of which eight of them are self-operated by VIP.com). This allows VIP.com to better utilize its overseas warehouses as well as its shipping services, while reducing costs and improving logistics efficiency.

Indeed, the setting up of overseas warehouses by CBEC operators can be regarded as a modification of the direct mail model (Exhibit 11). After customers place orders on a registered CBEC platform, overseas retailers will ship the products to the overseas warehouse instead of sending them directly to the warehouse in China. The CBEC operator will collect and store the parcels in the overseas warehouse before shipping them in lots to warehouses in China. For customers, a major advantage of using overseas warehouses is that logistics costs will be cheaper than that of the direct mail model as more recipients (customers) can share the logistics costs. However, shipping time will be longer than the direct mail model. For CBEC operators, setting up overseas warehouses involve substantial investments. They also need to spend some time to understand and adapt to local practices. Exhibit 12 shows the advantages and challenges of using overseas warehouses.

Exhibit 11: Flow of CBEC products, direct mail model vs. “direct mail + overseas warehouse” model



Source: Fung Business Intelligence

Exhibit 12: Advantages and challenges of using overseas warehouses

Advantages of building overseas warehouses	Challenges of using overseas warehouses
<ul style="list-style-type: none"> a. Lower logistics costs for consumers – By grouping parcels from sea freight and air freight to overseas warehouses first before sending to China warehouses reportedly can save 30-50% logistics costs compared with the traditional direct mail model. b. Better after-sales service – Consumers can send back the goods to the overseas warehouses for repair and return, which can increase their stickiness towards the platform. 	<ul style="list-style-type: none"> a. Local policies – The setting up of and operations of overseas warehouses are affected by local government policies. Any changes in local policies will affect the operations of the warehouses. b. High investment and operation costs – the costs of setting up overseas warehouse as well as the day-to-day operation costs are high. c. It takes time for overseas warehouses operators to fully understand, localize and adapt to local practices. d. As CBEC platforms build and use their own overseas warehouses, brand owners/ retailers need to deal with different warehouses when selling on different platforms. This is not convenient for brand owners/ retailers. e. Longer delivery time – The delivery time of CBEC goods is longer compared to the direct mail model.

Source: *Fung Business Intelligence*

4. Putting more emphasis on product tracking system

To provide better user experience, some leading CBEC platforms are applying various ways to track and trace the movement of CBEC goods. Blockchain technology is becoming increasingly popular among CBEC operators as a method for tracking products. Some CBEC players are also cooperating with relevant industry associations and government departments to make the movement of CBEC goods more transparent to consumers. For example, in August 2017,

Tmall Global launched the Global Product Traceability Project. Facilitated by blockchain technology and big data, product information including origin of production, logistics, custom clearance, inspection and quarantine details are made available for public use. China Certification & Inspection (Group) Co., Ltd., China National Institute of Standardization, National Monitoring Center for Cross-border E-commerce Security Risk have reportedly joined the project.

Going forward, it is expected that blockchain technology for product traceability will widely be adopted in the CBEC sector. With this technology, leading CBEC platforms can collect, integrate and display product information to consumers in a more transparent way, thus gaining customer trust and loyalty.

III. Major challenges

1. Potential policy changes may affect business operations

Currently, one of the biggest challenges facing enterprises engaging in CBEC business is the changing government policies. In late March and early April 2016, the government announced several new policies to ensure sustainable tax collection and foster fair competition (see Appendix 1; Stage 4). The new policies set forth new tax rules for different CBEC models, new tax rates for personal postal article tax as well as new supervision regulations covering new operation procedures, a positive list of permitted imported goods, etc. These may create new challenges for companies engaging in CBEC business, such as a higher tax burden, product entry, more complicated custom clearance procedures, and quality compliance issues. The transition period for the implementation of the new policies has been extended several times to end-2018 as the industry is not ready for the changes (see Appendix 2). Enterprises need to be alert to the policy changes and adjust their strategies accordingly.

2. China-U.S. trade war pose negative impact in long-run; import tariffs cuts narrow the price gap between general imports and CBEC goods

The China-U.S. trade war is likely to last much longer than originally thought — extending well into the second half of 2019; this may hinder China’s economic growth and pose a negative impact on people’s willingness to consume. This in turn may affect the business of

CBEC operators in the medium to long term.

In the past year, China has been keen to increase imports amid the rising tension with the U.S. It has taken bold steps to increase imports by reducing import tariffs. Earlier in July 2018, China reduced import tariffs on a range of consumer items including apparel, cosmetics, home appliances, and fitness products. In September 2018, the Ministry of Finance of the PRC announced further cuts on import duties on nearly 1,600 products including textile products starting 1 November, 2018. The overall tariff level will be reduced to 7.5% in 2018 from 9.8% in 2017. Indeed, promoting imports has been a major priority of the Chinese government; the price gap between general imports and CBEC goods is set to further narrow against this backdrop.

IV. Concluding remarks

China's CBEC business has been growing rapidly over recent years, while competition in the market has become more intense. Customers increasingly demand high quality and authentic products, but they also like to compare prices across different CBEC platforms. It is expected that less competitive players who cannot survive the competition will eventually leave the market. CBEC operators are advised to put more focus on streamlining cross-border supply chains, improving sourcing capability and increasing the variety and quality of products they offer.

Going forward, despite the potential negative consequences of the China-U.S. trade war, we expect the CBEC market to continue to thrive as Chinese consumers demand for good quality foreign products is set to remain strong and continue to drive the demand for CBEC products. New CBEC operation models will emerge as operators seek to differentiate themselves from their peers. The government is expected to further roll out new policies to better regulate the CBEC market, promote the growth of the sector, and build synergies among different players. Also, China's first E-commerce Law, approved in September 2018 and will come into effect on 1 January, 2019, is set to improve regulatory efficiency and optimize the supervision process for CBEC in customs declaration, tax payment, inspection and quarantine, etc.

Appendix 1: States of development of CBEC (import) market in China

1. Stage 1: The flourishing of “daigou” activities through “haitao” channels (Before 2012)

Before the regularization of the CBEC (import) business, Chinese shoppers mainly purchased overseas products through buying agents (or so-called “daigou” agents) or directly from overseas online shopping platforms. This activity is commonly referred to as “haitao.” Exhibit 13 compares these two traditional ways of carrying out “haitao.” Both methods have their own advantages and disadvantages.

Exhibit 13: Comparison of traditional “haitao” methods

	Purchased through “daigou” agents	Purchased directly from overseas shopping websites
1) Operation	<ul style="list-style-type: none"> • “Daigou” agents purchase overseas products on behalf of consumers; they provide assistance to consumers especially on payment and delivery 	<ul style="list-style-type: none"> • Consumers place orders directly via overseas shopping websites. • Payments have to be settled in foreign currencies. • Products are reliable, authentic, and legal.
2) Import price of commodity	<ul style="list-style-type: none"> • Commodity price + taxes* + “daigou” agents’ commissions + logistics fees 	<ul style="list-style-type: none"> • Commodity price + taxes + logistics fees
3) Order placement and payment settlement	<ul style="list-style-type: none"> • “Daigou” agents help customers place orders. • Customers can pay in RMB and agencies can help settle the payment in foreign currencies 	<ul style="list-style-type: none"> • Paypal or a credit card is needed; payment is settled in a foreign currency.
4) Limitations	<ul style="list-style-type: none"> • “Daigou” agents are not reliable. • The purchasing process takes a long time to complete. • “Daigou” agents may import goods illegally (smuggling). • Unclear delivery liabilities. • Difficult for returns/ refunds. 	<ul style="list-style-type: none"> • Customs clearance is needed if parcels are shipped by international couriers. • Only some foreign websites offer delivery to China.

Source: Fung Business Intelligence; Deutsche Bank; Morgan Stanley; China Customs; compiled by Fung Business Intelligence

* Note: Some “daigou” agents are reportedly not correctly declaring at China Customs when importing goods into China.

According to a survey conducted by Tmall Global, many consumers were not fully satisfied with their traditional “haitao” experience. Dissatisfied shoppers cited long delivery lead times as their number one cause of annoyance when using the traditional “haitao” methods. Other major causes of dissatisfaction included hidden costs, language barrier, uncertainty in product quality, and difficulty in product returns.

2. Stage 2: The setting up of pilot zones for CBEC (2012~)

To fight against the gray import market and unauthorized “daigou” activities, the Chinese government announced several favorable policies to promote CBEC development. In 2012, the government rolled out a pilot program and established pilot zones for the CBEC import business. These pilot zones take the lead in setting new standards for CBEC transactions, payment, logistics, customs clearance, exchange settlement, inspection quarantine, etc., and facilitate the development of the CBEC import business.

As of August 2018, China has 35 CBEC Comprehensive Pilot Zones; 22 of which were approved to establish on 7 August, 2018 by the State Council, including pilot zones in Beijing, Hothot, Shenyang, Changchun, Harbin, Nanjing, Nanchang, Wuhan, Changsha, Nanning, Haikou, Guiyang, Kunming, Xian, Nanzhou, Xiamen, Tangshan, Wuxi, Weihai, Zhuhai, Dongguan and Yiwu. The State Council also urges relevant government departments to support the innovation and development in CBEC Comprehensive Pilot Zones, including streamlining the process regarding logistics, warehousing and custom clearance; enhancing information sharing, promoting effective regulatory innovation, pushing forward international trade liberalization, facilitation and business innovation.

3. Stage 3: The emergence of new CBEC models and application of personal postal articles tax on CBEC imported products (2014~)

As a result of the government’s efforts to promote the CBEC business, two new CBEC models emerged in 2014, namely, the “direct mail” model and the “bonded area import” model.

“Direct mail” model

After customers place orders on a registered CBEC platform, the platform will submit particulars of the orders electronically for Customs clearance. The products will then be shipped by direct mail to customers.

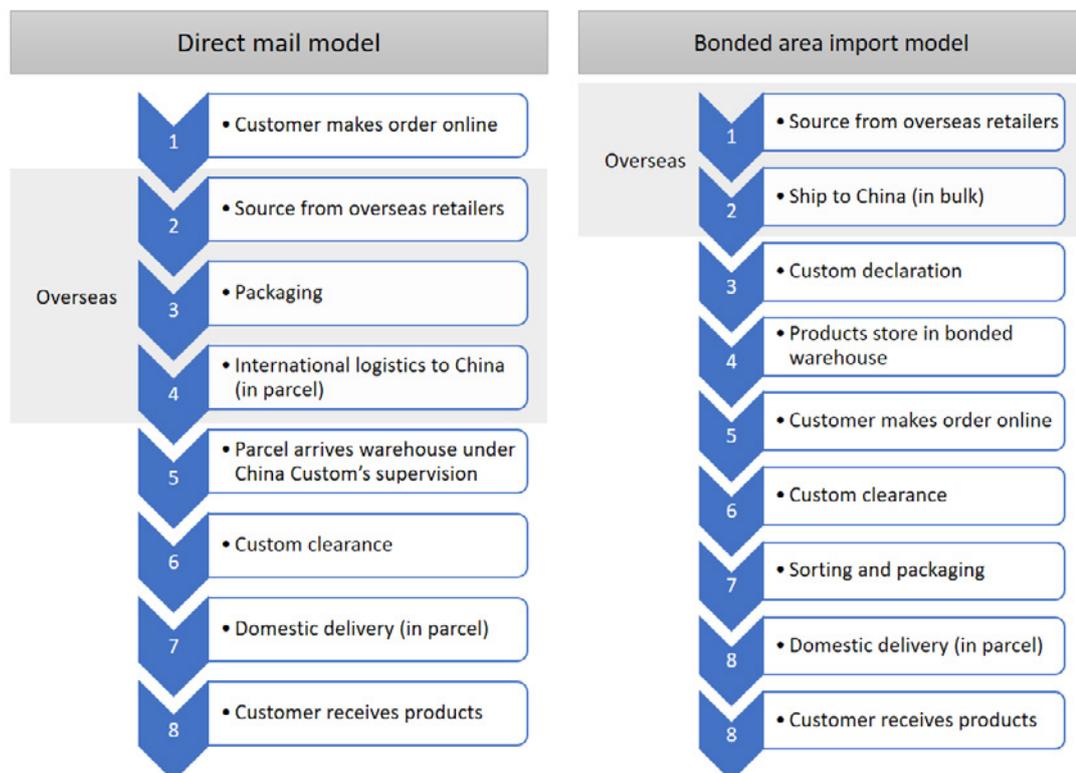
“Bonded area import” model

Products are shipped in bulk and stored in e-commerce platform’s bonded warehouse in pilot cities before consumers place orders online. The CBEC platform makes a declaration in real-time to Customs after customers have placed their orders. The products are shipped to customers from the bonded warehouse after completion of customs clearance, inspection, and quarantine procedures.

Imported goods are regarded as personal consumption items under the “direct mail” and “bonded area import” models. Instead of import duties, consumption taxes, and value-added tax (VAT), personal postal articles taxes are also levied. It is noteworthy that from April 8, 2016, a new tax for CBEC has replaced the tax for personal postal articles on CBEC imported products. Details on the new tax will be discussed in later sections. At the same time, the tax rates for personal postal articles were being revised in April 2016; the tax only applies to personal parcels, but no longer on CBEC imported products.

Exhibit 14 demonstrates the logistics flow of CBEC products in these two models.

Exhibit 14: Comparison of direct mail model and bonded area import model, as of April 2016



Source: Fung Business Intelligence

Exhibit 15 compares the CBEC imported model and the general import model for overseas products.

Exhibit 15: Comparison of different business models, as of April 2016

	CBEC model	General import model
Tax levied	<ul style="list-style-type: none"> • Before April 8, 2016: Personal postal articles tax • After April 8, 2016: Tax for CBEC* 	<ul style="list-style-type: none"> • Import duties + VAT + consumption tax
Tax rates	<ul style="list-style-type: none"> • Before April 8, 2016: Personal postal articles tax: 10%, 20%, 30%, 50% varies from products • After April 8, 2016: Tax for CBEC: Import duties (0%) + 70% of VAT and consumption tax 	<ul style="list-style-type: none"> • Import duties: varies from products • VAT: 17% • Consumption tax: varies from products (e.g., 30% for cosmetics)

Source: Various Internet sources; compiled by Fung Business Intelligence

* Note: From April 8, 2016, a new tax for CBEC has replaced the tax for personal postal articles tax.

4. Stage 4a: The introduction of new policies on CBEC (import) (April 2016~)

In response to the booming CBEC market in China, the Ministry of Finance, China Customs, and the State Administration of Taxation jointly announced new policies on CBEC. The new policies aim to better regulate the CBEC channels and reduce policy loopholes, ensure tax collection, and reduce the price gap between CBEC and general import, so as to provide a fair market environment for all players. The new policy is effective from April 8, 2016.

Key adjustments under the new regulation are as follows:

1. New transaction limit per order via the CBEC platform is increased from 1,000 yuan to 2,000 yuan. New upper limit per person each year (or the “annual cap”) will be set at 20,000 yuan.
2. For single orders with price tags larger than 2,000 yuan, or total transaction value over 2,000 yuan, taxes applicable for general import is levied.
3. For single orders with price tags under or equal to 2,000 yuan, or total transaction value under or equal to 2,000 yuan, a new tax will replace the tax for personal postal

articles. The new tax includes import tariff + VAT + consumption tax, where the actual tax payable to the Custom is 70% of the calculated taxable amount. Current import tariff is temporarily set at 0%.

4. Before the tax adjustment, the personal postal articles tax was exempt by the Customs if the taxable value was 50 yuan or below. Under the new regulation, the exemption for CBEC is cancelled.
5. Duty-paid value (the actual transaction price) includes retail price of goods, shipping costs, and insurance costs. End-consumers are liable to pay the taxes, but CBEC platforms can pay the taxes on behalf of customers.
6. Customers can apply for tax refund for goods returned within 30 days of purchase from CBEC channels.
7. A positive list has replaced the previous negative list for CBEC (import) goods.
8. The new regulation is effective from April 8, 2016.

Exhibit 16: Comparison of the regulations

	Regulation BEFORE April 8, 2016	New regulation AFTER April 8, 2016
Value cap per transaction	<ul style="list-style-type: none"> • ≤ 1,000 yuan 	<ul style="list-style-type: none"> • ≤ 2,000 yuan
Annual cap	No nationwide requirement	<ul style="list-style-type: none"> • 20,000 yuan
Tax applied	<ul style="list-style-type: none"> • Personal postal articles tax 	<ul style="list-style-type: none"> • Import tariff + VAT + consumption tax
Personal postal articles tax	<ul style="list-style-type: none"> • 10%, 20%, 30%, 50% varies from products • Personal postal articles tax ≤ 50 	--
Import tariff	--	<ul style="list-style-type: none"> • Transaction of single orders ≤ 2,000 yuan: 0% • Transaction of single orders > 2,000 yuan: import tariff for general import applied
VAT / consumption tax	--	<ul style="list-style-type: none"> • Transaction of single orders ≤ 2,000 yuan: 70% of VAT and consumption tax
Products can be imported via CBEC channel	<ul style="list-style-type: none"> • Negative list is published 	<ul style="list-style-type: none"> • Positive list applicable to CBEC is released

Source: Ministry of Finance; compiled by Fung Business Intelligence

Meanwhile, for personal parcels, i.e., items for personal consumption, gifts, and items not for reselling purpose, the personal postal articles tax still applies but is being adjusted. The four rates (10%, 20%, 30%, and 50%) have been replaced by the new rates, which are categorized into 15%, 30%, and 60% levels. Exhibit 17 compares the current and new personal postal articles tax rates.

Exhibit 17: Comparison of the current and new personal postal articles tax

	Personal postal articles tax BEFORE April 8, 2016	Personal postal articles tax AFTER April 8, 2016
10%	<ul style="list-style-type: none"> Food & beverage, leather clothes & accessories, bags & shoes, furniture, toys 	--
15%	--	<ul style="list-style-type: none"> Food & beverage, furniture, toys Products with a zero most-favored-nation (MFN) tariff rate
20%	<ul style="list-style-type: none"> Apparel & textile, general watches 	--
30%	<ul style="list-style-type: none"> Luxury watches (>10,000 yuan) 	<ul style="list-style-type: none"> Leather clothes & accessories, bags & shoes, apparel & textile, general watches
50%	<ul style="list-style-type: none"> Cosmetics, skin care products 	--
60%	--	<ul style="list-style-type: none"> Luxury watches, cosmetics Luxury products applicable to consumption tax

Source: China Customs; compiled by Fung Business Intelligence

5. Stage 4b: A positive list is released to replace the previous negative list (April 2016~)

On April 7, 2016, 11 government authorities, including the Ministry of Finance, National Development and Reform Commission, Ministry of Industry and Information Technology, Ministry of Commerce, General Administration of Customs and State Administration of Taxation, jointly released a positive list for CBEC imported goods. Effective from April 8, 2016, the positive list will replace the previous negative list for CBEC imported goods; only goods

that are on the list are eligible to be sold via CBEC channels. The positive list covers 1,142 types of product categories with an eight-digit H.S code. These products are mostly daily consumer goods with solid demand in China. According to the China Customs, these products can satisfy supervision requirements of authorities concerned, and can enter China via express delivery or direct mail. Product categories on the list include food and beverages, apparel and footwear, home appliances, cosmetics, paper diapers, and children's toys. Products on the list are exempt from submitting related import license to China Customs but should go through inspection and quarantine procedures in accordance with the laws and regulations of the PRC. The submission of China Inspection and Quarantine (CIQ) Clearance Notice is required when imported products enter bonded zones. Direct mailed products are exempt from CIQ Clearance Notice.

On April 15, 2016, 13 government authorities, including the Ministry of Finance, National Development and Reform Commission, Ministry of Industry and Information Technology, Ministry of Commerce, General Administration of Customs, and State Administration of Taxation, jointly announced the second batch of products allowed on the positive list for CBEC imported goods. The list covers an additional 151 types of product categories with an eight-digit H.S code. Newly added categories include fresh food (including meat and fruits), seafood, liquid milk, grains, cooking oil, certain nutritional and health products (including vitamin supplements), and registered medical instruments. Product categories on the positive list are set to be reviewed on a regular basis.

On May 24, 2016, General Office of China Customs issued a notice regarding the transition period for the implementation of new supervision regulations on CBEC imports. The document stated that the transition period will last for one year until May 11, 2017, during which importers will not be required to provide CIQ Clearance Notice before importing CBEC goods into bonded warehouses of pilot cities. Also, pre-market approvals for first-time imported goods such as cosmetics, infant formula, etc. via the bonded area import or direct mail models will be put on hold during the period.

On November 15, 2016, Ministry of Commerce further extended the transition period for the implementation of new supervision regulations on CBEC imports to the end of 2017. On 20 September, 2017, the State Council further extended the transition period to the end of 2018.

It is expected that with the launch of these new supervision regulations, some smaller CBEC players who cannot through inspection and quarantine procedures will be screened out. The CBEC (import) market is expected to become healthier and consolidate.

6. Stage 4c: The emergence of new CBEC models (2017~)

In recent years, some CBEC operators have trialled various ways to make shopping via CBEC (import) more convenient and provide customers with better shopping experiences. Two new models have emerged – the first one is an extension of the direct mail model with the use of overseas warehouses (the “direct mail + overseas warehouse” model), and the second one is the modification of the bonded area import model with the setting up of offline stores for transaction (the “bonded area import + offline store” model).

In the “direct mail + overseas warehouse” model, after the customers place orders on a registered CBEC platform, overseas retailers will ship the products to the overseas warehouse instead of sending them directly to the warehouse in China. The CBEC operator will collect and store the parcels in the overseas warehouse before shipping them in lots to warehouses in China. For customers, a major advantage of using overseas warehouses is that logistics costs will be cheaper than that of the direct mail model as more recipients (customers) can share the logistics costs. However, shipping time will be longer than the direct mail model.

In the “bonded area import + offline store” model, some CBEC players set up offline stores where customers can purchase and pick-up the bonded imported products directly in the stores. The offline store is de facto an extension of the bonded area model whereby overseas products in the bonded warehouse in China can be sold in the approved experiential store, and they will go through customs clearance only after customers have placed orders in-store or via the CBEC website.

Appendix 2: Key policies relating to cross-border e-commerce (import), August 2012 – September 2017

Announced date	Policy	Details
August 2012	Approval of Five Pilot Cities for CBEC business	<ul style="list-style-type: none"> • Issued by the NDRC • It approves Shanghai, Chongqing, Hangzhou, Ningbo, Zhengzhou to be the pilot cities for CBEC business.
February 2014	GAC Announcement No. 12, 2014 (The Addition of a Customs Supervisory Method Codec)	<ul style="list-style-type: none"> • Issued by the GAC • It specifies that “9610” customs supervision code is applicable to individual customers or e-commerce companies who would like to realize transactions through CBEC platforms. It is also the first customs supervision, particularly for CBEC.
March 2014	Notice on Issues Related to CBEC Service Pilot Online Bonded Imports	<ul style="list-style-type: none"> • Issued by the Department of Processing Trade and Bonded Affairs Control and Supervision of the GAC • It re-emphasizes the restrictions on individual customers’ overseas shopping value and volume, tax levies and other details, which are mentioned in GAC Announcement No. 43, 2010.
July 2014	GAC Announcement No. 56, 2014 (Announcement on Matters relating to the Regulation of Imported and Exported Goods and Articles via CBEC)	<ul style="list-style-type: none"> • Issued by the GAC • It states that customs supervision is applicable to both companies and personal cross-border transactions through an e-commerce transaction platform. E-commerce enterprises should process an e-commerce business filing with Customs for imported goods. Further, enterprises or individuals engaging in CBEC business should submit orders, payments, and logistics information to Customs before declaring goods to enter or exit China.
August 2014	GAC Announcement No. 57, 2014 (The Addition of a Customs Supervisory Method Codec)	<ul style="list-style-type: none"> • Issued by the GAC • It specifies that “1210” customs supervision code is applicable to bonded CBEC business.
March 2015	Official Reply of the State Council on Approving the Establishment of the China (Hangzhou) CBEC Comprehensive Pilot Zone	<ul style="list-style-type: none"> • Issued by the State Council • It approves Hangzhou to be the first CBEC comprehensive pilot zone.
September 2015	Letter on Strengthening Bonded Supervision over CBEC Online Imports	<ul style="list-style-type: none"> • Issued by the Department of Processing Trade and Bonded Affairs Control and Supervision of the GAC • It clarifies that only pilot cities that have special zones with bonded logistics centers and supervised by customs officials are allowed to engage in CBEC import business.

<p>January 2016</p>	<p>Official Reply of the State Council on Approving the Establishment of CBEC Comprehensive Pilot Areas in 12 Cities</p>	<p>Other cities and zones, including bonded warehouses, are not allowed to conduct CBEC business.</p> <ul style="list-style-type: none"> • Issued by the State Council • It approves the establishment of new CBEC comprehensive pilot zones in 12 cities including Tianjin, Shanghai, Chongqing, Hefei, Zhengzhou, Guangzhou, Chengdu, Dalian, Ningbo, Qingdao, Shenzhen, and Suzhou.
<p>March 2016</p>	<p>Circular on Tax Policy for CBEC Retail Imports</p>	<ul style="list-style-type: none"> • Issued by the MOF, the GAC and the SAT • It states that effective from April 8, 2016, CBEC imported goods are no longer subject to personal postal articles tax. New tax on CBEC is applicable which includes import tariff, VAT, and consumption tax, where the actual tax payable is 70% of the calculated taxable amount. Transaction limit per order and new upper limit per person each year are also amended.
<p>March 2016</p>	<p>Notice on Adjustment of Personal Postal Article Tax</p>	<ul style="list-style-type: none"> • Issued by the MOF, the GAC, and the SAT • It states that effective from April 8, 2016, personal postal articles tax is adjusted. New rates are categorized into 15%, 30%, and 60% levels.
<p>April 2016</p>	<p>GAC Announcement No. 25, 2016 (Announcement on the Classification and Nomenclature Table of Imported Articles of the PRC and the Duty-paid Price Table of Imported Articles of the PRC)</p>	<ul style="list-style-type: none"> • Issued by the GAC • It makes adjustment on the GAC Announcement No. 15, 2012 with details on the classification as well as the duty-paid price of imported goods.
<p>April 2016</p>	<p>GAC Announcement No. 26, 2016 (Announcement on Matters relating to the Regulation of CBEC Retail Imports and Exports)</p>	<ul style="list-style-type: none"> • Issued by the GAC • It provides guidelines for the submission of documents of CBEC business to the Customs, clarifies the customs clearance management, tax collection management, logistics control, and return management. The policy is effective from April 8, 2016. • It also abolishes the GAC Announcement No. 56, 2014 on CBEC trade supervision.
<p>April 2016</p>	<p>Announcement on Issuing the List of CBEC Retail Imports</p>	<ul style="list-style-type: none"> • Issued by 11 government authorities, including MOF, NDRC, GAC, and MOFCOM. • It announces a positive list for CBEC imported goods. The list covers 1,142 types of product categories. Effective from April 8, 2016, the new positive list will replace the previous negative list for CBEC imported goods.
<p>April 2016</p>	<p>Announcement on Issuing the List of CBEC Imports (Second Batch)</p>	<ul style="list-style-type: none"> • Issued by 13 government authorities, including MOF, NDRC, GAC, and MOFCOM. • It announces the second batch of positive list with an additional 151 types of product categories. The list is effective from April 16, 2016.

May 2016	Notice on the Implementation of New Supervision Regulations on CBEC Imports	<ul style="list-style-type: none"> • Issued by the GAC • It announces the transition period for the implementation of the new supervision regulations on CBEC imports to last for one year until May 11, 2017, during which importers will not be required to provide CIQ Clearance Notice before importing CBEC goods into bonded warehouses of pilot cities. Also, pre-market approvals for first-time imported goods such as cosmetics, infant formula, etc. via the bonded area import or direct mail models will be put on hold during the period.
November 2016	Transition period for the implementation of new supervision regulations on CBEC imports to extend to end-2017	<ul style="list-style-type: none"> • Issued by the MOFCOM • It announces the one-year transition period for the implementation of new supervision regulations on CBEC imports which starts from May 11, 2016 to extended further to the end of 2017.
September 2017	Transition period for the implementation of new supervision regulations on CBEC imports to extend to end-2018	<ul style="list-style-type: none"> • Issued by the State Council • It announces the one-year transition period for the implementation of new supervision regulations on CBEC imports which starts from May 11, 2016 to extended further to the end of 2018.

Source: Various government websites; compiled by Fung Business Intelligence

* Note: NDRC: National Development and Reform Commission; GAC: General Administration of Customs; MOF: Ministry of Finance; SAT: State Administration of Tax
Commerce



Spotlight on China Retail – Issue 9

Retail and E-commerce Logistics

Asia Distribution and Retail

 FUNG BUSINESS INTELLIGENCE

October 2018

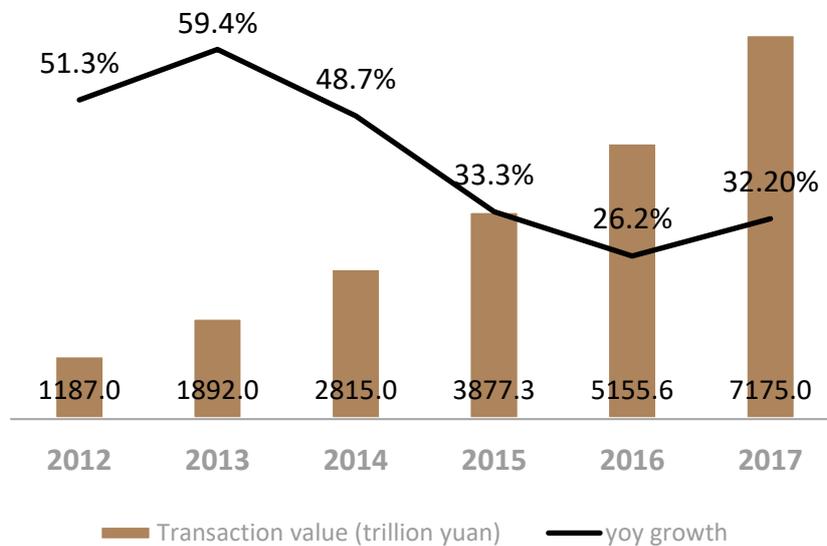
Technological advancement and the explosive growth of e-commerce in the country have rendered the retail and e-commerce logistics industry a fertile ground for development and growth. With half of the world's parcels now being delivered in China, logistics providers and e-commerce players alike are exploring new ways to better serve the customers and further expand their business, and making huge investments in logistics infrastructure home and abroad, with a hope to gain a larger pie of the fast-growing market. Many have come up with innovative ways to improve logistics services and provide quicker delivery for customers. Meanwhile, technologies have empowered logistics transformation; companies are becoming more digital, automatic and smart. “Smart logistics” is now dominating the retail and e-commerce logistics sector.

I. Market overview

1. Strong growth of online retail sales fuels demand for logistics services; total logistics value increases steadily

China's online retail market, which is now the world's largest, has experienced rapid growth over recent years. Total online retail sales increased by 32.2% year-on-year (yoy) to reach 7.18 trillion yuan in 2017 (Exhibit 1), while online sales of physical goods amounted to 5.48 trillion yuan, up by 28.0% yoy and accounted for 15.0% of total retail sales.

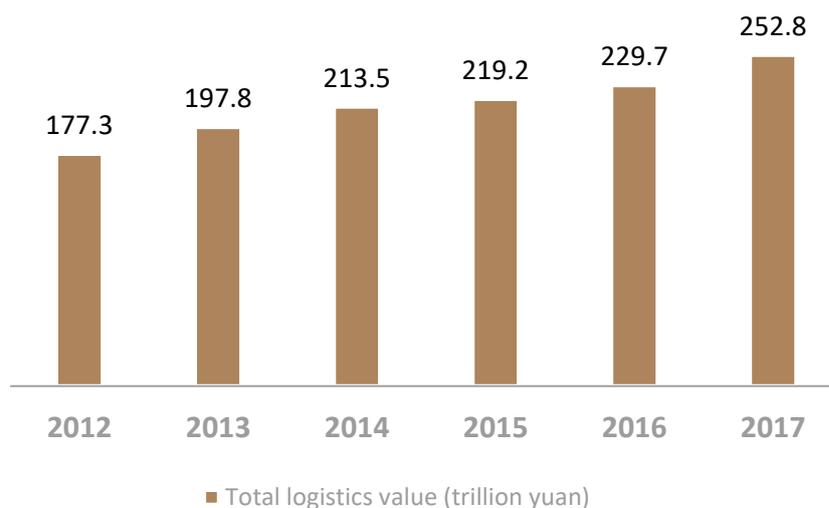
Exhibit 1: Total online retail sales of goods and services, 2012 – 2017



Source: China Federation of Logistics and Purchasing; compiled by Fung Business Intelligence

The fast growth of online retailing in China has given the logistics industry a boost in line with soaring demand for transport and delivery services. Total logistics value reached a record 252.8 trillion yuan in 2017 (Exhibit 2), up by 0.6% yoy in real terms.

Exhibit 2: China's total logistics value, 2012 – 2017

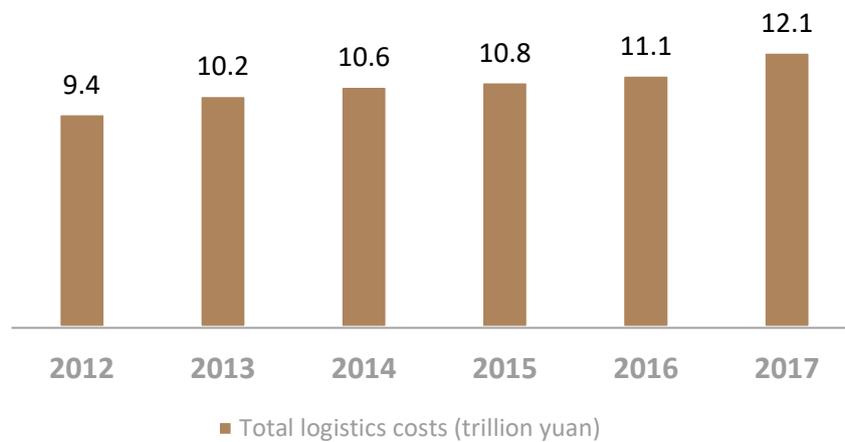


Source: China Federation of Logistics and Purchasing; compiled by Fung Business Intelligence

2. Logistics costs remain high; transportation costs account for the lion’s share of total costs

Total logistics costs remain high in China. According to the China Federation of Logistics and Purchasing, China’s total logistics costs amounted to 12.1 trillion yuan in 2017 (Exhibit 3), up by 9.2% yoy. The ratio of total logistics costs to GDP was 14.6% in 2017, down from 14.9% in 2016 and 16.0% in 2015.

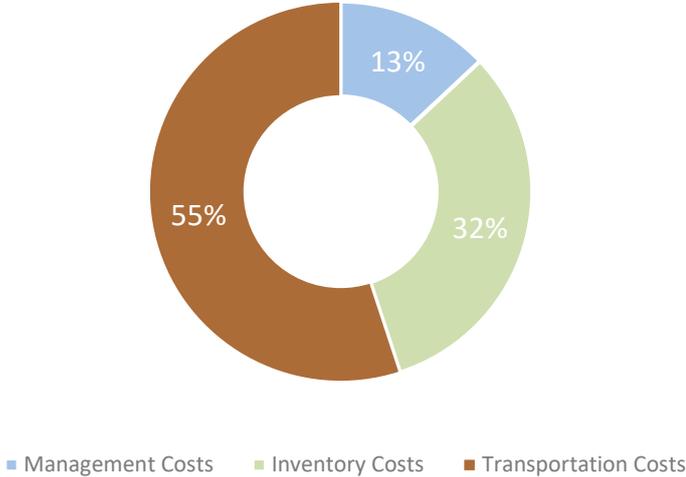
Exhibit 3: China’s total logistics costs, 2012 – 2017



Source: China Federation of Logistics and Purchasing; compiled by Fung Business Intelligence

As shown in Exhibit 4, transportation costs accounted for the largest share of total logistics costs and comprised almost 55% of the total costs in 2017, while inventory and management costs accounted for 32% and 13% of the total logistics costs respectively.

Exhibit 4: Cost structure of logistics industry in China, 2017

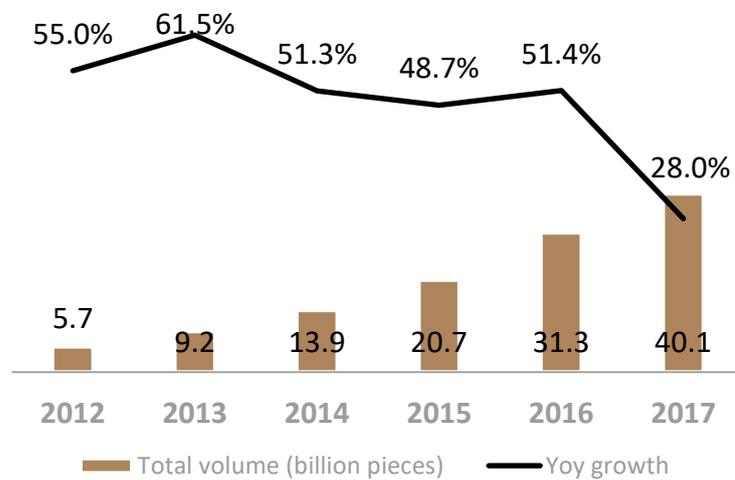


Source: *China Federation of Logistics and Purchasing; compiled by Fung Business Intelligence*

3. Express delivery market scales up; growing demand for intra-city courier services (same-city delivery)

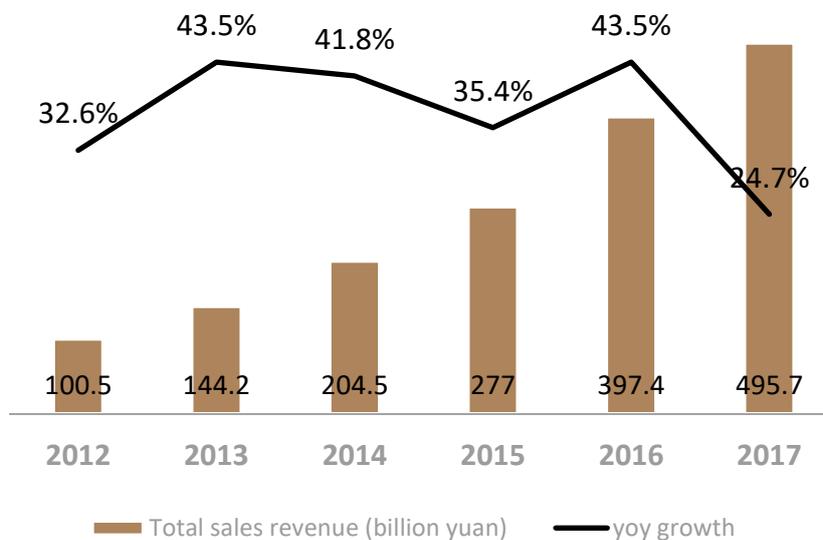
As a critical part of e-commerce logistics, the express delivery sector has grown rapidly. As shown in Exhibit 5, the total volume of completed deliveries amounted to 40.1 billion pieces in 2017, up 28.0% yoy, making China’s express delivery market the largest in the world in terms of delivery volume. Total sales revenue for the sector amounted to 495.7 billion yuan, up 24.7% yoy (Exhibit 6).

Exhibit 5: Total volume of China’s express delivery sector, 2012 – 2017



Source: State Post Bureau; compiled by Fung Business Intelligence

Exhibit 6: Total sales revenue of China’s express delivery sector, 2012 – 2017



Source: State Post Bureau; compiled by Fung Business Intelligence

China’s express delivery sector has three major market segments, namely, intra-city courier, inter-city courier, and cross-border delivery. As shown in Exhibit 7, inter-city courier accounted for the largest share of the sector, contributing 74.8% of the total market volume and over 50% of the total revenue. Intra-city business accounted for only 23.1% and 14.8% of the total market volume and total revenue in 2017 respectively. That said, the intra-city business has been the fastest growing segment in recent years. In 2017, sales revenue of intra-city courier increased by 30.0% yoy to 73.23 billion yuan; by contrast, sales revenue of inter-city courier rose by 19.7% to 251.28 billion yuan and sales revenue of international courier increased by 23.3% yoy to 52.89 billion yuan.

The surge in demand for intra-city courier is due in part to the emergence of new retail practices such as online-to-offline (O2O) e-commerce and an increasingly large number of online channels selling fresh produce.

Exhibit 7: Market share of the three segments of the express delivery sector, 2013 – 2017

	Intra-city courier		Inter-city courier		International courier	
	% of Volume	% of Sales Revenue	% of Volume	% of Sales Revenue	% of Volume	% of Sales Revenue
2013	24.9	11.5	72.2	57.5	2.9	18.8
2014	25.4	13.0	72.3	55.3	2.3	15.4
2015	26.1	14.5	71.8	54.6	2.1	13.3
2016	23.7	14.2	74.3	52.8	2.0	10.8
2017	23.1	14.8	74.8	50.7	2.1	10.7

Source: State Post Bureau; compiled by Fung Business Intelligence

II. Key trends and developments

1. “Smart logistics” dominates the agenda

In today’s high competitive and rapidly evolving era, developing smart logistics has become one of the most important strategies for business to outperform competitors. The adoption of advanced technologies such as Radio Frequency Identification (RFID), Global Positioning System (GPS), the Internet of Things (IoT), cloud computing, drones, and robotics, in addition to automation of logistics processes to improve efficiency, has become imperative for the retail and e-commerce logistics sector.

Recently, logistics and e-commerce operators have invested heavily in smart logistics, hoping to enhance fulfilment capability and efficiency, to streamline operations and reduce logistics costs. JD.com is a case in point. Over the past few years, the company has made substantial investments in smart warehouses and new delivery methods with an aim to improving fulfilment efficiency and increasing storage capacity. In June 2014, JD.com launched its first "Asia No.1" warehouse in Shanghai. The warehouse incorporates a high degree of automation; all operations in the warehouse are fully automatic, including receiving goods, storage, packaging and sorting. As of 2017, JD.com operated 14 "Asia No. 1" warehouses across the country.

JD.com's rival Cainiao is also continuing to invest in smart logistics. In April 2018, Cainiao announced to launch its first smart delivery system globally in a community in Yuhang District in Hangzhou. The smart delivery system features four major elements – facial recognition system, "smart pipes", smart lockers, and an app to control the locker. Authorized courier staff can scan their face to verify their identity and deliver parcels to the smart delivery system. After passing through the Cainiao Security System, parcels will be distributed to respective smart lockers inside each apartment. The smart delivery system also supports reverse logistics. Users can also adjust the temperature inside the smart locker for the storage of fresh food.

2. Innovations to strengthen last-mile delivery

To cater to consumers' heightened expectation for fast delivery, both retailers and logistics players have launched and tested various types of fulfilment models. Retailers such as Uniqlo, Walmart (China), Yonghui Superstores, YH Super Species and Watsons have introduced "click & collect" services. Many retailers have partnered with O2O platforms or logistics companies to roll out such services. For example, on-demand logistics and omnichannel e-commerce platform Dada-JD Daojia (a JD.com joint venture) has partnered with over 200 Walmart stores and 500 Yonghui stores, among numerous other supermarkets and grocery stores, to provide premium online fresh grocery shopping experience with 1-hour home delivery service. Watsons, on the other hand, has leveraged Cainiao's "ship-from-store" service to fulfil online orders and deliver goods as fast as two hours.

Meanwhile, some retailers and logistics operators have introduced innovative ways to speed up delivery and enhance consumer convenience. One such example is drone delivery; it has been increasingly adopted by companies. In May 2018, YH Super Species trialled drone delivery for physical products between YH Super Species store in Guangzhou M+Park and a

designated pick-up area in a residential community nearby. YH Super Species has employed some couriers in the residential buildings to collect delivery orders from drones and complete the last mile delivery to consumer’s designated address. It is reported that orders can be delivered in 15-20 minutes within a 3-km distance from the store. JD.com has also ramped up its efforts in drone delivery. The company has started tested drone delivery since March 2017. It gained the formal approval from the Civil Aviation Administration of China (CAAC) in February 2017 to start sending packages by drone in certain rural areas.

Besides drone delivery, some companies have trialled autonomous vehicle to handle last-mile delivery. An example is Suning. In July 2018, Suning’s logistics arm Suning Logistics signed a strategic partnership with Baidu Apollo to develop smart logistics. The two companies jointly unveiled a driverless delivery vehicle called the “MicroCar” which is equipped with Baidu’s L4-class intelligence system. According to Suning, the vehicle is designed to solve the last 5-km delivery problems. The autonomous vehicle will first be used in Suning Xiaodian (Suning’s convenience stores) to provide delivery services for online orders that are made within a 3-km distance of Suning Xiaodian’s surrounding communities.

Other innovations that facilitate last-mile delivery include smart pick-up tower in key locations. Prior to this year’s 6.18 shopping festival, Cainiao trialled and launched a number of smart pick-up towers in various communities and industrial parks in Hangzhou. With a height of more than 5 meters and in an octahedron shape, the smart tower connects with drones and unmanned vehicles and provides pick-up services 24/7 all around the year. It can store approximately 600 – 800 parcels, and customers can pick up their parcels by facial scanning.



Cainiao’s smart pick-up tower (Photo source: iwangshang)

3. E-commerce and logistics players put more emphasis on global logistics network expansion

Considering the rapid development of cross-border e-commerce (CBEC) in recent years, companies engaged in e-commerce and logistics have stepped up global expansion of their logistics network to better facilitate cross-border delivery between China and overseas countries. Cainiao is a case in point. In May 2018, Cainiao unveiled its plans to build world-class logistics hubs in several locations around the world – including Hangzhou, Kuala Lumpur, Dubai, Moscow and Liege – as part of its global hub expansion plan. Cainiao hopes to create more efficient logistics operations and offer single-day delivery in China and 72-hour delivery across the globe for countries and regions involved in the Belt and Road Initiative.

JD.com's logistics arm JD Logistics has upgraded its overseas warehousing services to cater the increasing demand for cross-border logistics services just before the 6.18 shopping festival. This has reportedly enabled the company to provide quick delivery for CBEC – an average of 3.9 days for products delivered via the “direct mail” model; customers living in major cities can even enjoy next-day delivery after placing their order. JD.com has over 110 overseas warehouses in five continents as of June 2018.

On the other hand, some local courier companies such as SF Holding Co, the parent company of delivery service provider SF Express have also speeded up global expansion in recent years. In May 2017, the company announced its plan to set up a joint venture with UPS Parcel Delivery Service Ltd. to collaborate on development and provision of international delivery services from, initially, China to the U.S. and, in the future, to other countries. The joint venture combines SF Holding Co's 13,000 service points in 331 cities in China with UPS' global network spanning 220 countries, allowing the two companies to leverage their complementary networks, service portfolios, technologies and logistics expertise to accelerate B2B and B2C cross-border trade. In the same month, Alibaba-backed YTO Express announced to purchase of 61.87% stake in Hong Kong-based On Time Logistics as part of its international expansion initiative. On Time Logistics is principally engaged in the air freight forwarding business and has established an extensive network overseas including Asia, Europe and North America; the acquisition will allow YTO to develop overseas business and further broaden its income stream.

4. Rural logistics is the next growth engine

China's rural e-commerce has continued its robust growth momentum over recent years. According to the Ministry of Agriculture and Rural Affairs of the PRC, online retail sales in rural areas reached 1.25 trillion yuan in 2017, accounting for 17.35% of the country's total online retail sales of goods and services, up from 6.45% in 2014.

The promising outlook for rural e-commerce has prompted many leading e-commerce and Internet companies to push ahead with “going rural” initiatives. For instance, in April 2018, Alibaba invested 4.5 billion yuan in Huitongda Network Co, a Chinese rural online services platform and a subsidiary of Jiangsu Five Star Appliances Co as part of its continued push to expand business in the country's rural areas. The two companies will work together on supply chain logistics, warehousing and technology to improve e-commerce infrastructure in rural areas. Indeed, Alibaba first launched its Rural Taobao initiative in late 2014, providing an e-commerce platform and logistics infrastructure for rural residents to buy and sell items online via Taobao. Since then, it has set up thousands of service centers in the countryside to provide e-commerce delivery in rural areas. In 2016, Alibaba followed up with a three-year plan to invest 10 billion yuan in rural e-commerce, with a continued focus on boosting infrastructure and building more service centers.

Another example is JD.com. In January 2018, JD.com said it planned to assign drones to China's northeastern “rust belt” region, comprising provinces such as Heilongjiang, Jilin and Liaoning, to help improve efficiency in farming and logistics. It also stated that it will invest more than 20 billion yuan in the three provinces over the next three years to help the region “upgrade its industries, create jobs, inject innovation and upgrade retail services”.

Earlier in October 2017, Suning Logistics announced that it will connect the towns and villages in Jiangsu and Zhejiang province by opening up a number of aviation routes for drones. Suning also revealed that it plans to build a smart logistics hub with 5,000 delivery drones, covering the country's unmanned aviation, research and development, production and after-sales ground service network.

5. Growing demand for cold chain logistics

Chinese consumers are more quality-driven and health-conscious nowadays, leading to an increasing demand for fresh produce. Temperature control is necessary in the handling of fresh products to retain their efficacy. This offers great development prospects for cold chain logistics. According to the China Federation of Logistics and Purchasing, the market size of the cold chain logistics industry in China is estimated to grow at a CAGR of 20% to reach 470

billion yuan by 2020, up from 250 billion yuan in 2017.

To tap this fast-growing market, some large-scale logistics companies have scaled up investments in cold chain logistics. In August 2018, SF Holding Co joined force with U.S. supply chain system provider HAVI Group LP to establish a cold-chain joint venture New HAVI in Shenzhen; the new company aims to provide customers throughout the cold chain market with comprehensive end-to-end solutions and services, while promoting the growth and development of the sector. Others express delivery companies such as STO Express and YTO Express also regard cold-chain business as a key business focus, and are setting up subsidiaries, new warehouses, etc. to facilitate the provision of cold chain logistics services.

Some e-commerce platforms have also put more emphasis on the cold-chain market. In July 2017, JD.com teamed up with Japanese logistics giant Yamato Transport Co Ltd. to strengthen its fresh produce cold-chain and cross-border logistics services, and jointly engage in logistics technology R&D development. Suning, on the other hand, has been expanding the scale of its cold chain warehouses. As of end-July, 2018, Suning Logistics operated 17 cold-chain warehouses across China.

6. Logistics players to go “green”

Nowadays, green logistics is at the heart of many logistics players. To attain sustainable development, they are exploring more environmentally sustainable ways to pack, transport, store, and distribute products. With the increase in the number of e-commerce parcels, particularly during the online shopping festivals, many logistics players have launched green initiatives to promote the use of sustainable, green packaging materials throughout the supply chain. For example, during the 11.11 Global Shopping Festival last year, Cainiao put in place a smart-packaging system in its warehouses to assess the category, volume, weight and delivered area of its orders, and match the goods to the most space-efficient form of packaging to reduce waste. The company has also set up 20 green warehouses across China where all parcels are packaged with renewable materials before shipping. In September 2018, Cainiao further announced that it has started to use recycling boxes for picking, loading and packing goods in some of its green warehouses.

Similarly, JD Logistics has also stepped up its green efforts with the establishment of “JD Logistics Green Fund” in December 2017. The fund is intended to be used for the transformation of green supply chain, R&D and innovations of green supply chain, and promotion of green consumption. Meanwhile, JD Logistics has also increased investments in new energy vehicles. It has launched over thousands of new energy vehicles across the

country to replace the traditional petroleum-based trucks.

In April 2018, Suning Logistics announced the setup of a green packaging laboratory to explore different forms of environmental friendly packaging products, develop new plans for packaging management in the industry and create a green packaging sharing platform.

Recognizing the importance of achieving sustainable logistics while enhancing efficiency, Alibaba’s new retail divisions including Tmall, Taobao, Xianyu, 1st.1688.com, Hema Xiansheng and ele.me jointly announced the commencement of its “Green Logistics Plan 2020” in May 2018. Major initiatives set forth in the plan include upgrading the delivery bags to eco-friendly bags, encouraging merchants to use fewer delivery boxes, reducing plastic wastage during takeaway delivering and opening up its carton screening technology.



Parcel packaged with renewable materials (Photo source: Alizila)

7. Government commits support to retail logistics development

The government has been very supportive towards the development of the logistics industry. In particular, a number of specific policies and regulations have been promulgated to promote retail and e-commerce logistics development over the past few years.

In March 2018, the State Council executive meeting passed the *Interim Regulations on Express Delivery*, the first regulations governing and facilitating the development of the express delivery sector in the country. According to the regulations, after filing with administrative authorities, courier firms and their branches can set up terminal service outlets without applying for a business license. Delivery companies are also encouraged to operate cross-border shipping businesses and to build sorting centers for international

shipments at key ports and service and processing facilities in foreign countries. The regulations also laid out personal information protection requirements targeting illegal sales, leakage or provision of user information generated in shipping activities. The regulations became effective from 1 May, 2018.

In January 2018, the General Office of the State Council promulgated the *Opinions on Promoting the Synergistic Development of E-commerce and Express Delivery Services*. To accelerate the development of e-commerce and express delivery services, the Opinions set out policy guidelines in six areas including optimizing policies and regulations to accelerate the development of e-commerce and express delivery services; accelerating the development of logistics infrastructure for e-commerce; strengthening regulations and facilitating the management of delivery trucks for e-commerce orders; encouraging innovations in express delivery services; encouraging enterprises to go smart and improve operation efficiency; and encouraging the development of green ecosystem. Noticeably, this is the first time the government proposed the idea of green e-commerce and green express delivery. The government encouraged e-commerce players and express delivery operators to jointly promote green e-commerce and delivery by launching green packaging and green process reengineering in the supply chain, promoting green consumption, and exploring the establishment of a complete package recycling system.

Earlier in March 2016, six ministries including the Ministry of Commerce, the National Development and Reform Commission, the Ministry of Transport, the General Administration of Customs, the State Post Bureau, and the Standardization Administration jointly issued the *Special National Plan for the Development of E-commerce Logistics (2016–20)*. The plan laid out important development tasks that will support the development of e-commerce logistics.

These government policies are set to provide a more regulated and transparent environment for the development of retail logistics.

III. Concluding remarks

The rapidly evolving retail and e-commerce market as well as the changing needs of consumers, particularly the requirement for immediacy and fast service, have continued to create huge development opportunities for the logistics sector. Given the rapid development of technology, new forms of technology-enabled logistics services models will appear to provide fast delivery and personalized pick-up options for customers. We also expect to see more strategic partnerships in the sector, especially in the express delivery segment as more express delivery companies strive to upgrade and expand their businesses and invest in innovation.

The retail and e-commerce logistics sector is set to be more competitive in the coming years. To succeed in the increasingly sophisticated and competitive environment, players need to be innovative and constantly come up with new services, while enhancing their logistics capabilities and expanding their logistics infrastructure and facilities. They should continue to go “smart” and adopt advanced technologies in the entire logistics process such as speeding up the construction of automated warehousing and logistics facilities and accelerating the logistics informatization process.

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