The Changing Face of China's Retail Market

September 2014

Fung Business Intelligence Centre

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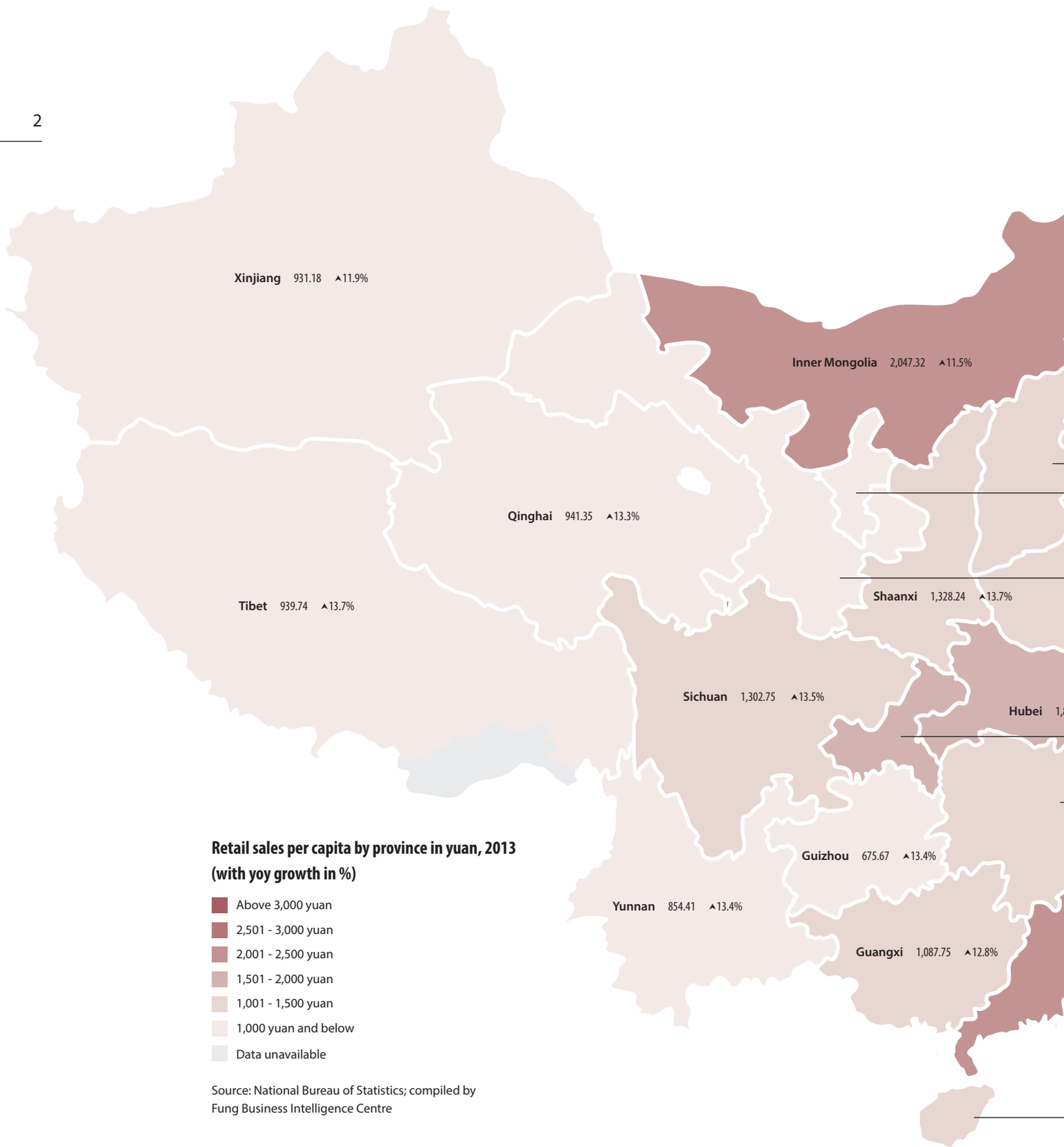
Introduction

Technological advances and changing consumer preferences are fast reshaping China's retail landscape. Chinese consumers today have different and more sophisticated expectations of products, services, experiences and value. They increasingly demand a seamless "shopping experience" across all shopping channels. The rapid development of online retailing continues to pose challenges for traditional retail. As the sector evolves, market players are increasing their efforts to keep up with and adapt to the changing landscape.

In this report, we offer an overview of China's retail market and assess its competitive landscape, with key highlights on developments for different retail formats. We supplement these with a review of the industry's latest developments and major challenges.

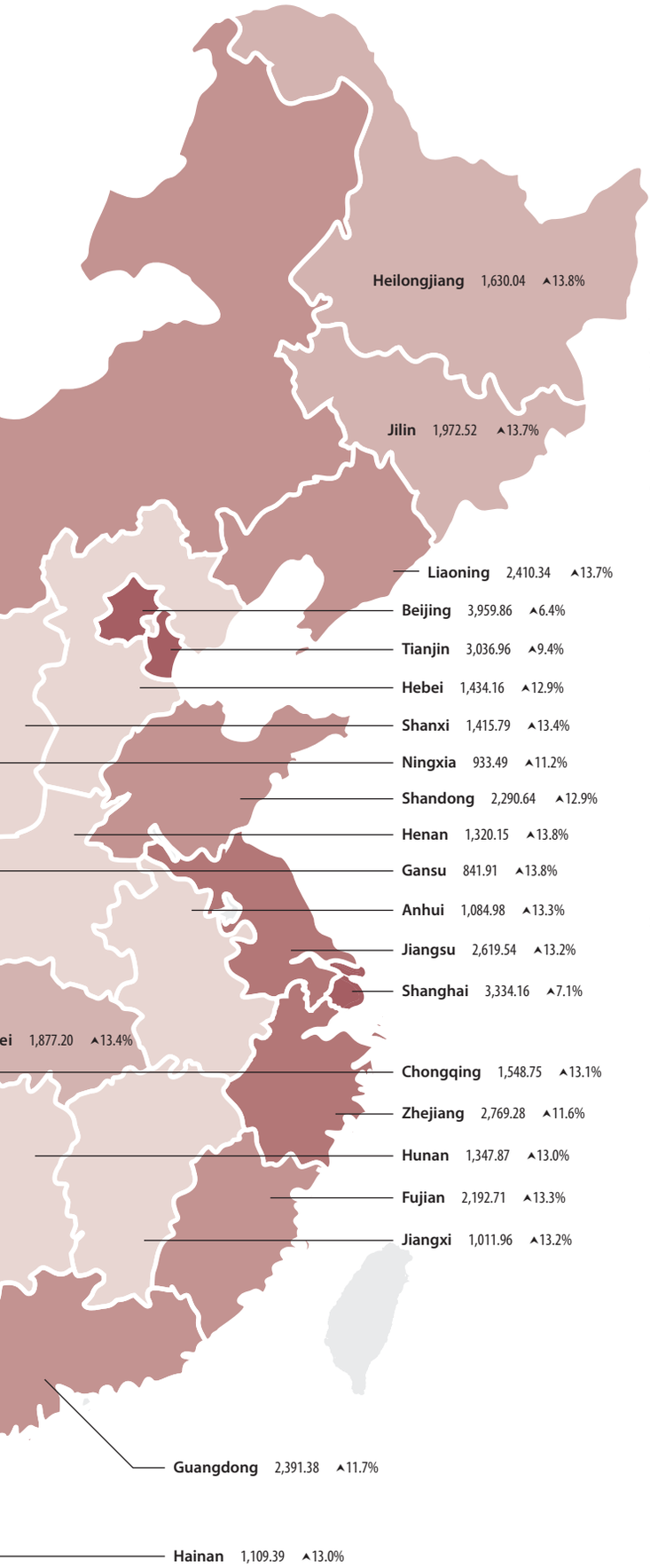
At a glance



Retail sales per capita by province in yuan, 2013 (with yoy growth in %)

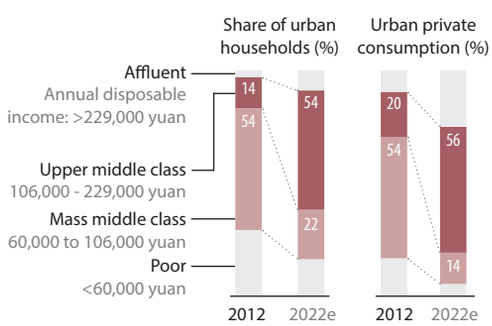
- Above 3,000 yuan
- 2,501 - 3,000 yuan
- 2,001 - 2,500 yuan
- 1,501 - 2,000 yuan
- 1,001 - 1,500 yuan
- 1,000 yuan and below
- Data unavailable

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



Nationwide, retail sales per capita grew from 1,553.18 yuan in 2012 to 1,747.68 yuan in 2013, a 12.5% growth yoy. With the continued growth of the middle classes, private consumption is expected to rise in the near future, revealing an impetus that can propel retail market growth into its next phase.

The changing middle class, 2012 & 2022e



Source: McKinsey Quarterly

Overview

Retail sales saw steady growth in 2013

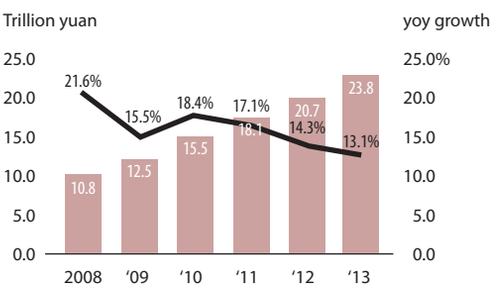
China is the world's second largest retail market after the US, according to the Ministry of Commerce (MOFCOM). The country's total retail sales of consumer goods reached 23.8 trillion yuan in 2013, up from 20.7 trillion yuan in 2012 (see **Exhibit 1**).

Having said that, retail sales growth has continued to decelerate in recent years due to slower economic growth. Nominal growth of total retail sales was 13.1% year-on-year (yoy) in 2013, the lowest level since 2007. In real terms, retail sales increased 11.5% yoy in 2013.

As to the retail market in 1H14, total retail sales of consumer goods rose nominally by 12.1% yoy to 12.4 trillion yuan, while the growth rate was a 0.6 percentage point (ppt) lower than in 1H13.

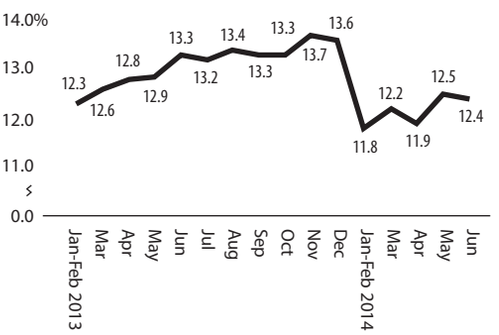
By month, nominal retail sales growth was down to 11.8% yoy in January and February 2014 from 13.6% yoy in December 2013; sales then scaled up slightly to 12.4% yoy in June 2014 (see **Exhibit 2**).

Exhibit 1. Total retail sales of consumer goods, 2008 - 2013



Source: National Bureau of Statistics

Exhibit 2. Nominal growth of total retail sales of consumer goods by month, January 2013 - June 2014



Source: National Bureau of Statistics

Growth rates diverged for different modes of sales

Retail sales of commodities of enterprises reached 20.9 trillion yuan in 2013, up by 13.6% yoy; of which, retail sales of commodities for enterprises above a designated size rose by 12.7% yoy.

Retail sales for enterprises above a designated size in the catering industry dropped by 1.8% yoy in 2013 (see **Exhibit 3**), due largely to the new Chinese leadership's continuing efforts to curb government spending on lavish banquets. In 1H14, the situation improved slightly as the growth of catering sales for enterprises above a designated size rose by 2.9% yoy. Mass catering enterprises, in particular, performed better.

The retail sales of commodities of enterprises above a designated size rose 10.2% yoy to reach 5.8 trillion yuan in 1H14. By product category, sales of telecommunications equipment achieved

the highest growth of 22.1% yoy in 1H14. By contrast, the growth in sales of gold, silver and jewellery was the slowest at –5.4% yoy, after posting rapid growth in 2013 (see **Exhibit 4**).

Retail sales are primarily driven by the urban population, which accounted for 86.4% of total retail sales in 1H14; however, rural retail sales grew at a faster pace. Urban retail sales increased nominally by 12.0% yoy to 10.7 trillion yuan in 1H14, 0.5 ppt lower than in 1H13; rural retail sales rose 13.2% yoy to 1.7 trillion yuan in 1H14, 1.1 ppt lower than in 1H13.

The sharp increase in rural incomes has been a positive driver for rural spending. The per capita net income of rural households increased 9.3% yoy in real terms to reach 8,896 yuan in 2013. The per capita disposable income of urban households increased 7.0% yoy in 2013 to 29,547 yuan in real terms. However, the per capita disposable income for urban households was still three times more than for rural households; urban residents still remain the major contributors to national total retail sales (see **Exhibit 5**, on the next page).

Online retail market continues to scale up

China's online retail market has registered stunning growth over recent years, and became the world's largest online market in 2013. According to iResearch, the transaction value of China's online market increased by 39.4% yoy to reach 1.84 trillion yuan in 2013, accounting for 7.9% of the country's total retail sales[1] (see **Exhibit 6**, on the next page). By 2017, total online sales are expected to reach 4.45 trillion yuan,

Exhibit 3. China's total retail sales by mode, FY12 - 1H14

	yoy growth (%)		
Mode	FY12	FY13	1H14
Total sales of consumer goods †	14.3	13.1	12.1
Commodities	14.4	13.6	12.4
of which: enterprises above a designated size ‡	14.8	12.7	10.2
Catering	13.6	9.0	10.1
of which: enterprises above a designated size ‡	12.9	– 1.8	2.9

† Total retail sales of consumer goods refers to the sum of retail sales of commodities sold by wholesale retailing, catering, publishing, post and telecommunications and other service industries to urban and rural households for private consumption, and to social institutions for public consumption.
‡ Enterprises above a designated size refer to enterprises with annual sales of five million yuan or more and with employee strength of 60 or more.

Source: National Bureau of Statistics

Exhibit 4. China's nominal retail growth of enterprises above a designed size, by product, FY13 - 1H14

	yoy growth (%)	
Product	FY13	1H14
Grain, oil, food, beverages, tobacco, and liquor	13.9	11.3
Clothing, shoes, hats, and textiles	11.6	10.0
Cosmetics	13.3	10.0
Gold, silver, and jewellery	25.8	– 5.4
Daily use products	14.1	10.3
Sports and entertainment products	7.2	n/a
Home appliances and video equipment	14.5	7.9
Chinese and western medicine	17.7	14.9
Stationery and office accessories	11.8	12.0
Furniture	21.0	14.9
Telecommunications equipment	20.4	22.1
Petroleum and related products	9.9	8.1
Automobiles	10.4	10.5
Building and decoration materials	22.1	14.8

Source: National Bureau of Statistics

accounting for 12.4% of total retail sales.

An expanding Internet population is a major driving force for the robust growth of China's online retail market. In fact, China has the world's largest online population. The China Internet Network Information Center (CNCIC) reveals that China's Internet population stood at 632 million in 1H14, with a penetration rate of 46.9%, while the number of China's online shoppers reached 332 million in 1H14.

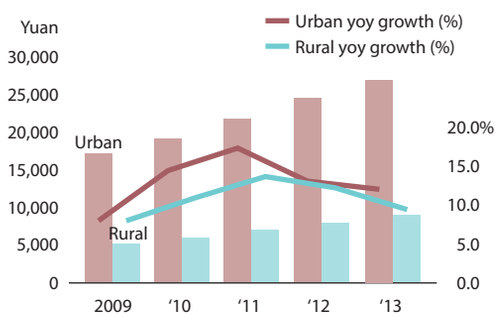
The customer-to-customer (C2C) segment still represents the largest in China's online retail market. However, the business-to-customer (B2C) segment is becoming increasingly important. In 2013, the C2C and the B2C segments accounted for 63.8% and 36.2%, respectively, of the total transaction value of online retailing in China. It is expected that the C2C and the B2C segment will each account for half of China's online retail market in 2016 (see **Exhibit 7**).

Currently, the two largest B2C players are both open platform operators: Tmall has a dominant share of 52.1%, while JD.com has a share of 18.3%[2] (see **Exhibit 8**).

Online payment is increasingly popular, as is mobile payment

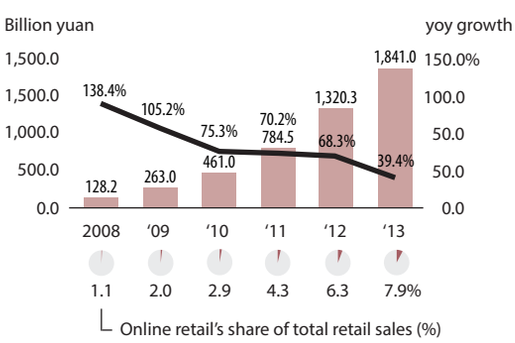
As online retailing continues to expand fast, the need for online payment systems also increases. iResearch estimates the transaction value of China's third-party online payment market to have reached 1.84 trillion yuan in 2Q14, up 64.1% yoy[3]. Although a large proportion of online shoppers still adopt cash-on-delivery when purchasing online, they are increasingly getting used to using third-party payment

Exhibit 5. Urban and rural disposable incomes per capita household, 2009-2013



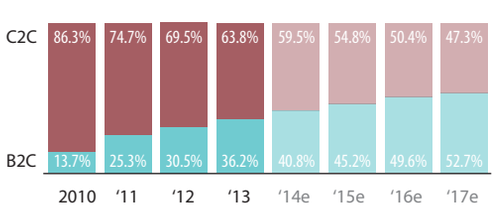
Source: National Bureau of Statistics

Exhibit 6. Transaction value of online retailing in China, 2008 - 2013



Source: iResearch, March 2014

Exhibit 7. Share of online retailing in terms of transaction value, 2010 - 2017 (estimates)



Source: iResearch

Exhibit 8. Market share of B2C market, 2013

Retailer	Market share (%)
Tmall	52.1
JD.com	18.3
Tencent B2C	6.4
Suning	4.3
Amazon China	2.2
VIPshop	2.2
Dangdang	1.9
Gome	1.8
Yihaodian	1.5
Vancl	0.7
Others	8.6

Source: iResearch

methods. At the same time, mobile payment is becoming increasingly popular too. The transaction value of mobile payments reached 1.38 trillion yuan in 2Q14[4]. The top two players in the online mobile payment market, Alibaba and Tencent, together held 88.8% of market share in 2Q14[5].

Luxury market slows

The growth of China's luxury sales has started to slow since 4Q11. Bain & Company expects luxury consumption in Greater China (including Hong Kong, Macau and Taiwan) to reach 15.3 billion euros in 2013, up 2.5% yoy; the growth rate was much lower than that recorded in 2011 (30%) and 2012 (20%). The slowdown is due, in part, to consumers' growing tendency to buy luxury goods abroad, as well as increasing government efforts to rein in extravagant spending.

According to Bain & Company, overseas purchases (including those in Hong Kong/ Macau, Singapore, Europe and North America) increased in 2013 to around 67% of Chinese total purchases of luxury products. This was mainly due to price differentials resulting from various Chinese taxes. Luxury products in China usually have a price gap of between 25% and 40% compared with Hong Kong[6]. The significant price differentials also drive purchases through "daigou" agencies in China. These agencies purchase goods from abroad through parallel channels. They usually offer consumers cheaper prices for the same products as they source direct from overseas, posing a potential threat to traditional channels. The professional "daigou" market has been growing at speed in China, with cosmetics being the largest category[7].

Despite the slowing luxury market,

?

What is happening in China's luxury market?

The luxury market in China has entered a slowdown phase. However, with the China market's strong economic underpinnings, growth potential and rising consumer spending power, it still presents abundant opportunities for many global luxury retailers. Below are highlights of some strategies that global players are pursuing:

1. Building up an online presence

Luxury brands have started to venture into China's huge online retail market. Burberry officially launched its flagship store on Tmall, China's largest online shopping platform, in April 2014[8]. This is the first time that an international luxury brand entered onto the third-party online shopping platform. Burberry's flagship store on Tmall reportedly

sold only 132 products in 18 days, which included 32 unconditionally returned items[9]. Although the results may not be satisfactory at present, Burberry's move may set an example for other luxury brands. More international luxury brands setting up storefronts on third-party online shopping platforms could be a trend to watch.

2. Some brands taking back China franchises

To better control brand image and oversee expansion, big brands have been opening more directly-operated stores, buying back franchises from local partners and taking stakes in other China retail partners. For instance, in July 2014, Hugo Boss was among the latest luxury brands to buy back a 40% stake in its Chinese mainland and Macau joint venture from franchise partner Rainbow Group[10]. Indeed, over recent years, other luxury brands such as Coach[11] and Burberry[12] have also bought back franchises or ended partnership with local partners to resume direct control over their China stores.

3. Brands setting their sights on lower-tier cities

Given the challenging times, some luxury retailers have shifted their focus from aggressive store openings to improving store productivity. LVMH plans to slow its annual China expansion to between 4% and 5%, about half the rate it recorded in 2013. Gucci has also said that in 2014, it will focus on renovating existing stores and renegotiating leases as they come due[13]. Others have started to make inroads into lower-tier cities. In fact, luxury brands no longer see tier 1 cities as a springboard to raise their profiles, but have started to push sales nationwide. Prada announced in early 2014 that it planned to open between 10 and 15 new stores in the country in 2014, with these stores earmarked for tier 2 and 3 cities, such as Urumqi[14].

Chinese consumers are the world's largest for luxury goods, and account for the consumption of 29% of global luxury purchases[15]. The rapid increase of household disposable incomes, fast-growing individual wealth and a more affluent middle class are factors matched by ongoing urbanisation and rising demand for luxury goods in smaller cities. These all constitute the driving force for the development of China's luxury market.

The size of China's middle-class growth is transforming the retail landscape

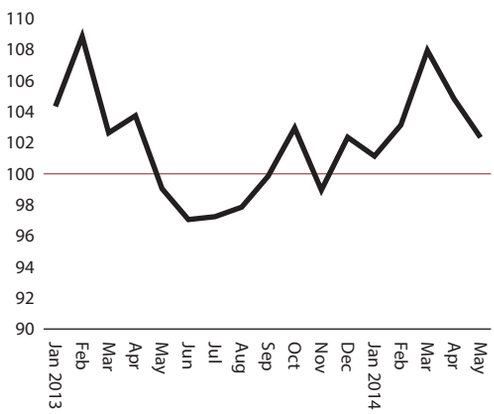
Middle-class consumers[16] in China are becoming more influential in the consumer market. McKinsey & Co. estimates that there were 230 million middle class consumers in China in 2012, and the number will increase to 630 million by 2020. McKinsey also predicts that by 2022, more than 75% of China's urban consumers will earn between 60,000 yuan and 229,000 yuan per year[17]. This middle-class segment is certainly a major consumer group not to be overlooked.

Consumers, entrepreneurs turn pessimistic due to weaker economic sentiment

The consumer confidence index[18] rose to 107.9 in March 2014 since the beginning of the year. It dropped slightly to 104.8 in April and 102.3 in May, indicating weaker consumer sentiment over the period (see **Exhibit 9**).

The business climate index also dropped from 125.6 in 1Q13 to 119.5 in 4Q13. Due

Exhibit 9. China's consumer confidence index, January 2013 - May 2014



Source: National Bureau of Statistics

to weaker market demand, the business climate was not particularly optimistic. In all, 77.9% of canvassed enterprises expressed the point that their profitability in 4Q13 was "normal" or "better than normal". The confidence index for large enterprises was higher than for small- and medium-sized enterprises[19]. ■

Competitive Landscape

The Top 100 retail chain operators

The Top 100s see steady development

Early this year, the China Chain Store and Franchise Association (CCFA) released its annual list of "the Top 100 Retail Chain Operators in China" (the Top 100s)[20]. Total sales of the Top 100s in 2013 were 2.03 trillion yuan, up 9.9% yoy. It is noteworthy that total sales of the Top 100s increased at the slowest pace since 2007 and the growth rate was slower than for national total retail sales of consumer goods over three consecutive years. The significant slowing of Top 100 sales was due to the combined impact of changing consumer behaviour and intensified competition from online retailers (see **Exhibit 10**).

As shown in **Exhibit 11**, total sales of the Top 100s accounted for 8.6% of total retail sales of consumer goods. China's retail market remains highly fragmented.

Exhibit 12 shows the Top 10 retail chain operators ranked by total retail sales in 2013. Suning Commerce Group ranked the top with total sales of 138 billion yuan.

Amid intensifying competition from online retailers, many traditional retailers have set up their own online platforms. Some 67 of the Top 100s had their own online stores in 2013, up from 62 the previous year.

Among the retailers who have set up online platforms, 51 of the 67 operate their own online stores, eight have both self-operated and third-party platforms, while only eight set up online stores on third-party platforms. The average share of Internet sales among total sales increased from 2.9% in 2012 to 3.7% in 2013.

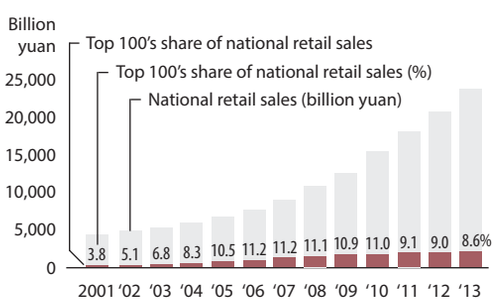
Exhibit 10. Performance of the Top 100 retail chain operators, 2008 - 2013

Year	Retail sales (billion yuan)	yoy growth (%)
2008	1,199.9	18.4
2009	1,360.0	13.5
2010	1,660.0	21.2
2011	1,650.7	20.0†
2012	1,870.0	10.8
2013	2,039.1	9.9

† Adjusted growth rate.

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

Exhibit 11. The Top 100's share of national retail sales, 2001 - 2013



Source: National Bureau of Statistics

Foreign retailers in the Top 100s outperform domestic players

Among the Top 100s, foreign players generally perform better than domestic players. In terms of gross profit margins, foreign enterprises achieved 19.0% while domestic enterprises had 16.4% in 2013. That year, there were 23 foreign enterprises in the Top 100 list, of which RT-Mart continued to hold top position, followed by

Exhibit 12. Top 10 retail chains, 2013 (Ranked by retail sales)

Rank	Company	Sales in 2013 (million yuan, pre-tax)	yoy growth (%)
1	Suning Commerce Group Co., Ltd.	138,000.0	11.3
2	Gome Electrical Appliances Holding Ltd.	133,340.0	13.5
3	China Resources Vanguard Co., Ltd	100,400.0	6.7
4	RT-Mart Shanghai Ltd.	80,720.0	11.4
5	Wal-mart (China) Investment Co., Ltd.	72,214.6	24.5
6	Lianhua Supermarket Holdings Co., Ltd.	68,818.4	0.2
7	Shandong Commercial Group Co., Ltd.	61,138.4	24.2
8	Shanghai Friendship Group Inc., Co.	60,800.0	6.7
9	Chongqing General Trading (Group) Co., Ltd.	60,297.0	10.6
10	Yum! Brands Inc., China Division	50,200.0	–3.8

Exhibit 13. Foreign retail chains among the Top 100s in China, 2013 (Ranked by retail sales)

2012 Rank	2013 Rank	Enterprise	Sales in 2013 (million yuan)	yoy change (%)	Number of stores	yoy change (%)
1	1	RT-Mart Shanghai	80,720	11.4	254	20.5
2	2	Wal-mart (China) Investment Co. Ltd	72,215	24.5	407	3.0
3	3	Yum! Brands Inc., China Division	50,200	–3.8	6,000	15.4
4	4	Carrefour China Inc.	46,706	3.2	236	8.3
5	5	Best Buy Co., Inc.	26,604	10.0	189	–25.0
6	6	Tesco China	20,500†	2.5	144	29.7
7	7	Parkson Retail Group Ltd.	20,453†	4.3	58	20.8
n/a	8	Golden Eagle International Shopping Center	18,791	0.7	27	–3.6
8	9	Metro Jinjiang Cash & Carry Co., Ltd.	17,500	14.4	75	19.0
9	10	Lotte Mart	15,500†	–5.0	110	11.1
10	11	Auchan (China) investment Co., Ltd.	15,091	7.0	59	9.3
11	12	New World Department Store China Limited	14,800†	14.7	41	5.1
13	13	Zhengzhou Dennis Department Store Co., Ltd.	14,200	16.4	181	25.7
12	14	C.P. Lotus Corporation	13,750	0.5	77	2.7
14	15	A.S. Watson & Co., Ltd. (Guangzhou)	13,500†	12.5	1,600	6.7
n/a	16	Springland International Holdings Ltd.	13,401	16.2	46	9.5
15	17	McDonald's Corporation (China)	10,300†	14.4	1,750	16.7
16	18	AEON Co., Ltd.	8,768	8.5	44	22.2
17	19	IKEA China	8,215	17.3	14	16.7
18	20	Ito-Yokado Co., Ltd	7,266	–2.9	14	7.7
19	21	Park'n Shop (China)	3,760	–7.8	65	27.5
n/a	22	FamilyMart	3,700	27.6	1,064	5.2
20	23	Emart China	2,250†	–6.3	15	–6.3
		Total	**489,190**	**8.4**	**12,480**	**12.2**

† Estimated value.

Source for Exhibits 12 & 13: China Chain Store and Franchise Association

Wal-mart and Yum!Brands (see **Exhibit 13**, on previous page). The three leading foreign enterprises were the same as for 2012.

Domestic versus foreign retailers

Foreign retailers: facing increasing challenges ahead

Currently, many foreign retailers are at a tipping point, as they suffer a slowdown in sales growth. Retailers targeting the mid- to high-end markets are particularly facing challenges.

International players face several common pitfalls. These include failure to understand Chinese customers, adopting limited localisation strategies, selling over-priced products and reluctance to design products specifically catering for the China market. Nowadays, Chinese consumers are more familiar with foreign brands, they know the price of the same product selling overseas and they can check prices easily online. If they find foreign retailers offering the same products in China but at much higher prices, they prefer to buy those products overseas, or purchase them through "daigou" agencies.

Differences of management style constitute another problem. Those foreign retailers that retain their own culture and management style can find it hard to integrate with the China market. In some cases, conflicts between headquarters management and the management team in China result in decision making delays and affect overall efficiency.

Some foreign retailers, such as apparel retailer Marks & Spencer[21] and department store operator Intime Department Store[22], have tried to compete through their own private labels and proprietary brands. However, retailers need to be very familiar with market preferences as the investment outlay is large and could well be irrecoverable.

For international retailers looking to expand in China, the vast landmass and fragmented market represent both an opportunity and a threat to business. Amid fierce competition, finding a local partner or establishing a foothold in key cities remain the most viable strategies. Galeries Lafayette partnering with I.T, a Hong Kong fashion brand management company, is a case in point. After leaving the China market for over a decade, the high-end department store operator chose to form a joint venture with I.T, hoping to leverage its own knowledge about the market.

Domestic retailers: focus on regional operations

Domestic retailers typically focus their operations on respective regional markets due to huge regional differences in consumer tastes across the country, as well as supply chain complexities and significant local networks. Domestic retailers usually have excellent local knowledge and understanding of economies of scale within the region.

In fact, domestic players are growing stronger. Recently, there are cases of mergers and acquisitions (M&A) of domestic retailers acquiring foreign units. China Resources Enterprise has merged Tesco's 135 stores and 11 shopping malls into its

nearly 4,000 Vanguard supermarkets and convenience stores (CVS). China Resources Enterprise will own 80% of the joint venture, with Tesco retaining the other 20%. This joint venture was approved in May 2014[23].

Moving into new retail formats is another strategy for some domestic players. For instance, Wumart adopted the strategy of opening hypermarkets, supermarkets and CVS extensively in the Beijing market[24]. Other multi-format operations include Shanghai Friendship Group, Dalian Dashang Group, Wuhan Zhongbai, and Wuhan Wushang.

Analysis by major retail formats

Among all major retail formats, Internet retail recorded the highest sales growth for 2013. As to traditional channels, specialty stores, in general, saw higher growth than grocery retailers such as hypermarkets and supermarkets (see **Exhibit 14**).

In terms of gross profit margins, all retail formats except convenience stores (CVSs) witnessed negative yoy growth in 4Q13. Gross profit margins of CVS increased slightly by 0.8 ppt compared with the same period in 2012 (see **Exhibit 15**). In terms of net profit margins, only CVS and professional stores proved to be slightly positive on yoy growth compared with 4Q12[25].

Department stores

Many department stores in China have been struggling over recent years. Not only do they face fierce competition from specialty stores, shopping malls and online retailers,

Exhibit 14. Yoy sales growth in retailing, by retail format, 2013

Retail format	yoy growth (%)
Total	**11.0**
Store-based retailing	**9.4**
Grocery retailers[26]	7.5
Non-grocery retailers	10.7
Apparel and footwear specialist retailers[27]	17.9
Electronics and appliance specialist retailers	3.7
Health and beauty specialist retailers	12.2
Home and garden specialist retailers	12.1
Leisure and personal goods specialist retailers	13.1
Mixed retailers[28]	8.9
Other non-grocery retailers	10.4
Luxury Retail	11.2
Non-store retailing	**37.8**
Direct sales	17.5
Home shopping	13.0
Internet retailing	43.3
Vending	11.9

Source: Euromonitor

Exhibit 15. Profit margins for different retail formats, 4Q13

	Gross profit margin (%)		Net profit margin (%)	
Retail format	4Q13	yoy change (ppt)	4Q13	yoy change (ppt)
Department stores	20.2	– 0.2	3.6	– 0.1
Convenience stores	20.2	0.8	2.4	0.2
Supermarkets	17.7	– 0.4	4.1	– 0.2
Hypermarkets	15.9	– 0.2	1.4	– 0.3
Speciality stores	24.3	– 0.5	4.6	– 0.5
Professional stores	22.4	– 0.4	5.1	0.1
Total	**19.8**	**– 0.2**	**3.7**	**– 0.2**

Source: MOFCOM; compiled by Fung Business Intelligence Centre

but they are also deeply affected by the government's anti-corruption initiatives. High-end department stores, in particular, suffer the most. A significant percentage of total sales, as high as between 30% and 40%, of many department stores come from pre-paid cards. The major users of pre-paid cards are government officials and retail parties.

Moreover, most department stores in China are operated under a concessionary business model. They lease designated store areas to concessionaires and receive commissions from such arrangements. By relying excessively on the concessionary model to generate income, department store operators tend to not be focused on improving core competencies and providing unique products or services, leading to poor differentiation.

Exhibit 16 shows the CCFA's top 10 department store operators by sales in 2013.

Major trends

i. Exploring direct sales and launching private labels.

Having experienced the drawbacks of the concessionary model, many department store operators are trying to develop a more sustainable approach. An increasing number, including Wangfujing Department Store, New World Department Store and Intime Department Store, have started to move to direct sales. They source products directly from local and international suppliers, hoping to increase product differentiation. It is noteworthy that regional department store operators tend to rely increasingly on direct merchandise sales, when compared to their national counterparts. For instance, Hebei Xinyulou Department Store purchases all its products directly from suppliers, in contrast with its catering services[29]. Other operators have sought to differentiate themselves by developing private labels. **Exhibit 17** lists some of the private brands launched by selected department store players.

ii. Enhancing the in-store experience

China's consumers consider shopping to be a social activity, largely to form closer relationships with families and friends. To enhance their "customer experience", some department store operators are incorporating more leisure activities in their stores, including cinemas, beauty and hair salons, kids' play areas, and increased catering services. Some operators have started to build or adapt some stores into "lifestyle" outlets, similar to shopping malls featuring a variety of entertainment facilities. Golden Eagle Department Store is a case in point. The retailer launched its first lifestyle shopping centre in Changzhou, Jiangsu Province in January 2014. Entertainment facilities and other amenities such as an aquarium, a 3D art gallery, a children's entertainment area and educational facilities are all offered within the shopping centre.

iii. Building synergies across sales channels

Chinese customers are now more sophisticated, and increasingly seek an integrated shopping experience across multiple channels. In view of these new buying preferences, some department

Exhibit 16. The top 10 department store operators by sales, 2013

Rank	Enterprise	Place of origin	Sales in 2013 (million yuan)	yoy growth (%)	Number of stores	yoy change (%)
1	Shanghai Friendship Group Inc. Co.	Shanghai	60,800.0	6.7	45	– 8.2
2	Dalian Dashang Group Co., Ltd.	Dalian	39,483.9	6.1	200	0.0
3	Chongqing Department Store Co., Ltd.	Chongqing	37,632.1	12.6	292	1.4
4	Yinzuo Group Co., Ltd	Shandong	34,434.6	12.8	179	11.2
5	Changchun Eurasia Group Co., Ltd.	Jilin	28,278.3	17.1	75	29.3
6	Beijing Wangfujing Department Store (Group) Co., Ltd.	Beijing	23,643.5	9.6	29	3.6
7	Liqun Group	Shandong	22,862.0	6.8	580	– 21.2
8	Rainbow Department Store, Co., Ltd.	Shenzhen	22,022.5	8.1	62	5.1
9	Yantai Zhenhua Department Store Co., Ltd	Shandong	21,964.0	15.2	113	3.7
10	Wenfeng Great World Chain Development Corporation	Jiangsu	20,716.8	6.3	921	– 7.4

Source: China Chain Store and Franchise Association

Exhibit 17. Private labels of selected department stores

Department store	Private Label	Product Category
Intime Department Store[30]	Just Intime	Women's apparel
New World Department Store[31]	LOL (Love Original Life)	Homeware
Ito Yokado Department Store[32]	pbi	Apparel
	IYB	Homeware
Wangfujing Department Store[33]	FIRST WERT	Men's apparel
Golden Eagle Department Store[34]	Aquila D'oro	Men's apparel
	IVREA	Men's apparel
	LISALEN	Women's apparel
	WONDERFUL LIFE	Homeware
	Antonghui	Kids' Apparel

Source: Company websites and news reports; compiled by Fung Business Intelligence Centre

store operators are investing in multi-channel capabilities. They have launched their own online platforms, mobile apps or social networking websites to engage their customers. For instance, Wangfujing Department Store has launched its store mobile app. The app provides in-store navigation services to guide customers to the right locations for the products they want. Customers can even make restaurant reservations via the app. Another example of this strategy is shown by Intime Department Store in Ningbo. The store launched a mobile app for shoppers who

buy via their smartphones, called "Let's go shopping"; selected products sold on the mobile app platform can be sent to customers' homes for them to examine or try on, and the service is free of charge[35].

Other department store operators have teamed up with Internet companies to launch third-party payment schemes. One example is New World Department Store. The retailer has partnered with Tenpay, a third-party payment solution developed by Tencent, China's popular Internet service provider. The solution takes the form of a WeChat-based virtual VIP card which functions as a membership card, as well as one that earns bonus points and can be prepaid. Consumers can shop without a physical card, accumulate VIP points and receive real-time promotion information via WeChat. Customers can also top up their cards and check their account balances via their WeChat accounts.

Shopping malls

Shopping malls continue to be among the most popular shopping destinations. The format has also attracted the attention of property developers over the past decade. According to CBRE, China retained its position in 2013 as the world's most active shopping mall development market. Nine cities out the world's top 10 for completed new shopping centre space were in China that year, namely Chengdu, Tianjin, Shanghai, Chongqing, Shenzhen, Hangzhou, Beijing, Wuhan and Shenyang[36]. CCFA estimates that around 300 new shopping centres are opened in China every year, and by the end of 2015 the total number is expected to reach 4,000[37].

Ongoing urbanisation, a burgeoning middle-class and increasing demand for a personalised shopping experience all contribute to driving the development of shopping malls in China. Aware of the huge potential of the format, retailers from other channels have also started to tap into this lucrative segment and develop their own malls. Some recent examples are shown in **Exhibit 18**.

Having said that, the shopping mall building spree has sparked concerns over the creation of a property bubble. Over the past several years, so-called "ghost malls" with poor foot traffic have been seen, especially in some fringe or less developed business districts.

Major trends

i. New shopping malls spread to suburban areas in tier 1 cites

Over recent years, increasing numbers of people have been moving from central to suburban areas, especially in tier 1 cities, thanks to the rapidly increasing number of private cars and improved transport infrastructure. According to CBRE[38], population densities in Beijing's and Shanghai's suburban areas have far outstripped those in central areas. Many more shopping mall developers have turned their focus on the suburbs to capture the potential for growing consumption in these emerging districts. Furthermore, the Beijing Municipal Government launched a new guiding opinion[39] in July 2014. This stipulates that developers are not allowed to build new commercial properties with

Exhibit 18. Selected retailers that have tapped into the shopping mall sector

Retailer	Format	Selected shopping mall project	Store location
InTime	Department store	Intime City	Fenghua, Hangzhou, Haining, Tangshan, Beilun, Zibo, Hefei, Huzhou, Linhai, Wenling, Wuhan, Wuhu, Liuzhou, Zhongda, Shaoxing
Rainbow Department Store	Department store	Rainbow Shopping Centre	Hangzhou, Shenzhen
Grandbuy Department Store	Department store	Grandbuy Sunny Mall	Zhuhai
Haiya Department Store	Department store	Haiya Mega Mall	Shenzhen
IKEA	Furniture speciality store	Inter Ikea Shopping Centre	Wuhan, Wuxi
Macalline	Furniture speciality store	Aegean Shopping Mall	Beijing
Aeon Supermarket	Supermarket	Aeon Mall	Beijing, Suzhou, Wuhan, Tianjin
Auchan	Supermarket	Auchan Shopping Centre	Dongguan
Better Life	Supermarket	Better Life Mall	Chengdu, Changsha
Tesco	Supermarket	Life Space Mall	Xiamen, Qingdao, Nanjing, Beijing, Anshan, Zhongshan

Source: Various Internet sources; compiled by Fung Business Intelligence Centre

gross floor areas (GFAs) larger than 10,000 sqm in Beijing's core city centre. It is logical to expect that more large commercial properties will be developed in the suburban areas.

ii. Mega malls remain a strong feature, while smaller-sized malls targeting local communities are on the rise

Grand-sized shopping malls are still favoured by property developers. According to Knight Frank, 24 of 68 new shopping centres opened across 11 major cities in China have GFAs above 100,000 sqm in 2013. For example, Global Harbor Shopping Mall, which was opened in Shanghai in 2014 has a GFA of 480,000 sqm[40]; while Global Centre Shopping Mall, which opened in Chengdu 2013 has a GFA of 400,000 sqm[41].

Alongside the development of mega malls in major shopping districts is the appearance of smaller-sized malls targeting local communities. These usually have a retail area of less than 50,000 sqm and typically serve neighbourhoods with amenities such as supermarkets, grocery stores, apparel specialty stores, restaurants and entertainment facilities. As these shopping malls can address the everyday needs of their customers, they are gaining ground.

iii. Increased floor areas for catering and entertainment

Many consumers now visit a shopping mall not only to buy a product, but to socialise with friends and family. To meet the changing needs of customers, some mall operators have started to reduce floor areas for retail shops and increase floor areas for catering and entertainment facilities. For example, Shenyang's MixCity

terminated its leasing contract with Central Department Store in June 2014 and is reportedly intending to lease the entire floor area previously occupied by its former partner, consisting of about one-fifth of MixCity's total area, to accommodate food and beverage tenants and entertainment services providers[42].

Other shopping mall operators, hoping to differentiate themselves, have added a variety of services and amenities such as art exhibitions and galleries. For example, Shanghai K 11 Art Mall, a shopping mall developed by New World Development, organised an exhibition by French impressionist Claude Monet in March 2014, and displayed 40 original Monet paintings. Reportedly, the number of visitors totalled 300,000 and daily sales at K11 rose by 20% over the three-month exhibition period[43].

iv. Using mobile apps to engage customers

As with department store operators, some shopping mall players are making efforts to expand their mobile services. In one case, shopping mall operator Joy City teamed up with Alibaba, China's largest e-commerce player, to provide mobile payment services. Shoppers can use Alipay app, a mobile payment service developed by Alibaba, to settle payments at Joy City mall[44]. Coco Park, a popular shopping mall in Shenzhen, partnered with WeChat to launch marketing campaigns. By scanning Coco Park's QR code, WeChat users can obtain coupons and enjoy discounts at the mall, and can also receive the latest promotional information from Coco Park retailers.

Hypermarkets and supermarkets

Many hypermarket and supermarket operators have experienced tough trading times in China over recent years. Slow economic growth, weak consumer sentiment, fierce competition from online peers and high operating costs are indeed hindering their growth. Some have seen customer footfalls shrinking and many of their existing stores are showing continuing sales slowdowns. Some have eased back on the pace of their expansion, while others have reduced operating areas or even closed some stores. For instance, Wal-mart, Carrefour and Tesco reportedly reduced their store openings by 27% in 2013[45]. Some recent examples of store closure are listed in **Exhibit 19**.

According to Linkshop[46], as many as 146 hypermarkets and supermarkets were closed in 1H14. The most common reasons included lease expiries, structural

Exhibit 19. Store closures of selected hypermarkets and supermarkets, FY13 – 1H14

Hypermarket / Supermarket	Stores closed in 2013[47]	Stores closed in 1H14[48]
Wal-mart	14	9
Tesco	3	0
Carrefour	2[49]	1
Lotte Mart	2[50]	5
Century Lianhua	0	2
China Resources Vanguard	0	1
Yonghui Supermarket	7	1
Beijing Hualian	0	1
CP Lotus	2	0

Source: Linkshop; compiled by Fung Business Intelligence Centre

Exhibit 20. Top 10 FMCG chain operators by sales, 2013

Rank	Enterprise	Place of origin	Store locations	Number of stores
1	China Resources Vanguard Co. Ltd.	China	National	4,637
2	RT-Mart Shanghai Ltd.	Taiwan	National	264
3	Wal-mart (China) Investment Co., Ltd.	US	National	407
4	Lianhua Supermarket Holdings Co., Ltd.	China	National	4,600
5	Carrefour China Inc.	France	National	236
6	Yonghui Superstores Co., Ltd.	China	National	292
7	Nonggongshang Supermarket (Group) Co., Ltd.	China	Shanghai, Eastern China	2,644
8	HNA Retailing	China	National	482
9	Wumart Stores Inc.	China	National	547
10	Better-Life Commercial Chain Share Co., Ltd.	China	Huanan, Jiangxi	445

Source: China Chain Store and Franchise Association

adjustments, weak profits, organisational restructuring and poor management.

Exhibit 20 shows the top 10 hypermarket and supermarket operators by sales in 2013. Topping the list was China Resource Vanguard, the same as in 2012. It was then followed by RT-Mart and Wal-mart.

Major trends

i. Increasing fresh food offerings

Some grocery retailers in China try to differentiate themselves by offering more fresh food. RT-Mart and Yonghui are prominent examples. Wumart also stated that, in 2013, its fresh food category achieved a yoy sales growth of 14.3%, while its gross profit increased by 17.9% yoy. In 2014, the company will continue to focus on improving logistics and sourcing processes for fresh food[51].

Wal-mart is also putting more emphasis on fresh food categories. As at April 2014, Wal-mart had nine fresh product distribution centres across China[52]. It aims to build a cold chain logistics network that covers all its stores across the country by the end of 2014[53].

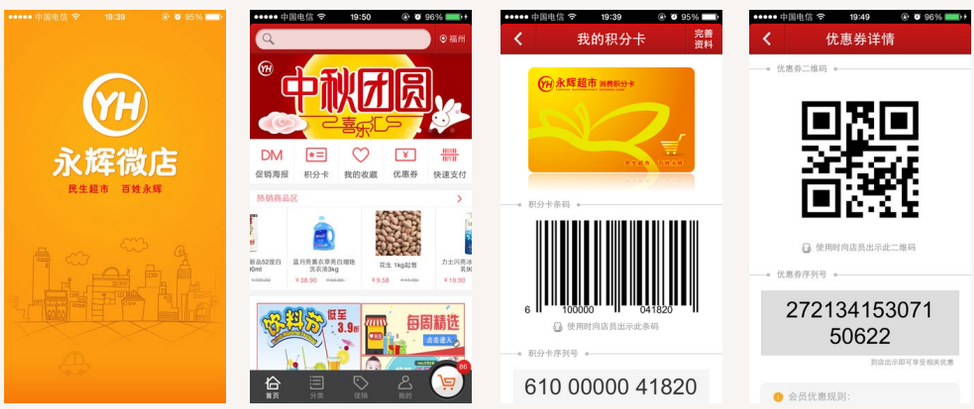
ii. Setting up online platforms, while tapping the mobile commerce market

Considering the massive growth opportunity of online retailing, an increasing number of hypermarket and supermarket players have developed their own online portals (see **Exhibit 21**).

RT-Mart, for one, leveraged its advantage in procurement and supply chain management by launching its e-commerce platform, Feiniu, in December 2013. Feiniu has a team of between 300 and 400 staff and has more than 200,000 SKUs. The company pledges to deliver online orders within 24 hours[54].

Apart from solely setting up online storefronts, some retailers also try to integrate their online and offline channels. For instance, Auchan launched a new initiative: "Auchan Drive" services were set up in June 2014 for its store in Jinjihu

Yonghui Superstore's iPhone app



Source: iTunes Store

(Suzhou)[55]. Customers can purchase products on Auchan's website and pick them up in Auchan's store. Customers can choose to pay online or when they pick up the products. A special feature of such services is that customers do not need to enter the store; they can simply park their cars in the car park next to the warehouse. Auchan's staff takes the ordered items to them.

Some hypermarket and supermarket players are also tapping into the mobile commerce (m-commerce) market. Yonghui Superstore started trials of its mobile app[56] in January 2014. Shoppers can place orders and complete the payment process via their mobile device; they can pick up the products in their chosen Yonghui store[57]. Now, the service is available in eight Yonghui stores in Fuzhou, and the company plans to expand the service into more stores across China.

iii. Accelerating industry consolidation via M&A; home-grown retailers take the lead

Underperforming foreign hypermarket and supermarket players over the past few years have provided tremendous M&A opportunities for local retailers. To expand their market share, some highly competitive domestic hypermarket and supermarket operators have chosen to acquire their foreign counterparts, while some foreign retailers actively seek cooperation with domestic players. In one example, Tesco formed a joint venture with China

Exhibit 21. Selected hypermarket/supermarket players which have launched online platforms

Enterprises	Online platform
Auchan	www.auchan.com.cn
Lianhua	www.lhmart.com
Bailian E-mail	www.blemall.com
Renrenlegou	www.rrlgou.com
RT-Mart	www.feiniu.com

Source: *"Challenges continue in 2014"*. 10 January, 2014. Deutsche Bank; Internet sources

Exhibit 22. Market leaders and respective market share in selected cities

Source: "*Report on Chengdu Hongqi Chainstore Co., Ltd.*" October 29, 2013. UBS Investment

Resources Enterprise in October 2013[58]. Tesco has a 20% stake and China Resources Enterprise 80% of the venture, with the deal completed in May 2014[59]. In another move in October 2013, Thailand's CP Group aimed to sell some of its China Lotus stores to Wumart, but the plan was scrapped[60].

A lack of knowledge about local consumers and neglect of food safety issues are among key reasons for foreign operators' underperformance. Domestic players seize the opportunity to gain market share by optimising product offerings and pricing, while enhancing their customers' shopping experience.

Convenience stores

The development of CVSs in China has increasing momentum. As small format retailers, CVSs have the advantage over their competitors of having closer access to their target consumers. CVSs are also able to offer faster services along with attractive product selections and added convenience.

Total sales revenues for CVSs rebounded in 2012 after three consecutive years of declines, reaching 26.4 billion yuan, according to the National Bureau of Statistics (NBS). The latest figures published by the MOFCOM in 4Q13 shows that CVS was the retail sector's fastest-growing format with average yoy growth of 13.8%.

Most leading players in China's CVS sector are regionally based. Currently, there is no national leader. As shown in **Exhibit 22**[61], top CVS players in Guangzhou, Chengdu and Shenzhen have a relatively high market share. Meiyijia, the market leader in Guangdong Province, accounted for more than 60% of Shenzhen's market share and 30% in Guangzhou itself. Hongqi, the market leader in Sichuan Province, accounted for 43.6% of Chengdu's market

Exhibit 23. Top 12 convenience store operators by number of stores, 2013

Rank	Enterprise	Convenience store brand	Place of origin	Store locations	Number of stores
1	Sinopec Group	Easy Joy	Beijing	National	23,300
2	PetroChina Co., Ltd.	uSmile	Beijing	National	14,000
3	Dongguan Sugar & Liquor Group Meiyijia Convenience Store Co., Ltd.	Meiyijia	Guangdong	Guangdong	5,580
4	Guangdong Tianfu Chain Business Co., Ltd.	Tianfu	Guangdong	Guangdong	2,300
5	Zhejiang Gongxiao Supermarket Ltd.	Gongxiao; Jialian	Zhejiang	Zhejiang	2,123
6	7-Eleven	7-Eleven	US	Beijing, Shanghai, Shenzhen, Guangzhou, Tianjin, Chengdu	1,925 †
7	Shanghai Lianhua Quik Convenience Stores Co, Ltd.	Quik	Shanghai	Shanghai, Liaoning, Zhejiang, Beijing, Jiangsu	1,905
8	Guangdong Sun-high Convenience Store Co., Ltd.	Sun-high	Guangdong	Guangdong	1,703
9	Nonggongshang Group	Kedi; Alidays	Shanghai	Shanghai, Suzhou, Wuxi, Hangzhou	1,700
10	C&U Group	Shizu; Zhishang	Zhejiang	Zhejiang	1,491
11	Chengdu Hongqi Chain Co., Ltd.	Hongqi	Chengdu	Sichuan	1,460
12	Shanxi Taiyuan Tangjiu Supermarket Co., Ltd.	Tangjiu	Shanxi	Shanxi	1,250

† Estimated value.

Source: China Chain Store and Franchise Association

share. Meanwhile, the market in Chongqing, Beijing and Shanghai is somewhat fragmented. Chongkelong has a 26.6% market share in Chongqing, while Easy Joy has a 23.8% market share in Beijing; Quik has a 17.9% market share in Shanghai.

Exhibit 23 shows the Top 10 CVS players in terms of store numbers. Meiyijia is the market leader in terms of store count, with 5,580 stores in Guangdong (excluding the count for forecourt retailers Easy Joy and uSmile) followed by Tianfu, Gongxiao and Jialian, 7-Eleven, and Quik.

Major trends

i. CVSs venturing online

Online retailing is becoming increasingly popular in the CVS sector. Some operators, such as 7-Eleven, have launched their own

online platforms, while others have set up online stores on third-party B2C platforms. For instance, Tangjiu, the largest CVS operator in Taiyuan formed a partnership with JD.com in December 2013; Tangjiu launched an online mall on JD.com, selling more than 30,000 SKUs within eight product categories[62]. The two companies have also launched a data-sharing scheme to collectively enhance their understanding of customers[63].

ii. Facilitating and implementing O2O initiatives

The role of CVSs has been changing recently. An increasing number of CVSs now act as "facilitators" in the online-to-offline (O2O) loop. Given the vast network of CVSs, more online retailers now use CVSs as pick-up points. For instance, Amazon China has teamed with Family Mart since March 2013 to offer pick-up services at the latter's outlets in Shanghai[64]. Yihaodian, an online retailer owned partially by Wal-mart, has recently formed a partnership with Family Mart to allow customers to pick up packages at 300 participating Family Mart Stores in Shanghai. Consumers have the flexibility to pick up their online orders at any CVS of their choice, and at any time they wish. "O2O Store", a CVS set up by Rainbow Department Store in Shenzhen in July 2014[65] also provides pick-up services for online purchases made in Rainbow Department Store outlets and its higher-end Dreams-on Department Store.

iii. Leveraging mobile payment for convenience

Some large CVS chains have started rolling out mobile payment services by partnering with third-party online payment providers. For instance, Meiyijia, C-Store in Eastern and Southern China, 7-Eleven in Guangzhou, Youyizhan in Hangzhou, and Hongqi have partnered with Alipay, Alibaba's third-party online payment platform respectively, to provide a mobile payment service in their stores. Tencent's WeChat Payment has also teamed up with CVS chains to launch a mobile payment service. Guangzhou 7-Eleven is one of the pilot CVS chains trialing the mobile payment service on WeChat[66].

iv. More on-site catering services

CVSs have been offering fresh, prepared foods for years, but the trend has become more pronounced as increasing numbers of time-conscious consumers look for on-the-go meals. Some retailers have revamped their stores and added on-site catering to provide hot and cold food and drinks. For example, some Circle K outlets provide in-store catering to offer meals and drinks under its own Hot & In brand. Circle K believes its Hot & In service is the main revenue driver in the Guangzhou market, contributing approximately 40% of its sales in FY2013[67].

Similarly, in May 2014, Family Mart introduced fast food and catering services via its first "third generation" convenience store in Shenzhen. The 100 sqm store features a dining area and a variety of fresh food offerings. Other value-added services such as mobile phone top-ups and credit card payments are also provided at the new store[68].

Specialty stores

Specialty stores – particularly fast fashion retailers – are becoming increasingly favoured by shoppers. According to Euromonitor, the sales of apparel and footwear specialty retailers grew by 18% yoy in 2013 to reach 581.8 billion yuan.

Exhibit 24 shows the pace of expansion for apparel specialty retailers. The compound annual growth rate for total sales, numbers of outlets and sizes of sales space have increased by 17.7%, 11.4% and 13.3% respectively between 2008 and 2013.

International fast fashion specialty retailers have been expanding aggressively over recent years. According to CBRE, the total store numbers for Uniqlo, Zara, H&M and C&A amounted to 523 by June 2013. Of these, 40% were opened in the past 18 months[69]. All such retailers target more remote areas in tier 1 cites, and at the same time have expanded fast in tier 2 and 3 cities.

Meanwhile, a number of new entrants entered the China market in 2014. Some examples include NewLook from the UK in February 2014[70], Old Navy from the US in March 2014[71], Abercrombie & Fitch from the US in April 2014[72]. All companies chose Shanghai for their initial launch.

Although tier 2 and 3 cities have become the new battle ground for fast fashion players, sales in tier 2 cities still lag those of tier 1 cities, as consumers in the latter are generally less aware of fashion trends and their purchasing frequency is lower than for their counterparts in tier 1 cities. According to T&C, a retail asset management consulting firm, sales per sqm of sampled fast fashion retailers in selected shopping malls in Tier 1 cities are significantly higher than for tier 2 cities[73] (see **Exhibit 25**).

Many local specialty retailers, on the other hand, have not performed well over recent years. For instance, Peak Sport registered a 10% yoy decline in turnover in 2013[74], while China Dongxiang registered a 20.2% yoy drop in sales in 2013[75]. Domestic retailers facing strong competition from foreign players are losing ground to international retailers in terms of design and lead times[76].

Specialty retail operators in China are not without their challenges. Some in the sector suffer from lacklustre sentiment in the retail market, fierce competition from online retailers, as well as heavy inventory problems. Many are making efforts to clear excess inventory, improve channel management, increase product

Exhibit 24. Apparel and footwear specialty retailers: Value sales, outlets and selling space, 2008 - 2013

	2008	2009	2010	2011	2012	2013
Value sales (billion yuan)	257.3	292.5	354.0	417.8	493.7	581.8
Outlets (thousands)	341.3	369.7	421.4	467.9	524.5	584.8
Selling space (million sqm)	31.9	35.1	40.9	46.2	52.6	59.7

Source: *"Apparel and footwear specialist retailers in China"*. March 2014. Euromonitor International

Exhibit 25. Sales per sqm for tier 1 and 2 cities, 2013

	Sales (yuan) per sqm
Tier 1 cities	1,500 - 3,000
Tier 2 cities	600 - 1,500

Source: T&C; compiled by the Fung Business Intelligence Centre

diversification and segmentation, and introduce product innovation. For example, Etam, a French apparel brand, intends to consolidate its retail network by closing 200 counters in department stores in 2014 while at the same time opening franchise stores in shopping malls. The company also plans to expand sales via online channels[77]. To clear excess inventory, Zara opened a number of outlets in tier 2 and 3 cities[78]. With a view to expanding into a new segment, Uniqlo, on the other hand, launched its low-end brand GU in Shanghai in September 2013.

In light of the fast growing e-commerce market in China, many specialty retailers have begun to integrate online and offline resources on the back of their strengths in supply chains and operations. For example, Zara launched its own online shop www.zara.cn in September 2013. Consumers can choose to pick up their online purchases from Zara's physical outlets, which in turn could increase store visits.

Discount outlets

Discount outlets have won the hearts of Chinese consumers, as they offer a relatively wide selection of products at lower prices. It is estimated that China has more than 400 discount outlets[79], surpassing the total number in the US in 2013.

Discount outlets remain one of the major channels for retailers and brand owners to offload their excess inventory. However, unlike discount outlets in other countries where consumers can easily find first-tier brands at deep discounts, China outlets can attract only lesser-known or mass-market brands. Moreover, as "Daigou" and cross-border online shopping becomes increasingly popular, consumers can find and purchase discounted luxury brands through the new channels.

Similar to some department store and shopping mall operators, many discount outlet operators today are striving to enhance customer shopping experience by increasing the number of restaurants, incorporating more leisure facilities such as cinema, kids' playgrounds and spas, and organising seasonal activities or promotions. For instance, Xinglong Outlets in Shenyang organised special promotions for kids during the week of International Children's Day[80]. Kids enjoy various benefits at outlets, from free movie tickets to free buffets, but adults can also enter lotteries once they have spent 500 yuan or above at these outlets.

Some discounters are actively integrating their online and offline channels, hoping to provide seamless, cross-channel shopping experiences. Discount outlet Shopin offers Wi-Fi to customers at its Hangzhou store. Selected products at the store come with a unique QR code; by scanning the code, customers will be directed to that product page on Shopin.com, an online platform. Shopin has also partnered with WeChat to provide in-store mobile payment services. Every sales associate carries a PDA that can process payments. Customers can scan the QR code via Shopin's WeChat account on their mobile device and pay via WeChat.

Online Retailing

Online retailing is now one of the most popular channels by which retailers extend

their customer reach and build brand awareness. Many traditional retailers are launching their online channels while other businesses, such as logistics companies, are also actively seeking ways to tap the lucrative online market.

Major trends

i. Online retailers strengthen last mile delivery services

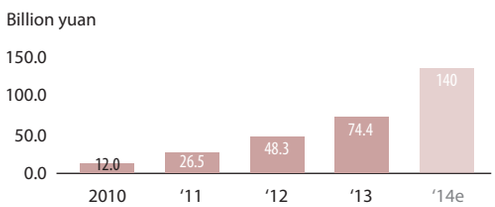
To satisfy increasing demand from customers for quick delivery, some online retailers have taken a variety of approaches to provider better logistics services. Some platform operators such as JD.com[81] and Dangdang[82] have, since 2011, offered same-day delivery services. Other online retailers such as Amazon[83] and Tmall[84] have partnered with CVSs to provide in-store pickup services for online orders. JD.com launched a pilot mobile pick-up service in July 2014 in Beijing and Chengdu. Consumers can pick up online orders from mobile pick-up stations in certain metro stations and community centres both in Beijing and Chengdu. The service will roll out in tier 1 and 2 city residential areas and key transportation hubs later this year.

ii. Chinese shoppers on cross-border online platforms

Over recent years, an increasing number of Chinese shoppers have shown an interest in international cross-border shopping. A popular method is to buy products via overseas online shopping platforms, commonly referred to as "Haitao". According to China E-Commerce Research Center[85], the transaction value of China's online purchasing from overseas online platforms reached 74.4 billion yuan in 2013, up from 12 billion yuan in 2010; this is expected to reach 140 billion yuan in 2014 (see **Exhibit 26**). Most purchases are from the US, followed by Hong Kong. The most popular categories are shown in **Exhibit 27**.

The growth of Haitao is likely to continue, as the Chinese government has actively promoted cross-border e-commerce. For example, Shanghai Free Trade Zone officially launched its cross-border e-commerce platform, kuajingtong.com, on December 28, 2013, the first cross-border e-commerce enterprise approved by the Chinese

Exhibit 26. Transaction value of China's shoppers buying on overseas online platforms, 2010-2014e



Source: China E-Commerce Research Centre

Exhibit 27. The most popular categories buying from overseas online retailers, 2014

Most popular categories
Milk powder, food supplements
Miscellaneous products for women
Cosmetics and skin care products
Colour cosmetics
Women's apparel
Perfume
Toys
Health products

Source: China E-Commerce Research Center

government. By the end of 2014, around 30 online retailers are expected to be operating on the platform[86]. International brands sold at kuajingtong.com are reportedly 30% cheaper than those sold in domestic offline stores[87].

iii. Online retailers seeking IPOs overseas

In 1H14, and riding the wave of growing investors' interests in China's online retailing market, a number of large online retailers have sought public listings overseas. In May, Jumei, the largest Chinese online retailer in the cosmetics category, listed on the New York Stock Exchange and raised US$245.1 million[88]. JD.com, China's second largest B2C shopping platform, listed on the Nasdaq in May 2014, raising about US$1.8 billion in its initial public offering (IPO)[89]. Alibaba is also set to list on the New York Stock Exchange after September 2014[90]. ■

Key highlights

Mobile and social commerce continue to power ahead

The rising popularity of mobile devices across China has changed the way people communicate, but also the way they shop. The mobile platform is now a highly popular sales and marketing channel. According to the CNCIC, the number of m-commerce users reached 205 million in 1H14, accounting for 32% of China's total Internet population[91]. iResearch estimates the total transaction value for mobile shopping to exceed 320 billion yuan by the end of this year, up from 167.6 billion yuan in 2013[92]. The growing popularity of budget smartphones, such as Xiaomi, is a major driving force for the explosive growth of m-commerce. Moreover, with the upgrade of broadband services, the popularity of m-commerce is set to continue.

Social media is also having an explosive impact on consumer purchasing decisions. Chinese consumers, in particular, are used to voicing their opinions on social media platforms. They enjoy carrying out product reviews, sharing images and connecting with friends – as well as providing information about their favourite brands on social media platforms. So, many retailers leverage the huge user databases from popular social media platforms such as WeChat and Weibo to promote their products and services. Influential social media can increase the conversion rate and encourage more customers to make purchases. However, tracking shopper data and deploying the most appropriate digital marketing strategy are not easy tasks. A lack of advanced technologies and information systems, or insufficient digital marketing initiatives or marketing expertise are some of the challenges faced by retailers when launching their digital marketing initiatives.

However, the trend for selling on social media websites continues to grow. Mogujie is a popular social shopping platform; it started as a social sharing website in 2011 and transformed into a marketplace in late 2013[93]. Meilishuo, another popular social media platform, also built its own trading platform in 2013, partnering with WeChat in early 2014. The strategy is to promote selected fashion products available on Meilishuo for WeChat users via its app[94]. Shoppers can also use WeChat to settle payments when they buy online.

*

Consumers' changing lifestyle brings about a new retail scene

With increasing wealth and rising consumer sophistication, the consumer market in China is undergoing sweeping changes. Chinese consumers can access information from various information sources , including newspapers, magazines, the Internet, social media and blogs, to name just a few. Consumers are becoming more discerning and sophisticated. They demand unique products and services while, at the same time, look for products that offer value for money. Moreover, Chinese consumers are now living much busier lifestyles than ever, and they increasingly seek "shopping convenience" where they can shop any time, anywhere and in any way via physical stores, desktops or mobile devices. They also expect multiple methods of payment and various pickup and return options. There is growing demand for an integrated shopping experience across multiple channels. White-collar workers who seek a work-life balance

are particularly receptive to paying for convenience. In addition, a growing number of consumers are keen to learn about the most environmentally friendly products.

Stereotypes of China's younger consumers

China's younger generation, or the so-called "post-1980s and 1990s generation", is becoming a leading consumer group. Compared with older generations, this group of youngsters is generally well educated and tech-savvy, and used to buying online. Before younger consumers buy a product, they will seek and obtain product information or peer feedback from social media platforms. They will also check prices from different retailers to find the best deals. After purchasing, they will then share their shopping experiences or write product reviews on social media platforms. Younger consumers also like to follow brands on social media; they are easily influenced by comments and recommendations by key opinion leaders or bloggers.

Changing lifestyles and consumption preferences

Consumers today:

- Are well educated, technology-savvy and sophisticated
- Have easy access to information
- Are easily influenced by reviews on social media platforms
- Seek a "shopping experience"
- Are demanding an omni-channel shopping experience

The omni-channel: a focus area for retailers

China's retail market is undergoing fundamental change. Consumers are becoming more discerning and highly connected. They are also looking for an integrated shopping experience where they can shop any time, anywhere and in any way, via a variety of channels.

Technological advances and increasing access to them, are also harbingers of change, particularly in the way consumers behave and interact. Likewise, technological access has also introduced new ways for brands and retailers to engage customers. More companies are embracing various types of new technologies and are investing in multi-channel capabilities, intending to create increasingly convenient and impactful shopping experiences. A larger number of traditional retailers are notably seeking to integrate their offline and online operations, while some are exploring various aspects of omni-channel strategies, such as partnering with Internet companies like Alibaba and Tencent to set up stores on these giant online platforms or utilise their mobile payment schemes. **Exhibit 28**, on the next page, shows some recent omni-channel initiatives by selected retailers in China.

Retailers pursue a smaller-sized format; community stores in focus

Chinese consumers are now pursuing busier lifestyles and are increasingly seeking "shopping convenience". Compared with large-scale stores, smaller outlets provide a quicker and more convenient shopping experience which customers value. Noticing changing consumer needs, many traditional chain retailers have turned their attention to small-format stores over recent years. For example, Wal-mart has launched its small-

Exhibit 28. Recent omni-channel initiatives by selected retail players in China, 2014

Retailer	Date	020 initiatives
Rainbow Department Store	July 2014	Launched the CVS "O2O store" to facilitate seamless shopping services by providing more convenient pick-up points for online orders[95].
SFbest.com (online grocery store operated by SF Express)	June 2014	Opened omni-channel stores nationally, called "Heike". Consumers can pick up products ordered via SFbest.com in the stores, and make purchases by scanning the codes on in-store virtual walls[96].
Auchan Hypermarket	June 2014	Launched "Auchan Drive" services so customers can pick up online orders in the car park next to the Auchan store[97].
Shopin Discount Store	April 2014	Partnered with WeChat to offer mobile payment services[98].
Intime Department Store	March 2014	Partnered with Alibaba to launch Yintaibao, a virtual VIP pre-paid card that can be used on both its website and physical stores[99].

Source: Internet sources; compiled by Fung Business Intelligence Centre

scale supermarket brand, Huisafe. Aeon also opened its smaller-sized supermarket chain, Maxvalue, in 2013. China Resources Vanguard opened around 40 of its smaller-sized format stores in 2013, and is expected to open 50 more in 2014[100].

To further enhance consumer experience, some retailers have started to launch "community stores" in local communities. These are usually smaller sized stores, including supermarkets and CVSs, which are intended to serve residents in different neighbourhoods. For instance, Rainbow Department Store has recently tapped into the CVS format and rolled out a number of CVSs in July 2014; most are located in local communities.

Affordable luxury is gaining popularity

As Chinese consumers become more discerning, their attitudes towards luxury brands and luxury goods consumption are changing. This is especially the case in tier 1 and 2 cities. Given the tighter anti-extravagance measures, people are more cautious when spending on premium luxury goods. The skyrocketing prices of some premium luxury brands have prompted consumers to turn to alternative affordable luxury brands at relatively cheaper prices. For example, Coach, an American affordable luxury brand selling leather goods, has seen strong growth in China over recent times. The company reported total sales growth of more than 25% yoy in the China market in FY2014[101]. The company first entered the China market in 2008 and has a total of 121 stores as of August 2014. Other niche brands such as Michael Kors, Kate Spade and Tory Burch have also expanded in China over recent years (see **Exhibit 29**).

Food safety concerns return amid recent food scandals

Food safety incidents have returned to the spotlight in China after a series of recent food scandals. Topping the headlines is Shanghai Husi Food, a meat processor and supplier owned by US-based OSI Group. Shanghai Husi Food has been accused of

Exhibit 29. Number of stores of selected affordable luxury brands in China, August 2014

Brand	Product Category	Year entered China	Place of origin	No. of stores	Price range, yuan (Majority) Women's skirt	Women's leather bag	Women's leather flat shoes	Men's leather wallet
Coach	Men's and women's wear, shoes, hand-bags, accessories	2008	US	121	7,950 - 11,000	1,950 - 3,500	2,000 - 4,000	2,450 - 3,150
Michael Kors	Women's wear, shoes, handbags, accessories	2011	US	20	1,600 - 1,900	2,500 - 4,900	~ 1,300	n/a
Kate Spade	Women's wear, shoes, handbags, accessories, kids wear, stationery	2011	US	22	2,300 - 3,500	2,000 - 5,000	n/a	n/a
Tory Burch	Women's wear, shoes, handbags, accessories	2011	US	7	2,450 - 4,000	4,000 - 5,000	2,280 - 2,680	n/a
Agnes B	Men's and women's wear, maternity wear, shoes, bags, food & beverages	2004	France	27	3,100 - 5,400	2,390 - 3,590	n/a	2,190 - 2,390

Source: Company websites; field trips; compiled by Fung Business Intelligence Centre

selling expired meat to several fast food chains in China, including KFC, Pizza Hut, Starbucks and McDonald's[102]. To follow up on the allegation, the Chinese government has launched an investigation and at the same time suspended all of Shanghai Husi's operations. The OSI Group has also recalled all the manufacturer's products, while affected food chains have stopped sourcing and serving products from Husi Shanghai[103].

Repeated food scandals have soured consumer confidence for dining out and consuming locally sourced or produced foods. To strengthen China's food safety control and regulation, the National People's Congress (NPC) released a draft of the revised Food Safety Law[104] for public comment in July 2014. It is the first revision of the law since its promulgation in 2009. The draft calls for the establishment of a food traceability system to track all foods through each stage of production, processing and distribution. This enables corrective action to be implemented quickly and effectively when necessary, and helps prevent contaminated food products from reaching consumers. In addition, the draft advises relevant authorities to increase penalties for food safety violations and strengthen supervision of online platforms which sell fresh food products. However, the NPC has yet to unveil the timeline for enacting the revised Law[105].

Retailers put increasing emphasis on sustainable development

China's worsening air pollution has sparked

increasing concerns on environmental protection and green issues generally. An increasing number of retailers have integrated sustainability initiatives into their business strategies. For example, Cuiwei Department Store has installed energy monitors in all branches to better control store energy usage. The retailer also invested 7.32 million yuan in 2013 for green renovation, aimed at conserving energy and reducing carbon dioxide emissions to save more than 2 million kWh of electricity and cut its electricity bill by more than 2.2 million yuan[106]. Another example is H&M. The company has launched a global garment collection initiative to recycle used garments[107]. Ikea has also made a pledge to ensure that all cotton used in its fabrics is produced in a sustainable manner[108].

In view of increasing concern about sustainability issues, some industry associations have organised sustainability-related events for member enterprises. Illustrating this in June 2014, the CCFA and the World Wide Fund for Nature (WWF) launched a "Green Sustainable Consumption Awareness Week" to promote green production among retailers and manufactures. The event was also intended to help consumers establish environmentally-friendly consumer habits.

Although retailers realised the importance of attaining sustainable development, some were reluctant to make greater efforts, since such green initiatives can have significant cost implications.

M&A continues to see strong growth

For many retailers, the M&A route is a fast and relatively easy way to increase their market profile and accelerate their growth in China. The numbers of M&A deals in the retail market have continued to grow robustly over recent years. Thomson Reuters reports that there were 36 M&As in the country's retail industry in 2013, up 44% yoy, while aggregate transaction value was nearly four times that for 2012[109]. M&A activities in the department store and hypermarket sector were particularly active.

Compared with deals in past years, the M&As that took place in 2013 showed some distinctive features. First, the majority involved acquisitions of foreign counterparts by domestic retailers. Furthermore, regional chain retailers are increasingly becoming M&A targets, expediting consolidation in the regional retail markets. With a stronger regional foothold and a better understanding of local culture and demand, regional chain retailers generally have an edge over national counterparts.

Exhibit 30 shows some recent major M&As in China's retail sector.

Better regulatory environment for the retail sector

The Chinese government has been very supportive on the development of the retail sector, playing an important role as the country moves towards a consumption-driven economy. Over the past few years, a number of key rules and guiding opinions have been issued to promote retail development (see **Exhibit 31**, on page 32). One of the most significant initiatives is the promulgation of the New Consumer

Exhibit 30. Major M&A deals in China's retail industry, June 2013 – August 2014

	Enterprise	Bidder company country	Bidder company industry	Target company	Target company country	Deal value	Remark
Jun 2013	Wanda Commercial Properties (Group) Co., Ltd	China	Real estate	Hengli Commercial Properties Group	Hong Kong	HK$466 million[110]	
Jul 2013	Capita Malls Asia Limited	Singapore	Real estate	CARE City Shopping Centre in Beijing	China	1.74 billion yuan [111]	
Sep 2013	Fujian Fengqi Investment Co., Ltd	China	Retail: Apparel	Dongbai (Group) Co,. Ltd	China	n/a[112]	25.12% share
Oct 2013	New World Department Store	Hong Kong	Retail: Department store	Shanghai Huizi Department Store	China	280 million yuan[113]	
Nov 2013	Cardinal Health	US	Pharmeceutical	Baiji Xinte Pharmaceutical Co., Ltd.	China	n/a[114]	
Mar 2014	Xi'an Minsheng Group	China	Retail: Department store	Baoji Huatong Shopping Center	China	126.66 million yuan[115]	
Mar 2014	Alibaba Group Holding Limited	China	E-commerce	Intime Retail (Group) Co Ltd.	China	HK$ 5.37 million[116]	25% equity interest
Apr 2014	Nanjing Xinjiekou Department Store Co Ltd	China	Retail: Department store	Highland Group Holdings Ltd	UK	155.3 million pounds[117]	89% share
Apr 2014	SanPower Group	China	Conglomerate	House of Fraser	UK	480 million pounds[118]	89% share
May 2014	Better-Life Commercial Chain Share Co.	China	Retail	Nancheng Department Store	China	1.58 billion yuan[119]	100% share
Jun 2014	Jintian Pharmaceutical Group	China	Pharmeceutical	Shenyang Wei Kang Drug Store Co., Ltd.	China	250 million yuan[120]	Jintian Pharmaceutical will be interested in the entire equity interest of Wei Kang
Aug 2014	Beijing Cuiwei Tower Co., Ltd	China	Retail: Department store	Beijing Modern Plaza; Beijing Ganjiakou Plaza	China	2.47 billion yuan[121]	Re-submitted after the rejection from the China Securities Regulatory Commission in July 2014
Aug 2014	The Dairy Farm Company Ltd	Hong Kong	Retail	Yonghui Superstores Co.	China	5.69 billion yuan[122]	19.99% interest

Source: Internet sources; China Venture; compiled by Fung Business Intelligence Centre

Exhibit 31. Major government policy initiatives affecting the retail sector, January 2014 – August 2014

Government Policy	Launched by	Effective date	Key highlights
Announcement on the Supervision of Imported and Exported Goods under Cross-Border E-Commerce Businesses[123]	The General Administration of Customs	Aug 2014	Cross-border e-commerce businesses are required to complete customs registration for customs declaration and clearance matters.
Opinion on Accelerating the Development of the Mass Catering Market[124]	MOFCOM	Jun 2014	Aims to promote mass catering, encourage innovation, improve food safety, act against food waste, and improve monitoring of the industry.
Administrative Measures for Online Trading[125]	SAIC	Mar 2014	Establishes regulations for online trading, protecting the rights of consumers and platform operators.
Consumer Protection Law[126]	NPC	Mar 2014	Revision of the Consumer Protection Law focuses on better protection of the rights and interests of consumers. It has heightened obligations and liabilities of retailers and expanded protection of online consumers.
Opinion on Further Strengthening of the Agricultural Products Market System[127]	MOFCOM	Mar 2014	Clarifies the development direction and major tasks in the construction of an agricultural products market system within six aspects: strengthening the regulation of the market, optimising market structures, cultivating market players, encouraging innovation, strengthening market supervision and improving the regulatory mechanism.
Circular on Tax Policies for Cross-Border E-Commerce Retail Exports[128]	MOF; SAT	Jan 2014	Further encourages the development of cross-border e-commerce; encourages enterprises to set up their own cross-border e-commerce platform by offering tax refunds and exemptions to exports.

MOFCOM: Ministry of Commerce
SAIC: State Administration for Industry & Commerce
NPC: National People's Congress
MOF: Ministry of Finance
SAT: The State Administration of Taxation

Source: Various government websites; compiled by Fung Business Intelligence Centre

Protection Law. This aims to provide more comprehensive rights for consumers amid a rapidly developing business environment and with changing consumer behavior. Among the highlights of the new law is the extension of consumer rights protection to online consumers; they can return products purchased online within seven days without giving reasons. Moreover, the new law provides that businesses need to respond to a consumer complaint within seven working days instead of between two to four weeks, as required under the previous legislation.

Penalties imposed on contravention by companies have increased from 1-5 times earnings to 1-10 times earnings. If no earnings arise from a transaction, the penalty increases from the previous 10,000 yuan to up to 500,000 yuan. Additionally, compensation for the consumer has increased from the original 100% to 300% of the given sales price. ■

Challenges

High operating costs remain a major operational challenge

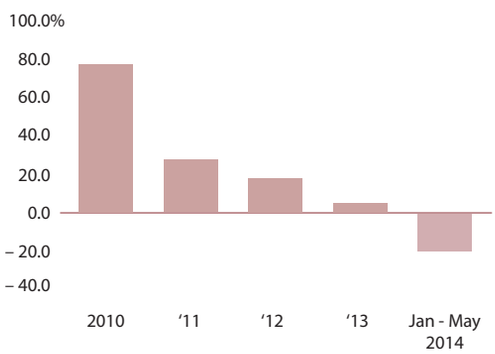
Operating costs in China have risen significantly over recent years, largely driven by surging rental and labour costs. According to the CCFA[129], the average rental increase for the Top 100s in 2013 was 11% yoy, while labour costs surged by 18% yoy. Mounting costs mean most retailers face pressures to cut budgets. Steeper logistic costs also bring huge challenges to retailers, especially online operators who compete with rivals on prices and speed of delivery. China's ratio of total logistics costs to GDP was at about 18% in 2013, almost twice that seen in other developed economies[130]. Retail margins are expected to be squeezed, while businesses are consolidated in the coming year.

Anti-corruption measures and reduced pre-paid card sales weaken consumer sentiment

Since late 2012, China's leadership has increased efforts to curb corruption. The government's anti-gifting campaigns have hit sales of high-end goods hard, affecting the profitability of high-end department stores.

Furthermore pre-paid card sales (see **Exhibit 32**), which constitute a large part of department store revenue, have seen a marked drop since the State Council issued a 2011 circular requiring issuers to register the identities of customers with purchases of 10,000 yuan or more. According to the China General Chamber of Commerce, sales of new pre-paid cards fell by around 20% yoy for the first five months of 2014[131].

Exhibit 32. Pre-paid cards sales growth within the Chinese retail market, 2010 – January-May 2014



Source: China General Chamber of Commerce; Nomura Research

Omni-channel strategies are still new in China; integration of online and offline operations remains a challenge

An increasing number of retailers in China have started to implement omni-channel strategies. However, omni-channel retailing is still very new in China and very few players have established a truly seamless and integrated omni-channel strategy. The challenge for retailers is to ensure that all channels complement one another and provide consistent, up-to-date information. At present, retailers' online and offline sales platforms are often separately operated, with little interaction between them. Inconsistencies often exist between online and offline platforms in product pricing, offerings and goods return policies. Also, online and offline platforms frequently have different customer databases, causing difficulties in merging customer data and carrying out data mining.

Securing the right store location is not an easy task

Some retailers believe that it is getting increasingly difficult to find good store locations, especially in recently completed commercial properties[132]. To enhance customer experience, many landlords are allocating increasing space for food and beverage operators as well as for entertainment and leisure facilities. So it is becoming more difficult for retailers to secure adequate retail space.

Again, some mainstream retailers remain cautious about opening new stores amid slowing economic growth and greater concerns regarding the oversupply of commercial properties. As a result, landlords either need to spend more time negotiating terms or make more attractive offers to potential tenants.

High staff turnover in the retail sector; difficult to recruit and retain talents

China's labour market is far more dynamic than in Western countries. In particular, retail industry employees in China change their jobs more frequently than their counterparts in the west and they usually have higher salary expectations when changing jobs. According to China Briefing, retail industry employees expect a 25% salary raise when they change their jobs – and even if they do not change jobs, they expect an annual pay rise of between 5% and 10%[133].

High staff turnover is another challenge for retailers. As reported by the Retail Business School magazine, the turnover rate for the retail industry as a whole is at between 30% and 40%; for some segments, such as junior staff, the turnover rate can be as high as 70%. Many retailers indicate that it is hard to recruit staff, especially to find junior sales associates. ■

Conclusions

With China's fast changing retail industry and new consumer needs, the current "theme" for retailers is all about innovation and rethinking business models. The followings are some areas that retailers need to keep closely in mind:

1. Customers, customers, customers
Successful retailers always put their customers' interests first. It is crucial to understand consumer preferences and provide products and services that suit their changing needs.

2. Omni-channel strategies
Chinese consumers are increasingly used to optimising their shopping experiences across different channels and sources of information. Retailers need to take account of consumers' shopping habits and embark on their own omni-channel development.

3. Retail technologies
To connect with increasingly digitally-empowered Chinese shoppers, retailers not only need to keep pace with the development of retail technologies but be prepared to invest in highly impactful technologies such as data analytics, 3D printing, cloud computing and augmented-reality, to name but a few.

4. Digital marketing
Huge user databases assembled by several social media platforms offer excellent opportunities for retailers to promote their products and services. Digital marketing is set to become the future of marketing.

5. Enhance in-store shopping experience
Physical stores are, and will remain, the most important consumer interface for brands. Retailers should constantly revamp their stores or incorporate more entertainment elements, in order to create exciting shopping destinations.

6. Compete through innovation
Optimising performances and improving competitiveness are crucial for success in today's highly competitive marketplace. Differentiated positioning is needed, as are continuous improvements of products and services.

7. Establish and maintain a strong brand image
As Chinese consumers become increasingly brand loyal, it is essential for retailers and brand owners to establish a strong brand image. Maintaining brand consistency across all channels is also important.

8. Go "green"
With sustainability increasingly perceived as a competitive factor, retailers should take account of green issues when formulating business strategies. ■

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