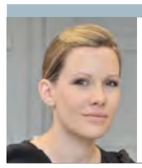
RetailWeek Reports

Produced in association with demandware

Retailing in China

Opportunities and challenges for international expansion

FOREWORD



Charlotte Hardie
COMMERCIAL EDITOR, RETAIL WEEK

With international expansion so high on UK retailers' priority list, it's no surprise that China has long been the focus of boardroom discussions. Retailers only need to look at the statistics and they could be forgiven for virtually hearing the tills ringing. The economic growth may have slowed slightly this year, but China is nevertheless home to 1.36 billion people with a burgeoning middle class. Annual retail sales growth has averaged 14.9% since 2010. Retail sales were 67.1% of consumer spend in 2013.

But, as retailers also know, this is a notoriously tough market to crack. As Pete Marsden, chief information officer of Asos – which launched there in 2013 – said succinctly at Retail Week Live earlier this year, "It's so different to anywhere else". Retailers' difficulties have been well documented – Tesco and Carrefour among them. It has also claimed more than its fair share of retail casualties. US electricals retailer Best Buy beat a retreat in 2011, Home Depot met the same fate, while Metro Group's Media Markt withdrew last year.

Why is it so challenging? The paperwork and bureaucracy, the government firewall, the endless licensing processes, stringent product specifications, regional legal variations, the list goes on. And this is why we have produced this report. UK retailers are at the top of the international game. Innovation is their forte. Their multichannel expertise is second to none. Their supply chain efficiency and agility is virtually unparalleled. They are adept at getting under the skin of their customers. And so as retailers continue to seek growth opportunities and decide which of the many untapped international markets will work best for their brands, it is invaluable to have an overview of the critical facts and figures as well as top-line thoughts on what the key considerations are. How does the Chinese shopper behave? Which categories hold the most promise? How can you start to contend with the inordinate level of red tape and legal pitfalls? How do you tap into Chinese shoppers' love of social networking?

Despite countless challenges and potential headaches posed by this vast Asian superpower, there are retailers who are getting it right. Inditex now has 500 stores as its mass-market brands continue to chime with the Chinese middle classes. Burberry has successfully translated its brand for the Chinese market, and is harnessing its digital expertise to tap into this digitally engaged nation. French grocer Auchan's venture RT-Mart – run jointly with RT-Mart in Taiwan – has become the leader in hypermarkets in China, while as Watson's health and beauty stores have become the first choice for many young consumers.

This is the first in a series of international reports that *Retail Week* is producing. The next report will focus on India. We hope that all of them will prove useful in aiding UK retailers' continuing ambitions overseas. This global drive is evidence of their retailing skill and tenacity. The opportunities are there for the taking.

"UK RETAILERS ARE AT THE TOP OF THE INTERNATIONAL GAME. INNOVATION IS THEIR FORTE. THEY ARE ADEPT AT GETTING UNDER THE SKIN OF THEIR CUSTOMERS. THE GLOBAL OPPORTUNITIES ARE THERE FOR THE TAKING"

PARTNER FOREWORD

Andrew Gilboy
VICE-PRESIDENT EMEA, DEMANDWARE

China is remarkable in the opportunity it presents to retailers that are able to overcome the complexities in doing business there. With average retail sales growth of almost 15% over the past four years, and projected online sales of ¥1.81bn (£173m) by 2018, the untapped potential of this market is enormous.

However, over the past few years Western brands have experienced a series of inglorious retreats from the Chinese market. Bureaucracy, fragmentation and a legislation minefield, combined with stark cultural differences in consumer behaviour, have left a litany of Western brands that have tried and failed to establish themselves. That said, as retail sales, connectivity, mobile saturation and appetite for Western brands continue to grow, a select few have been able to carve out a sizeable niche in this elusive market. The prospect of governmental reform and renewed focus on a consumer driven economy is drawing even more eyes to this Eastern corner of the world.

Lessons from Sun Tzu, China's infamous military philosopher, have been applied to the world of business thousands of times over. *The Art of War* exhorted its adherents to prepare thoroughly, understand their target and environment, behave with patience and humility, yet act rapidly and decisively when the time came.

Several of our retail customers have found success in this market with a step-by-step approach, beginning with the low risk (a local marketing site) and expanding, as appetite and their understanding grows.

While we may not be strapping on our armour any time soon, those lessons in foreknowledge, patience and speed are valuable when entering into this challenging and fragmented market. This report will go far in supporting the first of these and support the strategist in deciding when to make their move.

"THOSE LESSONS IN FOREKNOWLEDGE, PATIENCE AND SPEED ARE VALUABLE WHEN ENTERING INTO THIS CHALLENGING AND FRAGMENTED MARKET"

EXECUTIVE SUMMARY

In terms of untapped retail potential, it's all eyes to the East. China, with its population of 1.36 billion, rapidly rising household incomes, an economy which is now the second largest in the world, and year-on-year sales growth of nearly 15% for the past four years, holds untold opportunities for retailers looking to expand their international presence.

The caveats, though, are seemingly endless. As this report shows, it's one of the most fragmented and challenging retail markets in the world. And yet launching retail operations here will – albeit over significant time – become easier. For instance, the reputation China has for immensely complicated business practices and bureaucracy promises to lessen – one example being the alignment of its tariffs on certain products in accordance with the World Trade Organisation regulations.

There is also now an anti-corruption campaign instigated by its president, and there are practical, focused measures to keep inflation under control and reduce pressure on resources and the environment. Steps to address the limited social security provision and widen the provision of other welfare benefits will further bolster consumer spending. Furthermore, retailers and consumers alike will also benefit from widespread infrastructure developments, including the building of a high-speed rail network and opening up air travel.

Nevertheless, China remains and will remain a complicated market to crack. This is a country, arguably more than any other, which requires strong connections on the ground. Planning consent remains a logistical challenge, and licensing another administrative headache. When it comes to capitalising on the enormous online retail market, the entire licensing process for foreign retailers can take at least a year and involves obtaining a Chinese business licence, a wholesale licence and even a regional licence. In general, foreign businesses have been under greater scrutiny from regulators and the public. Both Walmart and Carrefour, for instance, have both been fined for alleged price fixing. As such, foreign businesses operating in China need to have tight systems in place and understand the regulations to avoid the fall-out.

Product specifications are also more stringent compared with the EU, making it difficult for foreign retailers to sell EU standard products in China as they do not necessarily meet the specifications to be sold in the country. In addition, there are obstacles in supplying stores even if a retailer manufactures its products in China. Furthermore, Chinese manufacturers producing goods for Western retailers prefer to export the goods because of tax incentives for exporting rather than supply those same retailers' stores based in China.

As with expansion into any international market, retailers need to get under the skin of the local consumer. In a country that has the highest population in the world, this is another major undertaking. However, the increasing adoption of Western shopping habits and exposure to international brands immediately puts foreign retailers in a buoyant position.

As retailers continue to test the water in this vast retail market, the optimum expansion methods will become clearer and there will be more lessons to be learned from the successes and failures. Home Depot, for instance, failed to recognise the basic fact that Chinese consumers simply don't do DIY. B&Q is evidence of how difficult it can be to compete with local players who understand the market. Burberry and New Look, on the other hand, have carved out a niche with their increasingly strong brand presence. The latter are evidence that it can be done.

China is, ultimately, about scale – be it population, land mass, economic growth or retail sales. Any retailer that, as Alibaba can, boast online sales of more than £3.61bn in one day will provide many retailers with a compelling reason to focus their efforts in this vast corner of the globe. More will unquestionably follow suit. Who will succeed and who will fail remains to be seen. But one thing's for sure. The numbers are compelling.

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- With resilient growth through the global recession, China has become the second largest global economy
- The economy and future trends are all conducive to retail success as demand and prosperity increases
- Government plans for manageable growth and to become a consumer-led economy
- The move to a service-led, rather than manufacturing economy, as well as urban living rather than rural, provides another boost to the retail industry
- New initiatives to extend social welfare will encourage the population to free up their high savings reserves
- Wage growth is exceeding inflation – improving disposable income levels
- Total household consumer expenditure in China exceeds that of Germany and the UK

CHAPTER 2
THE CHINESE SHOPPER
- Chinese middle class to triple over next decade – and spread across the country
- Shopping mode changing from functional, deal driven to emotional, status driven
- Shopping becomes a leisure activity as shopping centres and prosperity increase
- Two events drive high spending; Chinese New Year and Singles' Day – a world beating online event
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- Increase in travel and tourism is introducing Chinese consumers to international brands

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- The government is conducive to improving tax structures for foreign entrants
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- Clothing and footwear will gain from the expansion of store chains across China, as well as online growth, with the biggest gain among the mass middle market

CHAPTER 5
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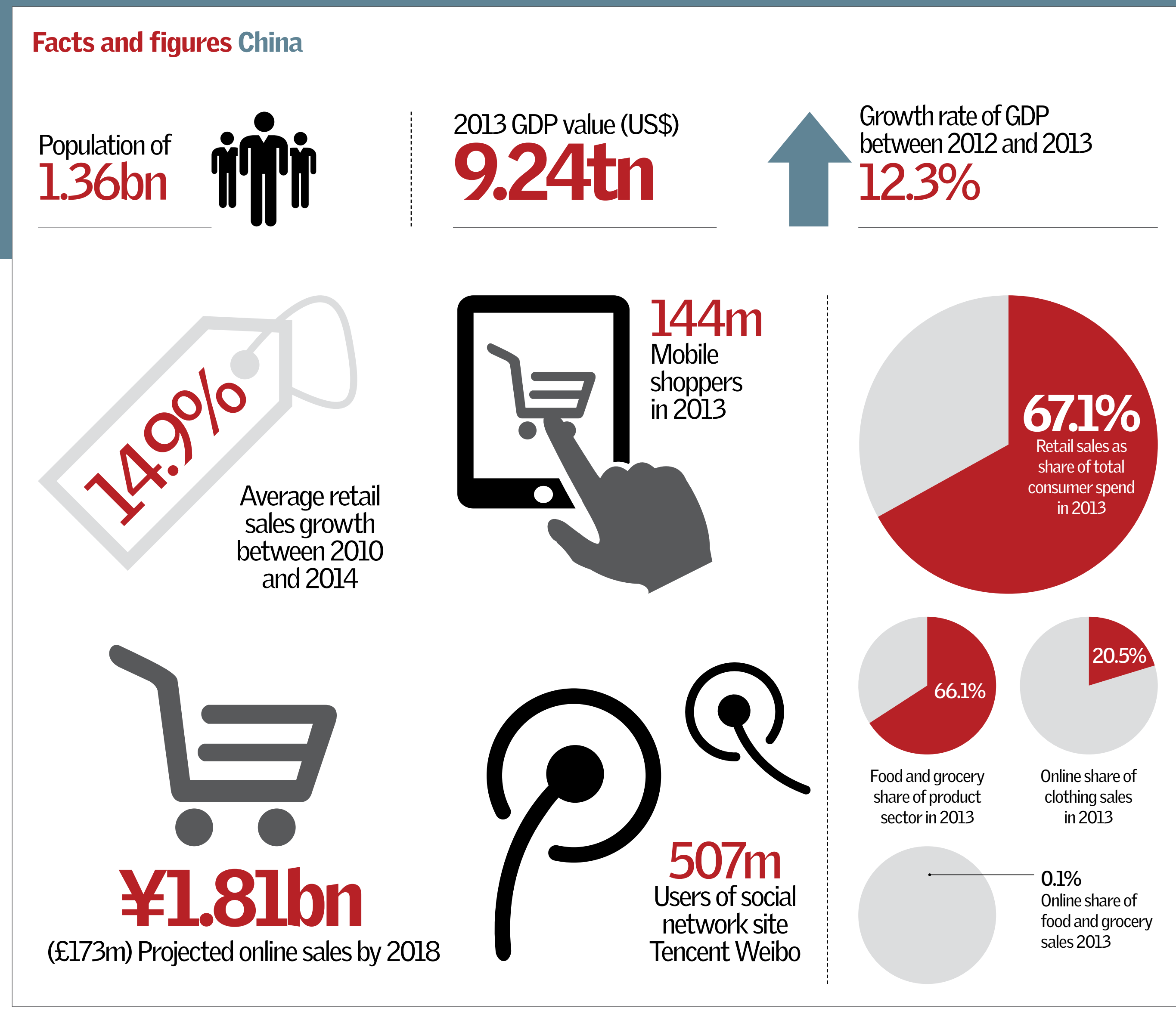
- The inconsistent enforcement of laws and regulations is a potential minefield, and is a major consideration for anyone looking to launch in China
- Retailers need to be aware that Hong Kong and China operate completely different legal systems
- One of the biggest issues is the regional differences between the application of laws, and so localised advice is essential
- Rising costs of property rental for retailers seeking a physical presence in China pose challenges
- The Consumer Protection Law, which came into force in March this year, is part of the government's push to ensure the economy is driven by consumers

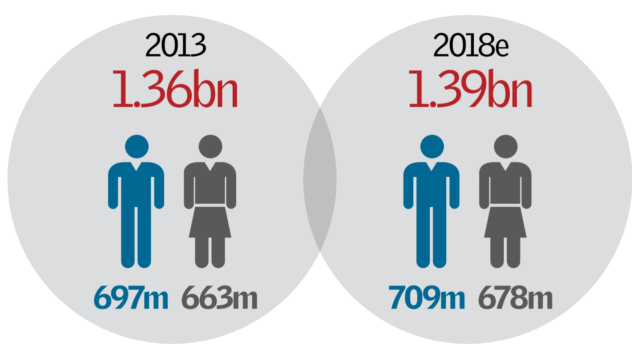


POPULATION OVERVIEW

With a population of 1.36 billion in 2013, even minor increases can add millions, but the introduction of the one-child policy in the 1980s has been a dampener on population growth and created some side effects.

- Ageing population; there will be about 200 million seniors (65+) by 2025, which will account for about 14% of the population
- Fewer children means the elderly need to contribute to their own care in old age and this tightens disposable income for children supporting elderly parents
- Highly educated younger generation – more prosperous, higher expectations for careers, lifestyles
- More men than women (34 million more in 2013) leading to a surplus of single men in their 30s
- Women have high participation in the workforce (67%) – greater spending power
- Appetite for higher consumption from younger generation who have had all their parents' attention and investment

1 Population split by gender (%), 2013 and 2018e



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SOURCE: World Development Indicators, the World Bank; Conlumino

China's vast population is routinely cited as one of the key opportunities for retailers as they seek to invest in the country. Yet, the shape of that population and the government's administrative efforts to curb population growth have some complex implications for the consumer economy.

The generations that were born after the one-child policy was introduced in the 1980s were also the beneficiaries of greater prosperity as China's economy grew. They therefore have a different attitude to consumerism than older generations who were brought up under the austerity of communism and tight state control.

Though the norm in China is for the children to look after their parents in old age, the ability of children to do this will be restricted in the future. The burden is greater for a single child, and could seriously impact the government's plan to drive a consumer-led economy. The government's extension of pension provision will help to alleviate this, but the elderly will start to make more provision for themselves, which will impact their spending levels in retail as they focus on necessities.

By 2018 the 65+ population will have increased by 30 million people reducing the workforce by 5 million as fewer young people join – which is a key factor in the government's desire to increase the spending and demand of those who remain active.

Meanwhile, the number of 15 to 24-year-olds will reduce by 50 million, which makes it vital that retailers identify not only who their target customers are, but where they are. Many younger people have moved to large cities to find better work opportunities, while older generations have stayed in their home cities, creating concentrations of older consumers.

Since 2005, per capita spending on retail has more than doubled as prosperity increased. Notably, the highest increase in per capita spending between 2005 and 2013 was among older consumers, who in general have fewer family commitments, and teenagers, who are still likely to be receiving support from their parents.

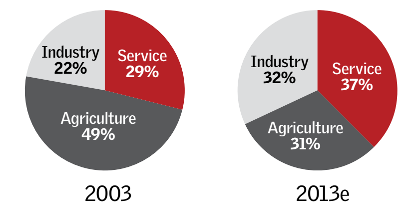
Over the next five years these teenagers will start to move into the family life stage, but with fewer women than men in the population (boys are considered more preferable to girls in the one-child policy), the number of families will be limited, despite a relaxation of that policy.

Furthermore, young Chinese women are more independent; have a higher share of the workforce than many Western countries; are taking on highly paid senior roles; and have less inclination to give up their freedom and independence than their mothers. This will impact the behaviour of those entering the family-life stage further as they adopt a more Western approach, continuing to work, having just one or two children and balancing the two aspects of their lives – which means the need for time-saving services and convenience.

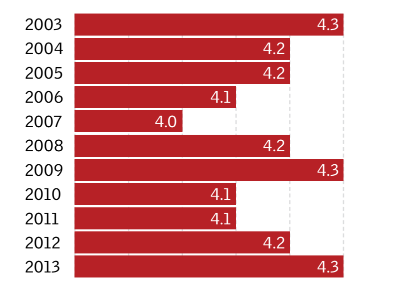
Population Key facts

- One-child policy has tempered population growth, but even minor increases are big with a population of 1.4 billion people
- Consequences of the one-child policy are an ageing population, shrinking workforce and an excess of men
- Seniors (65+) will account for 12% of population in 2018 and will dampen spending
- High participation of women in the workforce who want to retain independence and lifestyle – good target for retailers
- Excess of young men creates an opportunity to cater for their demands as they mature
- Workforce is shrinking as current workers reach pension age and fewer entrants to replace them

2 Employment share by sector (% total labour force), 2003 and 2013e



3 Unemployment rate (% total labour force), 2003-2013e



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SOURCE: International Monetary Fund, Conlumino

CHAPTER 1

OVERVIEW OF THE CHINESE MARKET

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There is a Chinese proverb that sums up the challenge facing retailers trying to break into the country: 'To open a shop is easy, to keep it open is an art.' Year-on-year growth in Chinese retail sales averaged 14.93% between 2010 and 2014, and the country is already the world's biggest grocery market. The attraction for Western retailers, struggling to eke out low single-digit or flat sales growth in their domestic markets is obvious. Yet for all the potential, few international retailers have cracked the country and recent history is still marred by a number of high-profile exits and failures.

And, while China has now usurped Japan as the second largest global economy, Chinese economic growth has been slowing in recent months. China's industrial output rose 8.6% in January and February 2014, according to the National Bureau of Statistics. Retail sales, meanwhile, also increased 11.8% from the year before, government figures show. However, the figures were less than analysts had been expecting, adding to fears of a slowdown.

And, yet, recent political and economic activity still point to huge opportunities in the country for retailers, and Asos' launch of a localised website this year, as well as restructuring in China by Kingfisher and Tesco, are timely reminders British retailers don't lack ambition in this giant market.

As 2013 drew to a close, China's top leadership met behind closed doors for a gathering known as the Third Plenum to debate the future of the country's economic progress. The end of the four-day conclave was marked by a pledge to let markets play a "decisive" role in the economy, a significant change in rhetoric from China's elite. And a target date of 2020 has been set to deliver "decisive results".

DESPITE THE RECENT SLOWDOWN, THE GROWTH OF CHINA'S ECONOMY TO DATE HAS BEEN REMARKABLE. THOUGH IT STALLED, IT DID NOT SUFFER A RECESSION IN 2009, BUT CONTINUED ON ITS PATH OF DOUBLE-DIGIT GROWTH

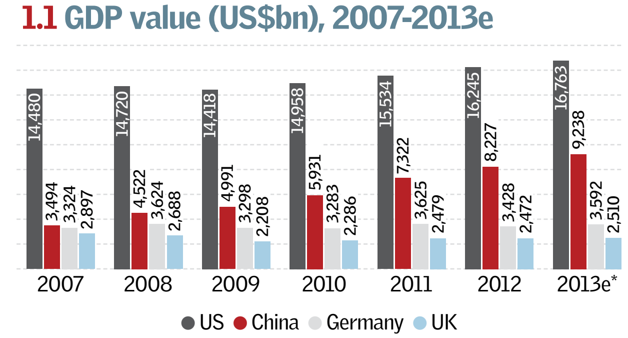
Details are in short supply but there was broad agreement that the administration will seek to drive economic reform that will create greater room for private enterprise as well as establishing an economy based far more on consumption.

The prospect, therefore, that central reforms might unlock greater and freer access to China's vast consumer base is tantalising – an opportunity underscored by the extraordinary retail activity around Singles' Day, which coincided with the Plenum, and generated about US$5.75bn (£3.61bn) in sales for the country's largest ecommerce business, Alibaba, alone.

Despite the recent slowdown, the growth of China's economy to date has been remarkable. Unlike Western economies, China, though it stalled, did not suffer a recession in 2009, but continued on its path of double-digit growth (based on US$ values). The result is that from being just less than a quarter (24.1%) of the value of the US economy in 2007, it had grown to more than half (50.6%) by 2012 and has now usurped Japan as the second largest global economy (see chart 1.1).

Following such strong performance, the ▶

1.1 GDP value (US$bn), 2007-2013e



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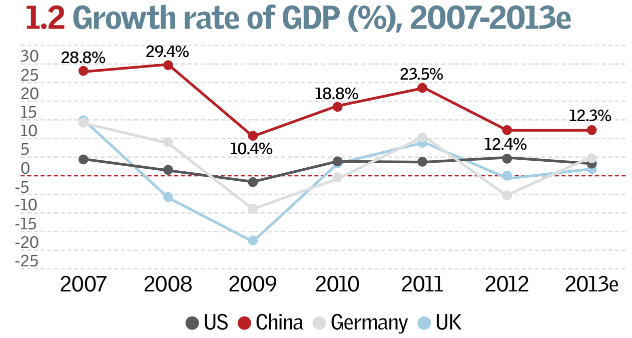
SOURCE: World Development Indicators, the World Bank; Conlumino

1.2 Growth rate of GDP (%), 2007-2013e



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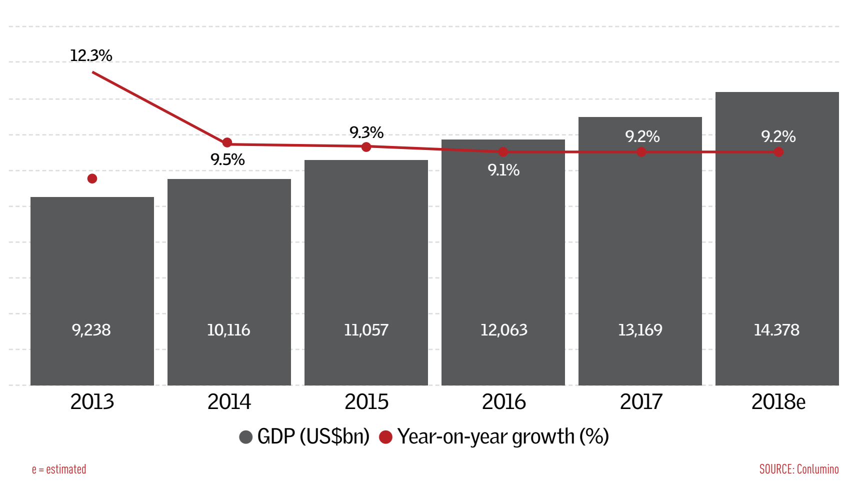
SOURCE: World Development Indicators, the World Bank; Conlumino

1.3 Forecasts for GDP value and growth (¥bn), 2013-2018e



Chinese government has developed a plan to produce more manageable growth that fits with its resources and workforce. The latter is shrinking, driven by the one-child policy. There are other major shifts occurring that will have a significant impact on the retail environment – one being the transition from manufacturing and agriculture to service-led sectors. Another is the fact that China is becoming increasingly urban as the population becomes more highly educated and prosperous. This economic evolution from an export-led, high-growth market, to one which is experiencing more manageable growth led by consumer demand, fits with the shift to more service-led employment. Retail will play a major role in this change.

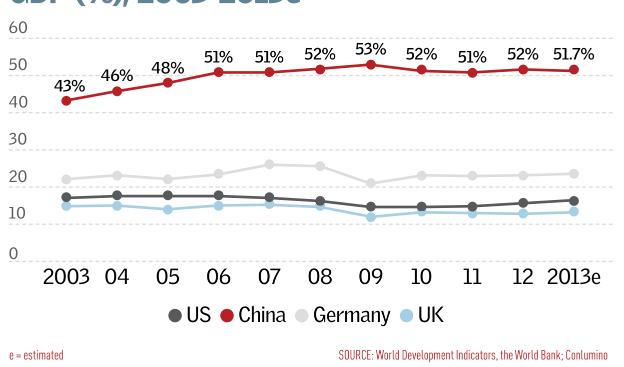
Retailers will also benefit significantly from widespread infrastructure developments. Heavy investment in this area has included building a high-speed rail network and opening up air travel. By 2015, China will have 230 airports, up from 175 in 2010. The opportunities the major cities have offered in the eastern and coastal regions are spreading to second- and third-tier cities in the West, broadening the prosperity to new communities across the country. Considering the population size and the fact that even fourth-tier cities can have populations of at least 10 million, the size of London, then the potential for retailers to reach new consumer markets is enormous.

THERE ARE OTHER MAJOR SHIFTS OCCURRING THAT WILL HAVE A SIGNIFICANT IMPACT ON THE RETAIL ENVIRONMENT – ONE BEING THE TRANSITION FROM MANUFACTURING AND AGRICULTURE TO SERVICE-LED SECTORS

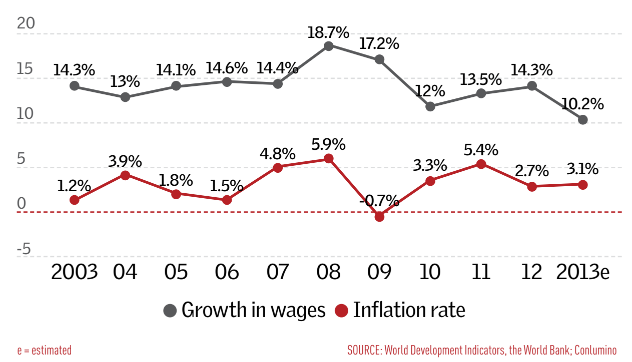
In terms of GDP growth, the Chinese government's aim is to keep it above a minimum threshold of 7.5% which, though much lower than its recent growth trajectory, is still far higher than mature Western economies can achieve. This figure will allow it to keep inflation under control and reduce pressure on its resources and the environment. One factor that may be worth monitoring is the fact that many of the investment projects across China have high-credit risks, although for the immediate future this does not appear to be a problem.

The country's social security system is also undergoing a transformation, which will help create a more consumer-led economy. Traditionally, the Chinese have been savers. With a non-existent or underdeveloped social security system, they have needed to fund their families' education, healthcare and retirement. All of these have become more expensive at the same time as uncertainty about employment and the growth in the economy have taken hold, driving savings rates up to as much as 53% of GDP during the global crash in 2009 (see chart 1.4). But that looks set to change. The government is addressing the limited social security provision and extending its coverage in pensions as well as widening the provision of other welfare benefits that will help to persuade consumers to free up funds locked into personal savings and encourage consumer spending.

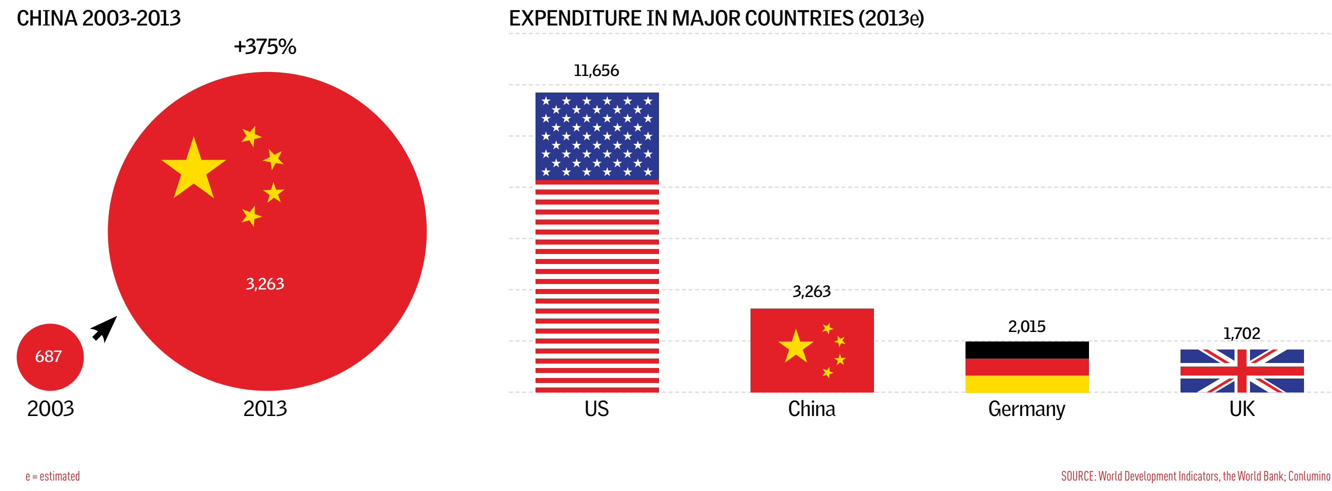
1.4 Household savings rate as share of GDP (%), 2003-2013e



1.5 Wage and inflation growth rates (%), 2003-2013e



1.6 and 1.7 Household consumption expenditure (US$bn), 2003-2013e

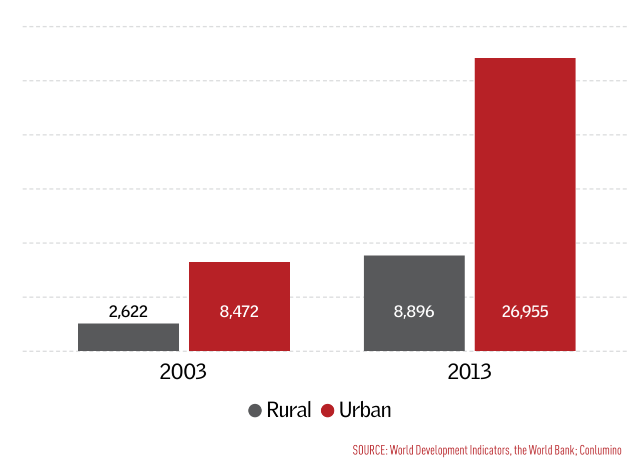


Despite the unemployment rate rising again after reaching a low of 4% in 2007, it is still no more than it was a decade ago at 4.3%. The recent increase was driven by the slowing economy, weak hiring plans, job cuts, especially by manufacturing units (the fastest since 2009), and less demand for unskilled workers who tend to be in the older age groups. But, the country's employment rate of 95.7% in 2013 is still at a very healthy level when compared with western economies that are struggling with high unemployment levels.

China's employment rate in 2013

95.7%

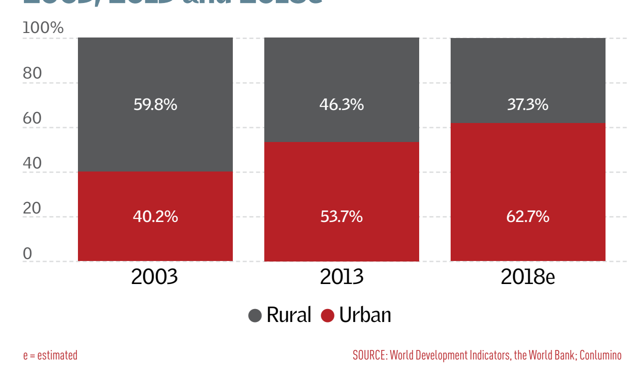
1.8 Disposable income value (¥) 2003 and 2013



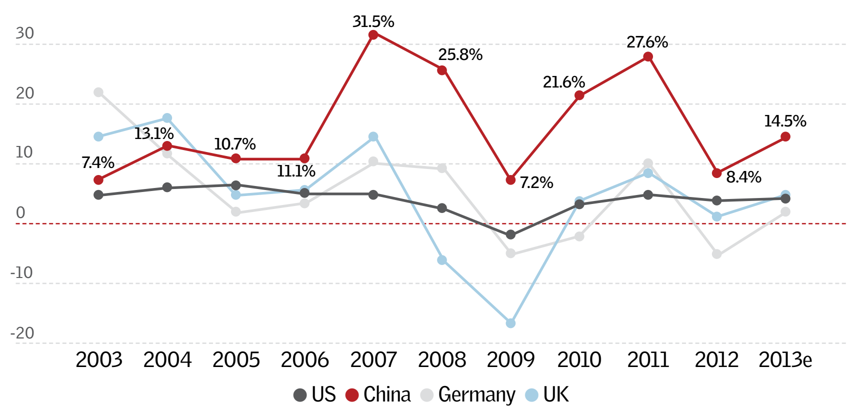
The shape of the Chinese employment market should also benefit the development of a modern retail sector. Agriculture used to account for the majority of jobs, but it was overtaken by the services sector in 2011.

This trend, which is experiencing a metamorphosis of an unskilled workforce to a skilled, highly educated one, is a big factor in more than half of the population (54%) living in cities as they seek higher paid, skilled work and more attractive working environments in retail, leisure and technology businesses. The improvements in education have created an excess supply of educated/skilled workers compared with demand. This is another factor in the drive to create more service-led jobs that pay higher rates and create a virtual circle of increased wealth and greater consumer demand – a sweet spot for retailers. ▶

1.9 Rural and urban populations, 2003, 2013 and 2018e



1.10 Growth of household consumption expenditure (%), 2003-2013e



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SOURCE: World Development Indicators, the World Bank; Conlumino

WHILE BOTH RURAL AND URBAN POPULATIONS HAVE ACHIEVED SIGNIFICANT INCREASES IN DISPOSABLE INCOME LEVELS, THE INCOMES OF URBAN POPULATIONS ARE STILL THREE TIMES AS HIGH AS THOSE IN RURAL AREAS

A key factor in China's attraction for retailers is the increase in consumer spending power. Over the decade to 2012, total Chinese household consumption expenditure more than trebled, growing from US$639bn (£380bn) to US$2,850bn (£1,695bn), overtaking both Germany and the UK. In contrast to Europe and the US, where consumers have been on an austerity drive during the global recession, China's population has become far more acquisitive as its prosperity increases.

While both rural and urban populations have achieved significant increases in disposable income levels, the incomes of urban populations are still three times as high as those in rural areas. But government efforts to increase the minimum wages will help to close this gap, and the extension of wealth and consumer-led businesses to second-, third- and even fourth-tier cities will increase opportunities for local populations and catchments to get higher-paid jobs and increase their spending power.

By 2018, on the current trend, retail research agency Conlumino estimates 62.7% of the population will be in urban areas (see chart 1.9 on p8).

Wage growth remains encouragingly strong in China; even when it was at its lowest rate for the past decade it still rose 10.2% year on year in 2013 (see chart 1.5 on p7).

However, the wage increase for 2014 is projected to be about 11%, according to analysts from Bank of America Corp. The central government's 2011-to-2015, five-year plan aims for a minimum wage increase of 13% for each year as it seeks to shift from a capital-intensive manufacturing economy to the more service-led one. Its strategy is to increase minimum wages until they reach 40% of average urban salaries by 2015, reducing disparities.

The inflation levels in China are largely driven by increasing credit availability in the country and the excess printing of money by the Central Bank in its efforts to keep a check on the appreciation of the Chinese yuan with that of the US dollar. The risk in all cross-border retail is the exchange rate, which can deplete profit levels if it goes the wrong way for retailers – but, of course, can be beneficial as well. Managing this risk is a key to success.

Increase in currency flow across China increased the demand for various products and the rise of global commodity prices contributed to the increase in inflation levels. Keeping a check on these levels is a central part of government policy. While wage growth remains above inflation, the prospects for increased consumer demand remain strong.

OVERVIEW OF THE CHINESE MARKET
DEMANDWARE ANALYSIS

- Entering the Chinese market can be a slow, laborious process. However, with the prospect of central reform, the retail opportunity in China will continue to develop. As disposable income rises above inflation, consumers are expected to begin driving further economic growth for the country.
- Broadband penetration across the country remains low, but as the opportunity for online commerce increases so will the broadband adoption. The largest cities – Beijing, Shanghai and Guangzhou – make up 50% of online sales. As industry and services continue to increase as the primary employment, tier two, three and four cities will become areas of real opportunity.

CHAPTER 2

THE CHINESE SHOPPER

TESTING | SHUTTERSTOCK.COM

- Chinese middle class to triple over next decade and spread across the country
- Shopping mode changing from functional, deal driven to emotional, status driven
- Shopping becomes a leisure activity as shopping centres and prosperity increase
- Two events drive high spending: Chinese New Year and Singles' Day
- Singles' Day is a world-beating online event
- Smartphones and tablet penetration high and readily adopted by Chinese consumers for online shopping
- Increase in travel and tourism is introducing Chinese consumers to international brands cross-border

China's rising middle class is set to transform the economic and social dynamics of the country. Those with incomes of between US$16,000 (£9,500) and US$34,000 (£20,000) – and thus classified as the middle-class population – is projected to reach 630 million by 2022, an increase from 230 million in 2012.

The higher personal consumption levels provide a prime opportunity for mass-market retailers to drive up volumes, particularly in the inland regions and second- and third-tier cities. Furthermore, the increased consumer spending provides the necessary fillip to continue to drive not only China's country, but that of the world economy.

The widening prosperity and changing lifestyles, combined with greater accessibility and availability of goods, is changing the way the Chinese shop. Although they still want the best deal and so are not generally brand loyal, they are more open to inspiration and brand influence. And, as their wealth increases, they want to convey their status to their peers by owning status products and brands.

With wealth and retail developments spreading to second- and third-tier cities like Chengdu and Suzhou, there are enormous opportunities for global mass middle-market brands to reach and satisfy regional Chinese consumers and drive high-volume sales. Value fashion brands, such as the UK's New Look, which have entered the market in tier-one cities such as Beijing and Shanghai with an offer adapted to Chinese tastes, will appeal to the rising middle classes in these second- and third-tier cities because of their price positioning and international brand status. At the same time, premium niche brands can not only fulfil the demand for less well-known brands in the tier-one cities (to provide a level of exclusivity to its shoppers) but can deliver aspirational targets for the less wealthy regional consumers. The Chinese perception of Ted Baker, for instance, is of affordable luxury for fashion shoppers – a different positioning to its general premium positioning in mature economies.

2.1 The changing Chinese shopper

Rural	→	Urban
Unskilled	→	Skilled
Low income	→	Middle income
Limited choice/availability	→	Wide choice, availability/access
Seeks value, durability, comfort	→	Seeks status/display wealth/taste
Time rich	→	Time poor
Researches, evaluates	→	Evaluates, open to impulse buys
Wants best deal	→	Wants inspiration, quality
Local brands	→	Local and international brands
Functional	→	Emotional

SOURCE: Conlumino

THE ATTITUDE TOWARDS SHOPPING IN CHINA HAS SHIFTED FROM BEING A NEEDS-DRIVEN ACTIVITY TO AN INTEGRAL PART OF THE URBAN CONSUMER'S LEISURE PURSUITS

CHINA'S EVOLVED SHOPPING HABITS

The attitude towards shopping in China has shifted from being a needs-driven activity to an integral part of the urban consumer's leisure pursuits. The new shopping centres are destinations for urban Chinese families and young people, much as they are in developed retail economies. They are smog-free, with plenty of dining outlets and other services apart from shopping to entertain a family.

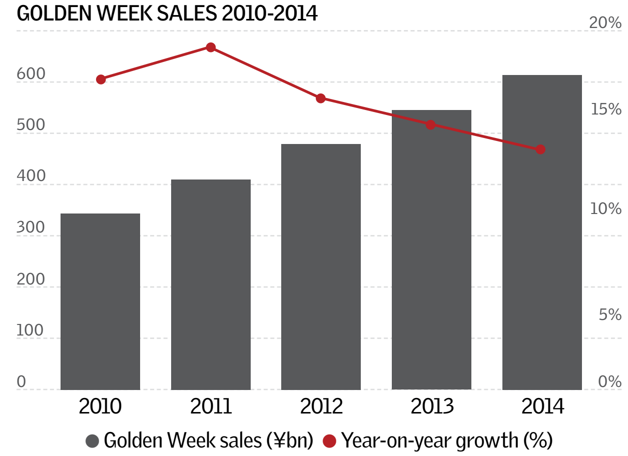
As with Western shopping habits, evenings and weekends are particularly popular as the opportunity to shop during the day is limited because of full-time working. The Chinese urban consumer will eat out often during the week – China is full of cheap places to eat and this is ingrained in the culture. As a result, restaurants and cafes are essential in shopping centres to drive footfall. What's more, shopping centres and high streets are more popular with the younger shoppers than department stores – again reflecting attitudes among young consumers globally.

The Chinese New Year – also known as the Spring Festival, which takes place in January or February – has long been a driver of overall retail sales in the country. The Chinese Ministry of Commerce suggests that sales of retail and catering enterprises grew 13.3% to reach ¥610.7bn (about £59bn) during the 2014 Spring Festival – also referred to as Golden Week from a retail perspective (see chart 2.2). This is the slowest Golden Week sales growth registered in more than a decade in China, as spending on items such as alcoholic beverages, tobacco products ▶

2.2 Chinese New Year sales

- The Chinese New Year fell on January 31 and the holiday week lasted until February 6
- According to the Ministry of Commerce, sales of retail and catering enterprises during the Golden Week grew 13.3% in 2014 to reach ¥610.7bn
- Retail sales of luxury goods such as expensive alcoholic beverages and tobacco products during the holiday season declined as the Chinese government curbed conspicuous spending among its officials

GOLDEN WEEK SALES 2010-2014



Product categories

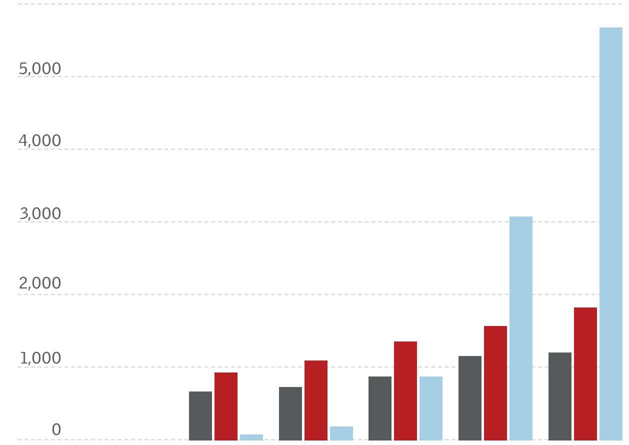
WINNERS	LOSERS
Mobile phones	Alcoholic drinks
Home appliances	Tobacco
Computers	
Jewellery	

SOURCE: China Ministry of Commerce and Conlumino

2.3 Chinese Singles' Day sales

- Singles' Day in China is celebrated on November 11 every year
- The online Singles' Day sales in China were popularised by the Alibaba group in 2009
- Sales of the Alibaba group online portals increased from US$1m in 2009 to US$5.6bn in 2013, a CAGR* growth of 687.95%
- Online sales on Black Friday and Cyber Monday in the US grew at a CAGR* of 19.12% and 18.26% respectively from 2009 to 2013
- Singles' Day online sales of the Alibaba group alone overtook the combined online sales of Black Friday and Cyber Monday in 2012 to become the highest online sales day in the world

ONLINE SALES (US$), 2009-2013



	2009	2010	2011	2012	2013
Black Friday	595m	648m	816m	1.04bn	1.2bn
Cyber Monday	887m	1.03bn	1.25bn	1.47bn	1.74bn
Singles' Day	1m	138m	805m	3.03bn	5.64bn

* Compound Annual Growth Rate

SOURCE: China Ministry of Commerce

2.4 Typical Chinese shoppers from 2013 onwards

The younger generations of Chinese shoppers are taking on many of the characteristics of the Western shopper as they are exposed to a wider global view from travel, education, the internet (even though state controlled) global music and entertainment. And, of course, greater awareness of international brands as these brands enter the Chinese market and spread across the country via stores or online.

Even the 45-to-64 year olds resemble the post-war baby boomers in the US and Europe as they spend their money on world travel and leisure activities.

	15-24 years	25-44 years	45-64 years	65-plus years
Age group	Good education, no commitments, city dweller for education/work, single	First of one-child generation, educated, urban dweller, settling down to start a family	Parents of one-child generation – fewer family commitments, though thinking of the future and their own parents' care	Less educated and skilled than their children and grandchildren. Saved for retirement but have limited funds – relying on children's help
Background	Travels abroad (including for education), uses internet, digitally advanced, has a global view, optimistic	Has a global view. Optimistic, but thinking of family commitments. Women having children at 27-plus years and continuing to work	Travellers – both domestic and international; big gift buyers; more global view than parents; use internet, but less than their kids	Domestic, local view; big savers; conservative spenders – researching, looking for best deals
Profile	Spends on recreational activities, entertainment, travel, themself	Spending on themself, home, family	Spending on family and experiences for themselves, have been big savers	Spending on necessities – food, clothing, health and well-being
Brand loyalty	Status and brand-driven; luxury consumers	Status and brand driven but time poor. Wants convenience for necessities plus value and quality	More open to brands but not particularly brand loyal	Not brand loyal – looking for value/ price and best deals
Preferred channels	Online, shopping malls, high streets, convenience stores, markets	Hypermarkets, convenience stores, shopping malls, department stores, online	Hypermarkets, convenience stores, markets, department stores, malls	Local stores, markets, convenience stores, but will use department stores, hypermarkets if they have access
Key target group	Young women with careers not settling down but working and spending on themselves – market for apparel and personal care	Abundance of single men in their 30s, with careers and money to spend on themselves – market for electronics, gadgets, apparel, entertainment, personal care	Mature men with high disposable incomes, buying necessities and products for leisure activities, gifts for family and some replacement products	Senior citizens with the need for food and grocery, necessities and convenience
What they buy	Electronics, personal care, apparel, accessories, luxury brands	Food and grocery, personal care, apparel for the family, big-ticket items for the home, electronics	Food and grocery, personal care, apparel, sports and leisure, books, electronics	Food and grocery, personal care, apparel for the family, big-ticket items for the home, electronics
Target for	Luxury brands, fashion retailers, technology, music entertainment	Grocery retailers, online, clothing retailers, big-ticket retailers, entertainment – convenience/ quality	Department stores, grocery retailers, sports and leisure, entertainment, books, online	Value retailers – price-led, convenience

and fine-dining services declined because of the Chinese government's initiatives towards curbing conspicuous spending by its officials. The product categories that drove the rise in New Year retail sales this year were mobile phones, home appliances, computers and jewellery.

The other major event driving retail sales in China is the recently popularised Singles' Day on November 11. Singles' Day has been a driver for online sales for the past few years. It has now morphed into one of the biggest online retail sales events in the world – surpassing Black Friday and Cyber Monday sales in the US. The Alibaba group-owned Tmall and Taobao registered sales of ¥35bn (about £3.4bn) on Singles' Day 2013. This is the highest ever online sales figure achieved in a single day across the world.

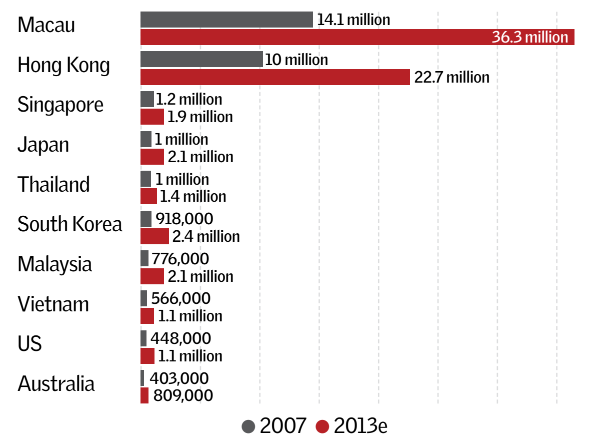
Taobao, which boasts about 800 million products on its site, is among China's top-10 most visited ecommerce marketplaces, with over a decade's presence. Tmall, formerly known as Taobao Mall, launched in 2008, and provides a unique mall experience. Nike, Apple, Microsoft, Uniqlo, L'Oréal, Adidas, Gap, Ray-Ban and Levi's have established storefronts on Tmall.com.

Other online and store-based retailers have also started to take part in Singles' Day sales to take advantage of the growing consumer spending on this day. Sales on this day are expected to grow in the future as more retailers and brands make a concentrated effort to attract consumers. The trend also suggests that promotional events are just as likely to attract the Chinese shopper as they do in other retail markets across the globe.

ONLINE SHOPPING TRENDS

The success of online sales during Singles' Day indicates the growing popularity of online shopping. The growth in the mobile devices market has led to an increase in Chinese consumers using multiple devices to access the internet. Data from Media Research Asia suggests that smartphone

2.5 Prime destinations for Chinese tourists, 2007-2013e

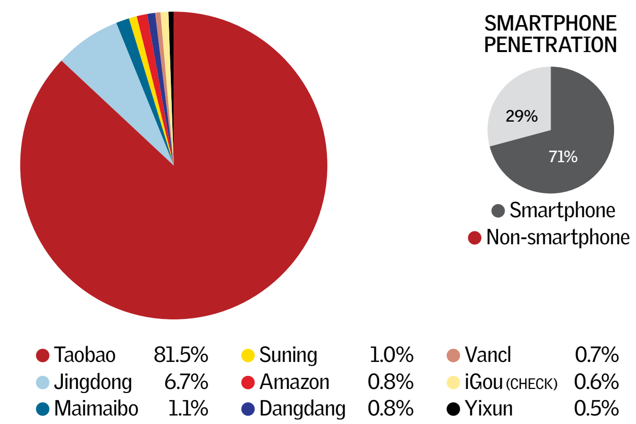


e = estimated

SOURCE: World Bank Development Indicators and Conlumino

2.6 Mobile retailing in China

MOBILE SHOPPING MARKET SHARE



SOURCE: Conlumino

ANOTHER CONSUMER SHIFT HAS BEEN THE CHINESE SHOPPER'S DESIRE TO ENSURE PRODUCTS ARE GENUINE, HIGH QUALITY AND FROM A RELIABLE SELLER. AS A RESULT, WESTERN BRANDS HAVE BENEFITED

penetration (based on total registered SIMS, including dual-SIMS) in China was 71% in 2012 and tablet ownership was at 45%. With the rise in ownership of these devices, there has been a surge in the number of consumers using them to purchase goods online.

A report by news website Alizila suggests that the number of mobile shoppers increased to 144 million in 2013 – a growth of 16% over 2012. The major factor motivating consumers to purchase online is, of course, the convenience of being able to shop anywhere at any time. According to the results of a survey conducted by KPMG in the last quarter of 2013, published in the report *China's Connected Consumers* (2014), of the 10,200 respondents, almost 60% prefer shopping online through their smartphones and 30% prefer using their tablets.

Alibaba dominates the market for mobile shopping in China. An article published on news website Tech in Asia suggests that its sites Taobao and Tmall together have a market share of 75.1%, followed by online shopping mall Jingdong, with a 4.5% market share of the mobile retailing market.

Other online retailers are expected to step up their efforts towards getting a mobile strategy in place. And, just as with every Western market, online shopping through mobile devices looks likely to increase further as more and more consumers buy smartphones. It is expected that smartphone penetration in China will cross 90% in 2014 and will become the main access route to online shopping because of the current low penetration of broadband in the country.

CONSUMER TASTES

Chinese appetite for Western brands continues to gain momentum. This is aided in part by the fact that the population has become – and will continue to become – more prosperous, and so the Chinese have begun to travel more. While they have become major contributors to tourist spend in Europe, it is the countries closest to them in the Asia-Pacific region that have benefited the most.

The proximity of Macau and Hong Kong, and their reputation for luxury shopping and gambling, attracts a wide range of Chinese citizens to these special administrative regions. In addition, most Chinese have their businesses in Macau and Hong Kong – as they are prime destinations for tourists – and so travel there regularly. These regions are often where they become acquainted with luxury foreign brands.

Another consumer shift has been the Chinese shopper's desire to ensure products are genuine, high quality and from a reliable seller. As a result, Western brands have benefited from this as they are regarded as more trustworthy. While China has been renowned for producing counterfeit goods there has been a backlash in recent years as counterfeit goods, especially in the food industry, have led to loss of life and posed serious health risks.

There have been incidents, such as the melamine-tainted milk scandal and pork contaminated with steroids, which caused serious health problems to Chinese consumers. The melamine-tainted infant milk, for instance, drove consumers to purchase an imported alternative, willing to pay a premium to ensure their child's safety.

Historically, consumers in China have been price sensitive, and have been known to spend time researching a product before making a purchase. However, these Chinese consumers are willing to pay a premium for quality.

THE CHINESE SHOPPER
DEMANDWARE ANALYSIS

demandware

- Chinese consumers, particularly the younger demographic and burgeoning middle classes, have developed a keen eye for Western luxury brands.
- Many of these consumers learned to shop online on Taobao and are seeking a more exclusive customer experience. The risk of counterfeit goods is high in a consumer-to-consumer market; places such as Taobao and direct-to-consumer offerings have the potential to instil greater trust.
- Most Chinese consumers have mobile phones and many are using them for online purchases. Some even use their mobile devices exclusively for online commerce.
- Social networks are also very important with many consumers sharing their retail experiences on blogs and social networks.
- Payment preferences are distinctly different within the Chinese market, with many preferring to pay on delivery rather than authorising payment online.

CHAPTER 3

THE REALITIES OF DOING BUSINESS IN CHINA

- The government anti-corruption campaign requires businesses to implement training, knowledge and rigorous systems to avoid prosecutions
- Complicated bureaucracy requires knowledgeable partners and employees to facilitate market entry and expansion
- Foreign retailers face more business obstacles than domestic ones
- The government is conducive to improving tax structures for foreign entrants
- Large infrastructure projects will open up new markets and reduce costs for foreign retailers

It would be an understatement to say that China does not have a reputation for simplicity when it comes to doing business there. Nevertheless, the business environment in China has changed significantly since the country's entry into the WTO (World Trade Organisation) in November 2011.

China has now aligned its tariffs on certain agreed products in accordance with WTO regulations and provides access to specific, government-designated industries and sectors that were earlier restricted for foreign retailers.

Foreign investment enterprises meeting specific requirements can earn exemption from import customs duties on machinery and equipment. CEPAs (Closer Economic Partnership Arrangement) help companies from Hong Kong and Macau by providing them with favourable tariffs in China, giving them an advantage. The Chinese government has also taken several steps to improve the way business is done in the country by streamlining registration rules for foreign companies with a view to ease market access and encourage social investments.

Under this law, the minimum registered capital requirements have been scrapped and replaced, and the major changes are relaxed registered capital requirements, a more transparent information disclosure system for companies, and the introduction of an annual reporting system and electronic business licenses.

However, it still remains difficult to do business in China owing to the enormous amount of paperwork and documentation that is attached to every procedure. For instance, foreign companies wanting to expand in China face issues relating to zoning and site-selection processes. Attractive preferential policies (relating to tax, investment and employment) are provided only to qualified enterprises in these zones (SEZ, ETDZ, export-processing zones and bonded warehouse zones).

The formalities for foreign companies are much more cumbersome and time consuming than those for domestic counterparts claiming for the same benefits. This in turn leads to competitive disadvantage owing to higher costs and delaying time to market for the foreign retailer.

ANTI-CORRUPTION CAMPAIGN

Although China's president Xi Jinping introduced an anti-corruption campaign in 2013 aimed at eliminating bribery and corruption in government departments, and cutting back on conspicuous spending, it creates more risks for Western retailers. Officials have been stopped from accepting luxury gifts, holding banquets, using high-end cars and even holding expensive funerals, and as many as 37,000 officials are under investigation. In theory, the outcome should make it easier and less costly to do business in China, but foreign businesses have fallen foul of the new laws as they become implicated in practices that were the norm beforehand.

Britain's leading pharmaceutical giant GlaxoSmithKline (GSK) was accused of corrupt practices in China. The executives of GSK were accused of bribing doctors and officials channelled through a travel agency in order to boost the sales of its medicines in the country. Furthermore, French company Danone was accused of bribing doctors and nurses with kickbacks, gifts, funded travel and complimentary show tickets in order to drive up its sales for baby formulas.

In general, foreign businesses have been under greater scrutiny from regulators and the public. Both Walmart and Carrefour, for instance, have both been fined for alleged price fixing. As such, foreign businesses operating in China need to have tight systems in place and understand the regulations so they do not fall foul of this government programme.

Despite the government's desire to stamp out corruption and nepotism, having a connection of some kind with official departments is still the fastest way to facilitate processes, especially in gaining planning consent. Foreign retailers in ▶

3.1 Individual and enterprise income tax rates in China

Individual income tax	Enterprise income tax
Income on wages and salaries have a tax rate of 3%-45%	Income of resident enterprises are taxable at 25%
Production and business income attract tax in the range of 5%-35%	High technology enterprises attract a lower tax rate of 15%
Other taxes vary between 20%-40%	Income of foreign enterprises that do not have establishment in China attract 10% withholding tax
	Income of foreign enterprises having establishment in China but whose income is not connected to the establishment attract a 10% withholding tax

SOURCE: World Development Indicators, the World Bank; Conlumino

WITH ONLY 15.4% PENETRATION THERE IS STILL A LONG WAY TO GO BEFORE THE BENEFITS OF BROADBAND WILL BE AVAILABLE TO THE MAJORITY OF THE POPULATION. HOWEVER, EVEN WITH THIS LEVEL IT REACHES 208 MILLION USERS

China also face tougher licensing norms compared with their domestic counterparts. A foreign retailer should first obtain a licence from the PRC Ministry of Commerce (MOFCOM) and then get a registration approval from the State Administration for Industry & Commerce (SAIC). On the other hand, domestic retailers only need to get a licence directly from SAIC without the need to get approval from MOFCOM.

ETAIL CHALLENGES

Even online retailing is difficult. Because of the government firewall on foreign businesses, retailers need to establish a Chinese URL. This means getting a Chinese business licence, a retail licence, a wholesale licence and even a regional licence. The process can take at least a year – which is why many retailers prefer to sell via local sites, as Marks & Spencer does with Alibaba.

The entire licensing process for foreign retailers is non-transparent and very time consuming, causing not only logistical headaches but also cost escalations. A 2009 US Trade Representative report on China's WTO compliance listed discriminative licensing procedures as a persistent problem for foreign companies in the country.

In addition, there are obstacles in supplying stores even if a retailer manufactures its products in China. Chinese product specifications are more stringent compared with the EU, making it difficult for foreign retailers to sell EU-standard products in China as they do not necessarily meet the specifications to be sold in the country. What's more, Chinese manufacturers producing goods for Western retailers prefer to export the goods because of tax incentives for exporting rather than supply those same retailers' stores based in China.

That said, China has rationalised its taxation structure during the past two decades. In 1991, it enacted a separate income tax law for foreigners and foreign enterprises, providing them tax incentives to facilitate investments into the country. In 2008 China introduced the Enterprise Income Tax Law (EITL) to remove unfair competition for domestic businesses resulting in taxation for both domestic and foreign enterprises.

Additionally, the Chinese government plans to revisit the tax incentives it provides at the provincial level and base these on market forces rather than on preferential treatment. Through this initiative, it plans to ensure that competition is not manipulated or altered. Furthermore it plans to bring in more equity and transparency in individual tax codes.

INTERNET AND TECHNOLOGY

With only 15.4% penetration (see chart 3.2), there is still a long way to go before the benefits of broadband will be available to the majority of the population. However, even with this level it reaches 208 million users. A further growth in broadband penetration would increase internet users' time on the web and drive online sales, but this would take several years to cover the population.

Meanwhile, the almost complete saturation of mobile phones indicates a greater opportunity for retail companies to use this platform to reach customers, and greater smartphone penetration will increase the online potential further, as will tablets, which have already become a preferred medium for shopping online.

There is a good argument that once online shopping takes off retailers will not need to open as many stores to reach and sell to consumers. So unlike in mature retail economies where retailers are burdened with too many costly stores and are closing them down, in China they can plan for the optimum space needed.

But with a country of this scale, retailers still have to deal with delivery. Even in high-density cities delivery is not straightforward as Chinese shoppers like to pay cash on delivery and will expect the courier to wait while they check goods. And although city dwellers tend to buy more online they shop less frequently than those in regional locations. For retailers, finding good delivery and warehousing partners is essential for both online and offline delivery.

SHOPPING ACCESS VIA SOCIAL MEDIA

Despite the blocks the Chinese government have put on global networks such as Facebook and Twitter, the Chinese are keen users of domestic social networks. Many of them have more users in China than US networks have worldwide. The challenge for international retailers is how to engage with users on these sites with the restrictions imposed.

Sina Weibo is one of the popular social networking sites in China, with nearly 500 million registered users. It allows users to display photos and videos on timelines. Similarly, Tencent Weibo, which provides a similar service and has 507 million registered users. Tencent's instant messaging service QQ attracts users from smaller cities. Qzone, another Tencent network, allows users to blog, keep diaries, listen to music and share photos, and claims to have had a user base of 712 million in 2013, which might include users with multiple profiles. ▶

Luxury goods

The luxury goods market in China has suffered as a result of government intervention. It is plagued by high taxes on imported luxury goods to support domestic companies. The differences in prices across luxury goods categories has increased as a result of these tax regulations and the goods are available at much cheaper prices outside of China, making it an expensive proposition for domestic Chinese consumers. The government imposes both customs duty rates and consumption tax rates on luxury goods.

This was a key factor in the slowdown of the luxury market in China in 2012 compared with previous years. It grew at a modest 10% (year on year) during 2012, compared with 30% and 27% during 2011 and 2010 respectively. Weaker economic growth along with the curbs on gifting in government departments influenced this trend, and will deliver slower growth in the luxury sector in the future – although it is still far ahead of many other international luxury markets.

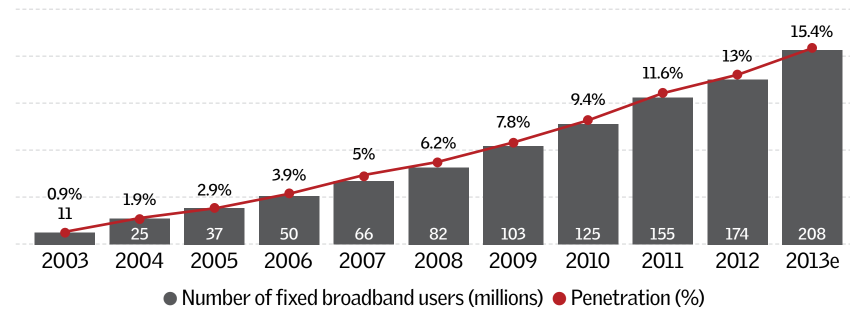
Nevertheless, the Chinese continue to be major consumers of luxury brands' products – they have a greater tendency to buy luxury products when travelling abroad to the homes of luxury brands (such as France and Italy), making sure they are still a major force in the luxury market.

CUSTOMS DUTY RATES AND CONSUMPTION TAX RATES OF LUXURY GOODS

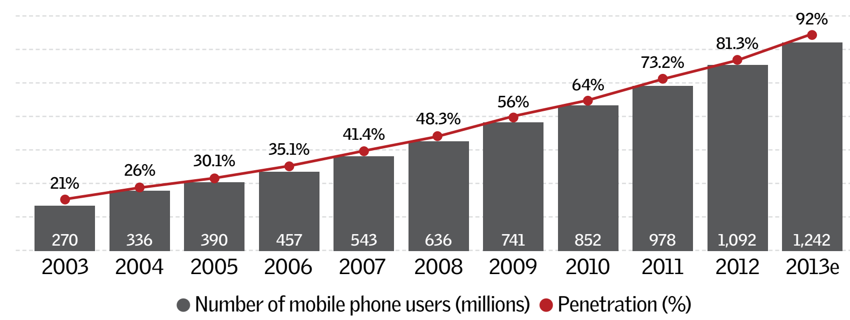
Categories	Customs duty rate	Consumption tax
Jewellery	0-35%	10%
Watches	11-23%	20%
Clothing	14-25%	N/A
Bags	10-20%	N/A
Wine	0-65%	5-20%
Cosmetics	6.5-15%	30%

SOURCE: KPMG

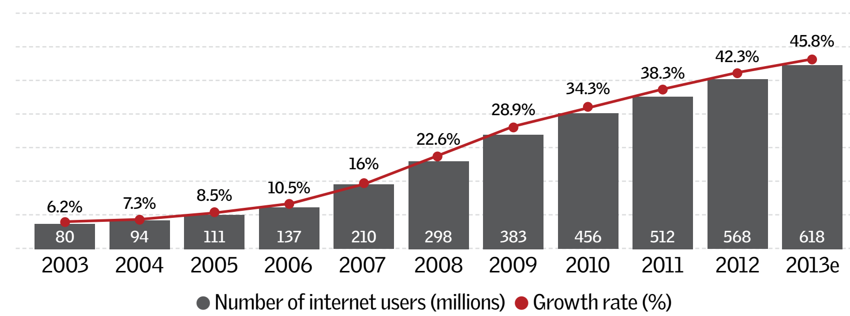
3.2 Total number of fixed broadband users (millions) and penetration (%), 2003-2013e



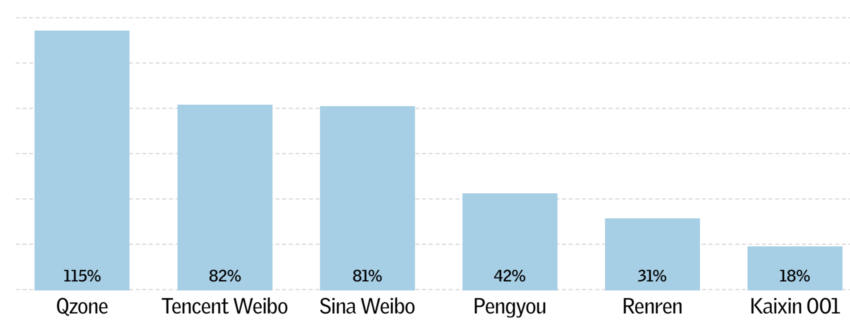
3.3 Total number of mobile phone users (millions) and penetration (%), 2003-2013e



3.4 Total number of internet users (millions) and growth rate (%), 2003-2013e



3.5 Penetration of social networking among internet users (%)



e = estimated

SOURCE: World Development Indicators, the World Bank; secondary sources; Conlumino

3.6 Market entry requirements

High reserves of investment	Process will take time, often stalls and has setbacks, so needs capital commitment and time to research the market and deal with the bureaucracy and processes
Local partners	Suitable partners with official connections, clean background, knowledge of market and processes, real estate and legal environment
Time	Long drawn-out process that can take a minimum of a year to sort paperwork
Tailored offer	Proposition and products must be tailored to the market and its customers (and these can vary by region)
Scale	Operating in such a large country needs scale to make a return
Local teams	Having marketing and retail teams in the country builds local knowledge and quick response to consumer demand
Local delivery partners	Local delivery partners that can warehouse, transport to retailers' stores across the country, manage stock and even deal with online will save time and costs
Local online partners	Barriers to entry for online businesses in China make it an expensive, time-consuming process. Starting with a local partner enables retailers to demand and reduce risk

Renren is a Facebook-like service that targets students and teens. The network, which launched its mobile app in 2013, has a registered user base of 194 million. Kaixin 001 is also a Facebook-like service, which allows users to add friends, however it targets older and white-collar professionals. Pengyou, which is part of Tencent, also allows users to add friends and follow brands. It has 259 million users.

TECHNOLOGY AND RETAILERS

Retailers in the country have been adopting new technologies such as virtual stores and QR codes for effectively engaging shoppers, among them Yihaodian and Montblanc.

Yihaodian, an online retailer of groceries, (owned now by Walmart) introduced augmented reality supermarkets in vacant lots in cities across China. People wandering around the locations can use their smartphones for shopping products from the augmented reality supermarkets and have them delivered to their specified address.

On similar lines, Montblanc stores launched Virtual Timepiece, a feature that takes shoppers on a virtual tour detailing major events in the history of the brand, to effectively engage consumers.

Other prominent examples of consumer side technology adoption by retailers in the country include Nike and Haworth, an office furniture manufacturer. While Nike opened a concept store in Shanghai in August 2013 made entirely from trash, including drinks cans, water bottles, and old CDs and DVDs, Haworth's Beijing showroom was recognised as the world's first certified LEED v4 beta project by the United States Green Building Council (USGBC) in October 2013, as the building is developed by extensive use of sustainable, resource- and cost-efficient practices.

Alibaba, the major ecommerce player in China (and about to float) has agreed to invest US$692m (£411m) for a 35% stake in Intime Retail, a Chinese mall operator and department store group. The companies will form a joint venture to start online-to-offline initiatives in order to combine Alibaba's ecommerce platform with Intime's retail outlets. While Alibaba's Tmall will be in a better position to service its customers through Intime's inventory of offline products, Intime shoppers will receive targeted promotions through location-based technology in-store, and use virtual pre-paid cards through Alibaba's mobile wallet service Alipay.

As opposed to the deployment of technology on the front-end operations, technology deployment on the back-end operations, primarily supply chain, has mostly been at a slower pace. However, as transport infrastructure in China varies considerably from region to region and the fact that distribution networks in rural China are less explored than the coastal regions, seamless technology implementation in back-end operations remains an issue, and needs to be addressed as second- and third-tier cities open up to more and more retailers.

A few methods that need to be implemented include integration of logistics facilities and resources, and the adoption of technologies, such as GPS and e-barcodes to ensure effective information flow between the various stakeholders in the retail supply chain.

While technology adoption in retail has been evident in the country over the years, there are operational challenges. The challenges are more evident in the case of online retailers, as the industry faces consumer-centric issues, such as online credit card fraud, counterfeit goods shipment and specific regulations, such as the recent Administrative Measures for Transaction Rules of Online Retailing Conducted on Third-Party Platform, released by MOFCOM. The new draft has provisions to solicit public opinions on matters related to revised transaction rules.

THE REALITIES OF DOING BUSINESS IN CHINA
DEMANDWARE COMMENT

demandware

- For foreign retailers looking to establish a brand presence we typically advocate a multiple-step approach.
- The first step is to establish a local marketing website. Chinese consumers are familiar with luxury Western brands and a local language site can easily be rolled out. The site can help brands gauge interest in their offering, offer catalogues, deals and information on the brand. As brands expand further into the region these sites can direct potential buyers to products in marketplaces such as Tmall.com or concessions, or stockists around the region. An initial web presence also gives the retailer the ability to assess demand and build a team on the ground.
- Online retailing in China is dominated by marketplaces, whether business-to-consumer or consumer-to-consumer. Entrance via these channels offers brands an immediate audience and ease of transaction; however, they offer much less control and flexibility around marketing and promotion.
- The last online mile is the direct-to-consumer transactional site. This offers much greater flexibility for branding and special offers, and building customer loyalty among the luxury-hungry middle classes. Although it comes with significant new challenges around payment methods, fulfilment and addressing Chinese consumers' 'mobile-first' approach, direct-to-consumer provides a huge opportunity for brand building and the creation of exclusive customer experiences.

CHAPTER 4

THE RETAIL SCENE IN CHINA

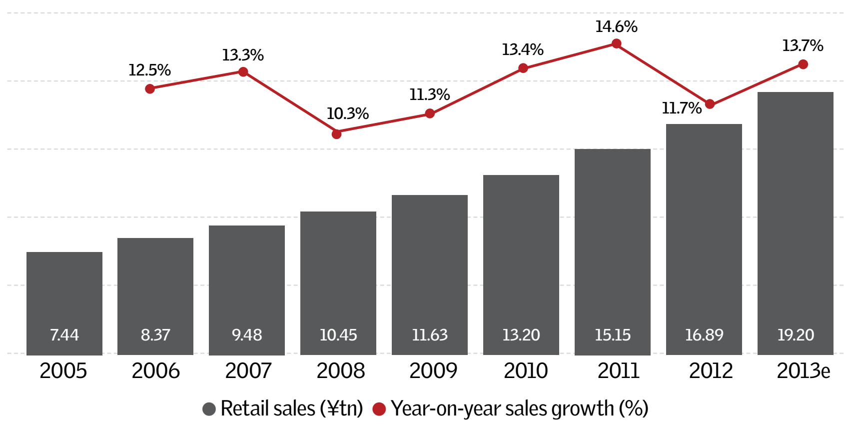
PORCUCIATTI / SHUTTERSTOCK.COM

- China's ever-increasing share of consumer spending underlines why it is such an attractive market for international retailers
- Online growth will outstrip the broader market as more consumers gain digital access
- Cultural and financial changes among the younger generations will benefit multiple categories, including electricals, jewellery, watches and accessories
- Food and grocery will lose share of overall spending as other categories grow
- Clothing and footwear will gain from the expansion of store chains across China, as well as online growth, with the biggest gain among the mass middle market

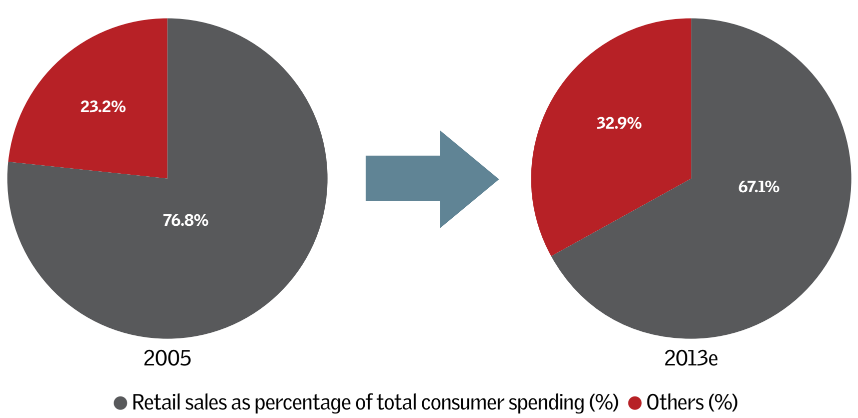
CHINA'S RETAIL SCENE

- With stable growth, rising disposable incomes, the move to a consumer-led economy and the expansion of retail as a sector, retail spending will continue to deliver double-digit growth and see it continue taking a larger share of consumer spending.
- The rate of online growth will outstrip the broader market as more consumers gain digital access via tablets and mobile devices and broadband penetration increases.
- Categories such as electrical and electronics, jewellery, watches and accessories, and music, video and entertainment software, will benefit from the cultural changes taking place among younger consumers. As the younger generations move up the career ladder and change their lifestyles, retail will benefit from their greater levels of disposable income, access to more choice and a greater inclination to spend.
- The categories making the biggest gains online will be those where there is easy digital downloading, such as books, music and video; where it is easy to make price comparisons, such as branded electrical products; and where there is increasing demand and easy delivery, such as clothing.
- Though population growth has been dampened by the one-child policy, the population is still rising – an extra 6.7 million in 2013. As the younger population matures and takes on higher-paid employment than their parents' generation, spending and volumes will continue to increase.
- The result is that retailing is taking a greater share of consumer spending in China – demonstrating why this is such an attractive market for international retailers.

4.1 Retail sales value (¥tn) and growth (%), 2005-2013e



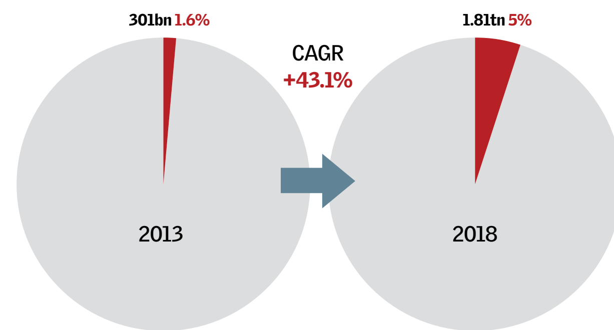
4.2 Retail sales as % of total consumer spend, 2005 and 2013e



e = estimated

SOURCE: World Development Indicators, the World Bank; secondary sources; Conlumino

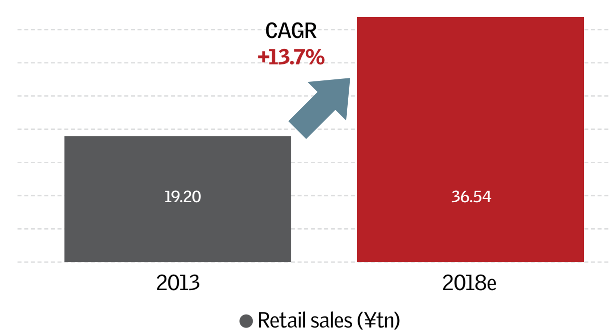
4.3 Online sales value (¥) and growth rate (%), 2013-2018e



e = estimated; CAGR = Compound Annual Growth Rate

SOURCE: Conlumino

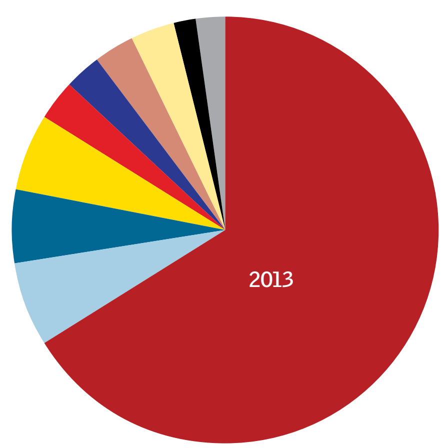
4.4 Total retail sales (¥tn) and growth rate (%) 2013 and 2018e



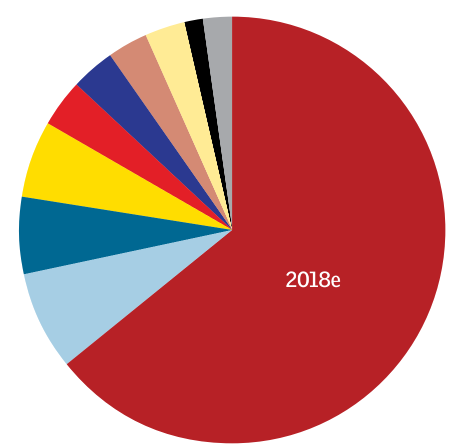
e = estimated; CAGR = Compound Annual Growth Rate

SOURCE: Conlumino

4.5 Share of key product sectors (%), 2013 and 2018e



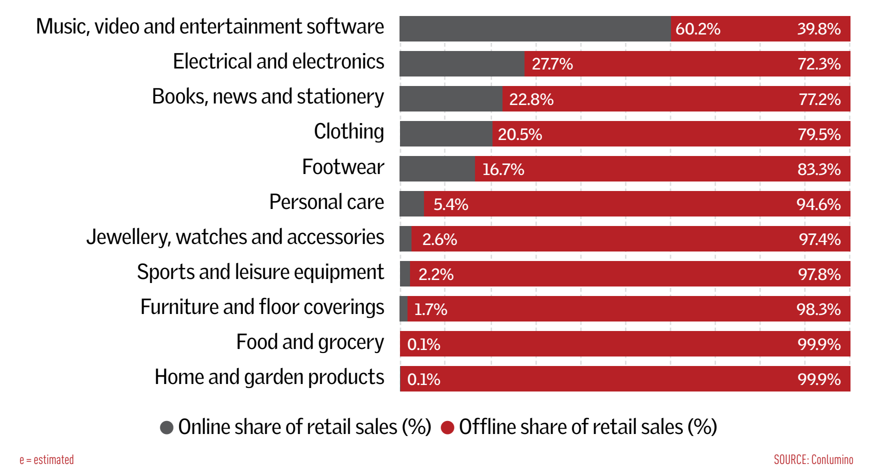
	2013	2018e
Food and grocery	66.2%	64.2%
Electrical and electronics	6.5%	7.5%
Clothing	5.6%	6%
Home and garden products	5.7%	5.8%
Jewellery, watches and accessories	3.1%	3.6%
Books, news and stationery	2.8%	3.3%
Furniture and floor coverings	3.1%	3.2%
Footwear	3.2%	2.8%
Personal care	1.8%	1.5%
Others	2%	2.1%



e = estimated

SOURCE: Conlumino

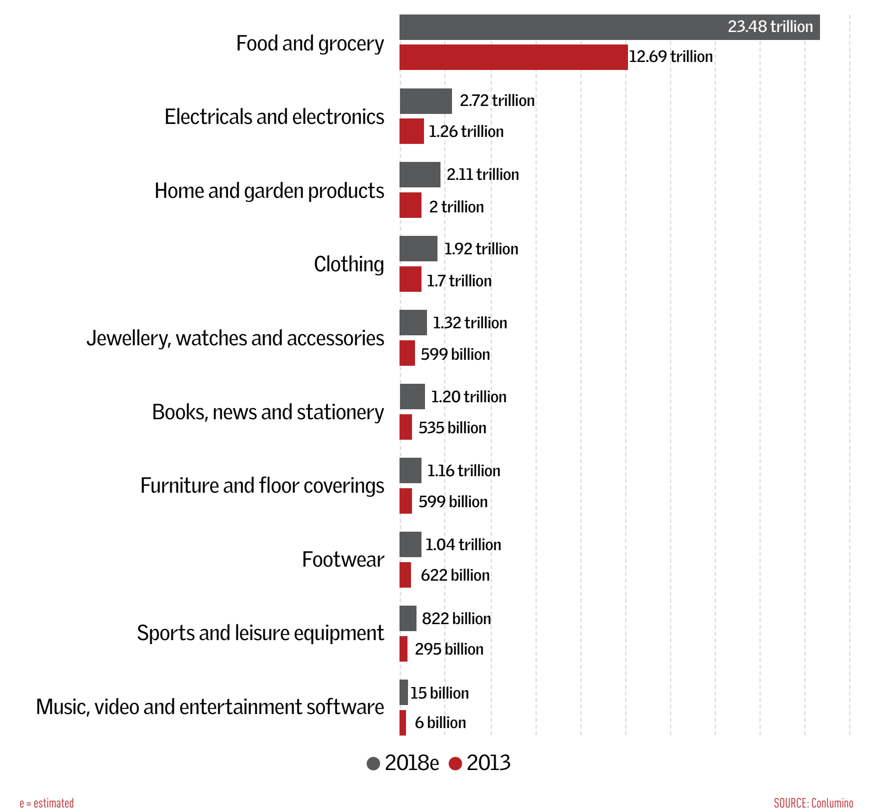
4.6 Online penetration of key product sectors (%), 2018e



FOOD AND GROCERY'S BIG INCREASE IN VALUE IS DRIVEN BY AN INCREASING POPULATION, FOOD INFLATION AND TRADING UP FROM THE GENERAL POPULATION, ESPECIALLY THE NEW GENERATION OF YOUNG FAMILIES

Food and grocery (which in chart 4.7 includes personal care), though showing the largest gain in value, will lose share of overall spending to 2018 as other categories grow. Its big increase in value is driven by an increasing population, food inflation, and trading up from the general population, especially the new generation of young families who are looking for convenience and time saving shopping. Working mothers will use local markets less and go to convenience stores and supermarkets for top-up and family shops to save time.

4.7 Retail sales (¥), 2013 and 2018e



Young couples will also be spending on big ticket items for the home as they start families, while in general there will be more take-up of new technology.

Clothing and footwear will gain from the expansion of store chains across the country and online growth, giving access and availability to the growing middle-class population. The biggest gain will be among the mass middle market.

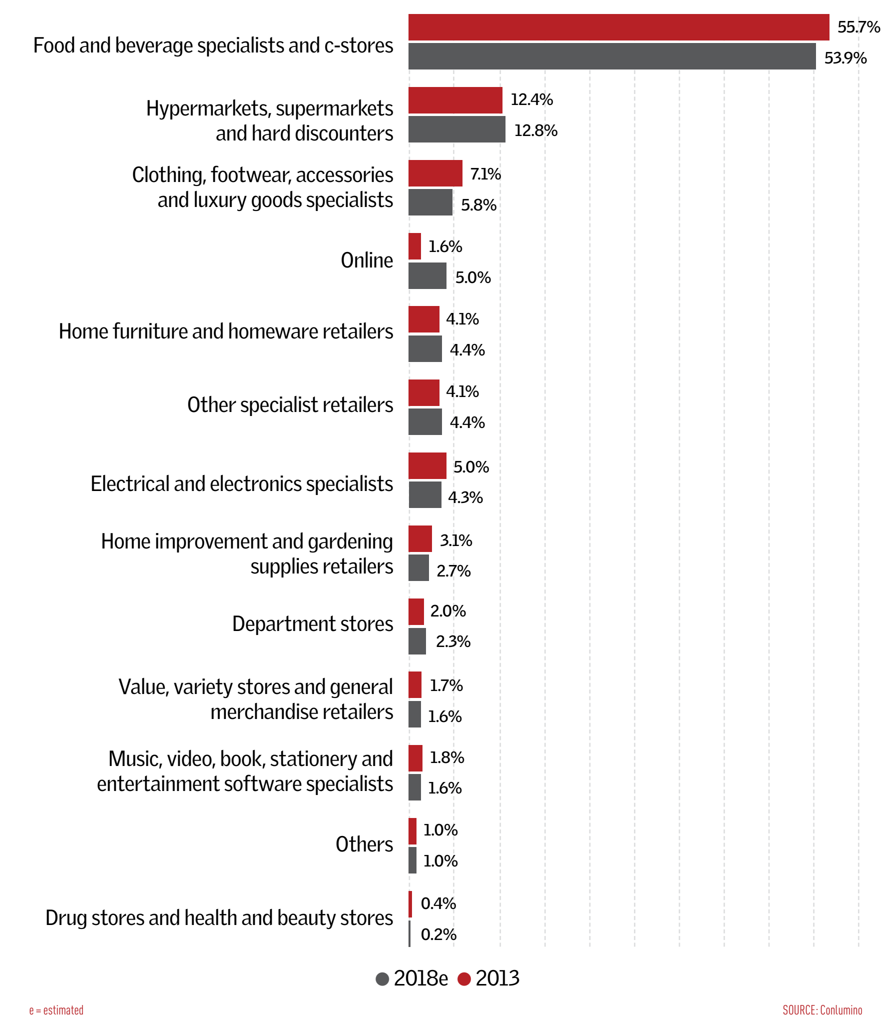
China is the biggest gold market after India, and there is an appetite for the personal acquisition of jewellery and watches as a sign of status as well as investment, which will drive sales in these categories despite the clampdown on official gift giving.

Food and beverage specialists and convenience stores (this category includes local market stalls) are still the main channel for food and grocery and general merchandise sales, particularly for urban top-up shopping, and the less mobile older generations. But hypermarkets/supermarkets are growing share as Chinese shoppers move towards using them for weekly shops and buying non-food products in one location.

Department stores, on the other hand, will begin to lose share, as specialists open stores to give their brands higher visibility and have tighter control over their own fortunes. The Chinese department stores were popular destinations for clothing, but the expansion of shopping malls and the entry of international clothing specialists have made malls fashion destinations. And online is making consumers far more aware of non-domestic brands.

Following these trends, domestic players are making greater efforts to build their brands and increase brand visibility. Similarly, some of the well-established international players such as Zara, Uniqlo, H&M, Gap and Marks & Spencer are devising strategies to penetrate into the lower-tier cities in China, to improve their market presence.

4.8 Spend per channel (%), 2013 and 2018e



OVERVIEW OF CHINA'S BIGGEST RETAILERS

As international retailers continue to expand their presence in China, their examples of operational efficiency will in turn continue to strengthen the efficiency and competitiveness of its domestic players. So who are the major domestic and international retailers to be mindful of?

4.9 Major domestic retailers in China

Retailer	Clothing	Footwear	Books, news and stationery	Electrical and electronics	Food and grocery	Furniture and floor coverings	Home and garden products	Music, video and entertainment software	Sports and leisure equipment	Jewellery, watches and accessories
China Resources Enterprise					★					
Suning Appliance Company				★						
Lianhua Supermarket Holdings					★					
Peak Sport Products									★	
Belle International Holdings		★							★	
Chow Tai Seng										★
Meters/Bonwe Group Shanghai	★									
Tmall.com			★	★		★	★		★	
Dangdang			★				★			
GOME Electrical Appliance				★			★			
Vipshop Holdings	★									
VANCL Chengpin Beijing Technology	★									
Xinhua Bookstore			★							
Jingdong Mall			★	★						
Rainbow Department Store	★									

SOURCE: Conlumino

4.10 Major international retailers in China

Retailer	Clothing	Footwear	Books, news and stationery	Electrical and electronics	Food and grocery	Furniture and floor coverings	Home and garden products	Music, video and entertainment software	Sports and leisure equipment	Jewellery, watches and accessories
FamilyMart					★					
7-Eleven					★					
Chow Tai Fook Jewellery Group										★
Inditex	★									
Newegg				★						
Ikea						★				
Kingfisher							★			
Amazon.com			★	★		★		★		
Brown Shoe Company		★								
Staples			★							
Carrefour					★		★			
Luk Fook Holdings (International)										★
H&M	★									
Page One Group			★							
Adidas									★	
Nike									★	
Jiangsu Five-Star Appliance				★				★		

SOURCE: Conlumino

INSIGHT INTO THE OPERATIONS OF SOME OF THE MOST SIGNIFICANT RETAIL OPERATORS

CHINA RESOURCES VANGUARD

CRV is a multi-format retailer, operating over 4,000 stores in China. It operates as a subsidiary of China Resources Enterprise, which is a conglomerate company with operations in retailing, food processing and distribution, beverage, textiles and real estate across Hong Kong and mainland China. CRV's retail formats are mainly hypermarkets, supermarkets and convenience stores: Vanguard, Suguo, Ole, Vango, Pacific Coffee, VIVO mining live and Ode to Joy. It also sells online via its websites Crvmore.com and Crvanguard.com.hk and manages various subsidiaries including Suguo Supermarket.

It operates in 31 provinces and 100 cities across China & Hong Kong.

CRV'S ONLINE BUSINESS HAS HIGH GROWTH POTENTIAL FOR THE CONVENIENCE IT OFFERS TO ITS CUSTOMERS, THE TRUST THEY HAVE IN THE BRAND AND THE GENERAL GROWTH TREND IN THIS CHANNEL

The business has scale and geographic coverage with a diverse range of brands and formats. It is continuing to expand with new stores and acquisitions and its brands are well known to Chinese consumers.

Its online business has high growth potential for the convenience it offers to its customers, the trust they have in the brand and the general growth trend in this channel. It is also moving into other areas such as coffee shops which complement its existing offer.

The company faces intense competition from both domestic and international players as they expand their own store networks. Companies like Walmart and Auchan have scale and big promotional and marketing budgets, and can use price as a way of gaining market share from competitors. Any price war would have an impact on CRV's margins.

LIANHUA SUPERMARKET HOLDINGS

Lianhua Supermarket Holdings along with its subsidiaries operates a total of 4,698 outlets spanning across 19 provinces and municipalities throughout the PRC. Its hypermarkets, supermarkets, convenience stores operate under the brand names of Century Mart, Lianhua Supermarket, Hualian Supermarket and Lianhua Quik.

Lianhua Supermarket operates 2,510 supermarkets, which include 653 directly operated supermarkets and 1,857 franchised supermarkets. It also has distribution and ecommerce operations.

Like CRV it is an established player in the market and well known to Chinese consumers, but faces more competition from the expansion of rivals and new entrants to the market, who benefit from international scale.

GOME ELECTRICAL APPLIANCES HOLDING

GOME is a big player in China. It retails electrical appliances and consumer electronic products across China and Hong Kong.

Its main fascia is GOME, but it also has Paradise and Dazhong Appliances, and is primarily found in first- and second-tier cities. It has a wide distribution and logistics network, and operates repair service stations and after-care services (it has an extensive warranty service). It has changed many of its stores into Xin Huo Guan flagship stores which are more stylish than its core stores and offer the opportunity to sell higher margin products.

GOME is a well known and trusted brand in the Chinese market so should benefit from the growth over the next few years as young consumers spend more in this sector. However, just as in mature Western markets, it faces price competition from non-specialists like hypermarkets, department stores and ecommerce sites. In order to keep its differentiation – the specialism and service it offers – it needs skilled customer service operators and finding these in a competitive job market will be challenging, especially as it expands.

LI-NING COMPANY

Li-Ning Company designs, manufactures and distributes a wide range of sports products such as footwear, apparel and accessories for sport and leisure use. The company retails primarily through the Li-Ning brand. It directly operates 700 of these stores, the rest are franchised.

Double Happiness produces high-quality table tennis equipment which is wholesaled to other retailers and the company is licensed to sell Lotto-branded products.

LI-NING FACES TOUGH COMPETITION FROM THE EXPANSION OF BIG GLOBAL BRANDS SUCH AS ADIDAS AND NIKE, WHICH ARE WELL KNOWN TO CHINESE CONSUMERS AND SPONSOR SPORTSPEOPLE ACROSS KEY MARKETS

The group retails its Z-DO brand via hypermarkets and sells its core brands via online flagship shops on third-party sites such as Taobao.com and Paipai.com.

It faces tough competition from the expansion of big global brands such as Adidas and Nike, which are well known to Chinese consumers so began sponsoring various sportspeople across key markets to drive up brand recognition. There is also a lot of counterfeiting in the sportswear market which can hit margins.

BELLE INTERNATIONAL

Belle International Holdings is one of the largest footwear and sportswear retailers in China. The company owns a total of 18,316 outlets in China, of these 11,516 are company-owned retail outlets in the footwear segment.

Apart from some of its major brands such as Belle, Teenmix, Tata, Staccato and Basto, the company distributes a range of foreign sportswear brands such as Nike, Puma and Converse. The company expects low single-digit growth in 2014, impacted by rapid growth in ecommerce and a surge in shopping mall space. In spite of this bearish market scenario, the company still plans to open around 1,000 retail stores in each of the next three years.

PARKSON DEPARTMENT STORES

Parkson department stores are owned by the Parkson Retail Group. The parent group operates in Malaysia, Hong Kong, Indonesia and the British Virgin Islands as well as in China. It has 57 Parkson-branded department stores located in 34 cities throughout the PRC. These are typical department stores, offering branded cosmetics and accessories, fashion and apparels, household and electrical goods, groceries and perishables. Its one Xtra-branded supercenter offers food and groceries.

Along with other department stores it is finding trading challenging as specialists expand and new entrants come into the market. It already has a very wide geographical coverage so this competitive landscape will worsen as the specialists expand further.

It has been revamping and remodelling its flagship stores, and these have performed better in general. This is an ongoing process.

4.11 Key food and grocery retailers in China

Retailer	Channel	International/ domestic	Store count (2013)	Revenue (¥m)
Lianhua Supermarket Holdings	Hypermarket, supermarket, convenience store	Domestic	4,637	30,380
China Resources Enterprise	Hypermarket, supermarket, convenience store	International	4,425	N/A
Long Hui Supermarkets	Supermarket	Domestic	292	N/A
Sun Art Retail Group	Hypermarket	Domestic	323	86,195
Wumart Stores	Superstores, minimarts	Domestic	547	18,886.3
Walmart	Hypermarket	International	395	N/A
Carrrefour Hypermarket	Hypermarket	International	236	N/A
7-Eleven	Convenience store	International	2,001	N/A
FamilyMart	Convenience store	International	1,031	N/A
Lawson	Convenience store	International	391	N/A

SOURCE: Conlumino

KEY DOMESTIC AND INTERNATIONAL RETAILERS BY SECTOR

Figures for many of the domestic retailers in China can be difficult to obtain, but the following gives an overview of the retailers dominating each category and an indication of the scale of their operations

4.12 Key clothing retailers in China

Retailer	Channel	International/ domestic	Store count (2013)	Revenue (¥m)
Rainbow Department Store	Department store	Domestic	60	N/A
Parkson	Department store	International	57	17,211
VANCL Chengpin Beijing	Online store	Domestic	N/A	N/A
Vipshop Holdings	Online store	Domestic	N/A	N/A
Inditex	Specialist retailer	International	440	N/A
Uniqlo	Specialist retailer	International	225	N/A
H&M	Specialist retailer	International	205	1,660.8
Dangdang	Online store	Domestic	N/A	6,325.0

4.13 Key footwear retailers in China

Retailer	Channel	International/ domestic	Store count (2013)	Revenue (¥m)
Belle International Holdings	Specialist retailers	Domestic	13,183	22,277.7
Daphne International Holdings	Specialist retailers	Domestic	6,319	N/A
Walker Shop	Specialist retailers	International	932	N/A
New World Department Store	Department store	International	43	N/A
C Banner International	Specialist retailers	International	2,286	N/A

SOURCE: Conlumino

4.14 Key electricals retailers in China

Retailer	Channel	International/ domestic	Store count (2013)	Revenue (¥m)
GOME Electrical Appliances	Specialist retailer	Domestic	1,075	56,401
Suning Appliance Company	Specialist retailer	Domestic	1,568	N/A
D.com (Jingdong Mall)	Online retailer	Domestic	N/A	N/A
Tmall.com	Online retailer	Domestic	N/A	N/A
Jiangsu Five Star Appliance	Specialist retailer	International	189	N/A

4.15 Key sports and leisure retailers in China

Retailer	Channel	International/ domestic	Store count (2013)	Revenue (¥m)
Adidas	Specialist retailers	International	7,600	N/A
Li Ning Company	Specialist retailers	Domestic	5,915	5,824.0
ANTA Sports Products	Specialist retailers	Domestic	7,737	7,281.3
361 Degrees International	Specialist retailers	Domestic	7,299	3,583.5
Peak Sport Products	Specialist retailers	Domestic	6,012	1,044.352
Belle International Holdings	Specialist retailers	Domestic	19,077	13,971.4

4.16 Key furniture and floor coverings retailers in China

Retailer	Channel	International/ domestic	Store count (2013)	Revenue (¥m)
Tmall.com	Online retailers	Domestic	N/A	N/A
Kinhom Group	Specialist retailers	Domestic	300+	N/A
IKEA	Specialist retailers	International	16	N/A
Da Vinci Furniture	Specialist retailers	International	12	N/A

4.17 Key home and garden products retailers in China

Retailer	Channel	International/ domestic	Store count (2013)	Revenue (¥m)
Tmall.com	Online retailers	Domestic	N/A	N/A
Dangdang	Online retailers	Domestic	N/A	6,325.0
M18	Online retailers	Domestic	N/A	N/A
GOME Electrical Appliances	Online retailers	Domestic	N/A	56,401
B&Q (Kingfisher Group)	Specialist retailers	International	39	4,241.5

SOURCE: Conlumino

INTERNATIONAL CASE STUDIES

The lessons to be learnt from the successes and failures of international retailer entry into the Chinese market is to adapt your offer to suit Chinese consumers and their lifestyles – never to think a one-size-fits-all proposition will succeed. Getting local knowledge through on-the-ground partners, and having your own teams in the country building up in-house knowledge is a factor in success

TESCO

Tesco entered China in 2004 and has built up a chain of 134 stores, mainly hypermarkets, with a few Express formats. These are mainly located in the east around the Shanghai, Tianjin and Liaoning provinces.

In scale it lags behind other international chains such as Walmart and Carrefour, and incumbent brands, and had failed to make a deep impression on the Chinese food and grocery shopper who has no particular loyalty to supermarket retailers. Though as an international brand it is trusted for food quality and safety, it does not stand out as particularly different to other hypermarket chains and had failed to engage significantly with the Chinese shopper.

Tesco's sales in China for the year end 2013 were £1.7bn, but its losses were £72m, and to gain any kind of efficiencies it would have to expand considerably, but with problems in its home market and poor performances generally in its international businesses, this was not an option.

So in September 2013 Tesco announced it was entering into a joint venture with one of the largest supermarket operators, China Resources Enterprise (CRE), which had built up a chain of nearly 3,000 Vanguard supermarkets in China in a little over 15 years. Tesco acknowledged that it will benefit from CRE's strong brands, its deep understanding of local Chinese customers, established nationwide infrastructure, local sourcing skills, strong property development and management skills, and probably most significantly its deep and established local, regional and national government relationships.

IN SCALE TESCO LAGS BEHIND OTHER INTERNATIONAL CHAINS SUCH AS WALMART AND CARREFOUR, AND FAILED TO MAKE A DEEP IMPRESSION ON THE CHINESE GROCERY SHOPPER WHO HAS NO PARTICULAR LOYALTY TO SUPERMARKET RETAILERS

These connections are still essential in China to speed up any kind of business development.

While Tesco brings its retail practices, international sourcing and digital/ecommerce capabilities, its share will only be 20%, demonstrating its junior status, and how it is being absorbed into a far bigger business.

BEST BUY

In 2006 Best Buy was virtually the last man standing in the US electricals sector and needed to find new growth avenues. Moving into China seemed like a good idea – a huge market with a growing middle class. It bought a 75% share in one of the largest electrical specialists in China, Jiangsu Five Star Appliance, intending to use this as a vehicle to launch the Best Buy brand and format on to the Chinese market.

It believed its low prices and famed customer service would set it apart from competitors and appeal to the new middle classes. By 2008 it had trained up local staff and opened its first Best Buy big-box store (followed by another seven).

What it had misjudged was the Chinese consumers' willingness to change their style of shopping to suit Best Buy – an unknown brand to them. The Chinese are price led and like to do a deal when shopping. They perceived Best Buy as an expensive incomer offering largely the same products and brands as the market leaders, but at fixed prices, unlike competitors whose staff were allowed to do deals on price.

WHAT BEST BUY MISJUDGED WAS THE CHINESE CONSUMERS' WILLINGNESS TO CHANGE THEIR STYLE OF SHOPPING TO SUIT THE RETAILER – AN UNKNOWN BRAND

Competitors' employees were working on commission so had a real incentive, whereas Best Buy employees were on fixed wages. The offer of warranties and service was also considered an extra expense – consumers were used to getting repairs done locally and inexpensively. The large-format store had little pull as most Chinese prefer to shop nearby to avoid traffic jams.

Its main competitors, Suning and GOME, fought back aggressively, and with much larger scale, brand recognition and lower costs easily fought off Best Buy. The company closed all nine branded stores in 2011 and although it provides corporate support for Five Star (which it now owns 100%), the stores adapt their ranges to local demand.

BURBERRY

In July 2010 Burberry acquired the stores and related assets of its long-standing Chinese franchisee Kwok Hang Holdings. The franchised business had operated in China for nearly 20 years and by then had 50 stores across 30 cities, including nine stores in Beijing and four in Shanghai. Burberry had high brand recognition among the Chinese but the retailer wanted to be able to manage its expansion by having complete control of its brand image and proposition.

The operational management was transferred to its Asia-Pacific team, run by an executive with more than 10 years' experience of the luxury industry in China. The management then applied Burberry's global marketing, retail, merchandising and IT disciplines to the business to give it a consistent global identity and began opening more stores.

Not only is Burberry enhancing its brand status to Chinese consumers in China but globally as well. Chinese luxury tourists receive the same high level of service wherever they are. Over 150 Mandarin-speaking associates have been integrated into its teams in top tourist destinations outside Asia, and of course its digital prowess means Burberry reaches Chinese consumers with dedicated content across multiple Chinese platforms.

NOT ONLY IS BURBERRY ENHANCING ITS BRAND STATUS TO CHINESE CONSUMERS IN CHINA BUT GLOBALLY AS WELL. CHINESE LUXURY TOURISTS RECEIVE THE SAME HIGH LEVEL OF SERVICE

It has just opened a new flagship in Shanghai. Inspired by its Regent Street store, it has 40 video screens and 130 speakers throughout the store, and has a programme of live events planned including a launch event that offers WeChat followers the opportunity to experience the event on its platform.

This engages with the younger aspirational consumers as much as the typical luxury shopper and ensures even higher brand status for Burberry.

Indeed having the strength of proposition that gives a retailer global brand status appeals as much to Chinese consumers as any others – especially in apparel and accessories – and is a reason Inditex' mass-market brands have done so well there (the global fashion giant has about 500 stores in China already).

CHAPTER 5

CHINA'S LEGAL LANDSCAPE

- The inconsistent enforcement of laws and regulations is a potential minefield, and is a major consideration for anyone looking to launch in China
- Retailers need to be aware that Hong Kong and China operate completely different legal systems
- One of the biggest legal issues is the regional differences between the application of laws, and so localised advice is essential
- Rising costs of property rental for retailers seeking a physical presence in China pose challenges
- The Consumer Protection Law, which came into force in March this year, is part of the government's push to ensure the economy is driven by consumers

UK retailers contemplating the move into China need to be prepared for an undulating and unpredictable legal landscape. Not only must they contend with a different legal system, but also with the potential minefield of inconsistent enforcement of laws and regulations.

One pitfall to avoid is thinking that Hong Kong and China have similar legal challenges. Hong Kong has a more accommodating common law regime. As a former British colony, its laws were originally founded on equivalent English legislation and its legal framework, while now entirely separate, is still largely based on and draws its focus from English law and the precedents set by the English courts.

Meanwhile, China operates a civil law regime for foreign businesses to grapple with. Not only is the legal system completely different to that of Hong Kong, another challenge is the fact that law enforcement varies from one region to another.

There are numerous processes that need to be followed before launching in China, such as the need to get employment visas for any foreign nationals being sent into the country, as well as getting a business licence through the Ministry of Commerce or the equivalent local authority, which can be time consuming.

"The total estimated time to set up a retail business in China is approximately six to nine months and most of this time is spent on the preparation of necessary paperwork, organising the board members and finding a suitable location for the retail establishment," says Karmen Yeung, China tax partner at KPMG.

While there are numerous routes to take to market for UK businesses wishing to sell in China, which each bring with them their own specific bureaucracy issues, there are key legal considerations for retailers to bear in mind.

REGIONAL DIFFERENCES

One of the biggest challenges for foreign retailers planning to tap into China's potential is the regional differences between the application of laws. "China has national laws and regulation. However, at the same time those laws can be applied in a very different way according to the different regions within the country," says Ravenna Long, legal manager at international law firm Eversheds. "This is extremely important for businesses to understand because we can give advice on what the law is in general, but a lot of the time we are suggesting to our clients that they get very localised advice because each region may apply that law differently, and will look to favour its own local businesses and enterprises, even over national businesses, and then of course above international businesses."

While regulation and getting process approval in China has improved, differences in the application of laws can remain. Seeking local advice is a must for foreign retailers. "Local authorities can be quite protectionist, and that will apply to numerous laws, whether it is antitrust, technology regulations, product testing, customs duties – it's enforced region by region," says Long. The desire to protect their own businesses is prevalent both in city and rural locations. Local authorities are likely to interpret laws in a way that suits their own local commerce and commercial interests.

PRODUCT LABELLING AND TESTING

With some foreign investors reducing the level of product manufacture that takes place in China, an awareness of the requirements around product labelling and testing are increasingly relevant. All consumer goods being imported to ▶

OBTAINING BUSINESS LICENCES

During the launch process in China, obtaining a business licence is a two-phase process: firstly obtaining the licences with a wholesale scope and, secondly, adding the retail scope to the licences.

"This phased approach is preferred because if companies try to obtain licenses for both wholesale and retail business at the start, they will have to rent a retail shop at first and wait for more than six months before they can begin operations," explains KPMG's Karmen Yeung. As such, dividing them into two phases is more efficient and cost saving. Both processes require applications with at least 10 government agencies. Those 10 agencies are:

- Administrative Bureau for Industry and Commerce
- Ministry of Commerce of PRC
- Public Security Bureau
- Technical Supervision Bureau
- Tax Bureaus (Local Tax Bureau and State Tax Bureau)
- State Administration of Foreign Exchange
- Finance Bureau
- Statistics Bureau
- Customs Bureau
- Fire Department

SOURCE: KPMG

China need to be labelled and safety tested in line with Chinese laws and standards before they enter the market. At the point of entering the Chinese market, the products will then be verified by customs to confirm that they meet the standards imposed on them.

"They may also then be subjected to subsequent testing once they have arrived at the local distributor's warehouse or in store," explains Long. "In a way it is a double layer of testing, which means that it can be quite rigorous and daunting for retailers coming from overseas."

Foreign retailers should also be aware that regional differences can also have an impact here too. For instance, in a city such as Shanghai, if a product fails a safety test on arrival at customs then the authorities may permit a company to produce its own safety testing records, which the authorities may then take into consideration to decide whether the products can be re-tested. However, in Wenzhou, the authorities may take a company's own safety tests into account even at the initial testing stage at customs, as well as in subsequent applications by a company to re-test such products, explains Long.

Responsibility for product testing lies with whoever is importing the goods.

IMPORT DECLARATIONS

When importing goods, retailers need to be particularly conscientious, particularly around getting the customs value and tariff classification right. "Import declarations should be made as accurate as possible since even small variations in value or tariff classification could potentially trigger customs challenges and penalties," says Yeung. She adds that even where companies use brokers, the ultimate responsibility for declaring accurate information still falls to the importer on record. "All brokers should therefore be closely supervised to ensure that the correct information is declared," says Yeung.

Many multinational companies are now thinking about investing in Global Trade Management (GMT) software solutions to give their head office visibility on the information that is actually declared to the customs authorities, which allows them to regularly run reports and gauge the performance of their customs brokers. Even once the goods are in China, customs records of the merchandise should be kept by the retailer because customs audits can be undertaken at any time.

PHYSICAL RETAIL SPACE

For those retailers looking to enter China with a physical store presence, securing space is – particularly in the retail hubs – one of a number of challenges. "As a result of [the shortage of space] the retail space that is available is extremely expensive and prices are rising astronomically year on year," says Long. "We are looking at 5% to 8% increases, so that's something that is definitely a concern."

As well as the rising costs of property rental, retailers need to be aware that many leases are short term, and the rent payable for leases is tied to revenue performance of the store, placing extra pressure on the retailer's profitability. "It can be volatile and quite expensive," explains Long.

The cost of rental is just one of the factors that is encouraging retailers to consider etail as their means for selling into China, allowing them to import from home markets into China and Asia. In fact, 6% of China's overall retail market is focused on ecommerce. "UK retailers don't have to launch in China with a physical store presence, and if they do go down the physical store route, they just have to be prepared to pay a lot, and for it to be a very competitive market," says Long.

ANTITRUST REGIME

With a similar concept and a similar aim as the competition regime in the UK, the antitrust regime is intended to make sure businesses do not have too much of a market share in their relevant market, whatever that may be. This can prove problematic for retailers because of the fact that it is a well-developed system that can prove quite a surprise for retailers coming over from the UK. Authorities can, for instance, block mergers with Chinese companies because they perceive them as having too dominant a share in the market. It is something that is actually quite monitored and something that people should be aware of," says Long.

Media reports last year suggested that foreign investors in China have expressed concerns that they are being targeted in official investigations of pricing practices and to potentially block some mergers and acquisitions.

TECHNOLOGY TRANSFER REGULATIONS

The Chinese technology transfer regulations apply to retailers that are developing software technologies or the knowledge around the development of that technology. It governs the import or export of the software and knowledge into and out of China. For instance, where a company is setting up a licensing agreement with a Chinese company, the regulations can apply whether they are providing the software technology or being provided with it. The regulations require that, for example, the associated licensing agreement or distribution agreement between the parties is registered with the local authorities. "If the relevant contract isn't registered, there's a risk that the contract may not actually be enforceable and there might be issues with getting foreign exchange to pay for whatever the goods are that are being transferred. That can have some quite serious implications," says Long.

NEW CONSUMER PROTECTION LAW

Revision to the Consumer Rights Protection Law of the People's Republic of China, an amendment to legislation enacted 20 years ago, came into force in China on March 15 this year. It appears to be intended by the Chinese authority to offer greater protection to consumers. It means that retailers must take back goods returned within a seven-day period for a full refund, and in the case of web-based purchases without reason.

The government is keen to ensure growth of the economy is driven by consumers. While it is such early days that the impact of the law is as yet unknown, retailers looking to invest in China should be aware of potential implications and the move towards more consumer protection. This might create an advantage for Western companies over their Chinese counterparts as they are already familiar with working with consumer rights protection regimes in their country of incorporation.

"It will be different for companies already operating in China because previously they had no obligation to accept the return of a product – unless they had a fault or a similar issue – so suddenly you are going to have to look as a business to the implications of dealing with refunds and so, that could be quite serious," says Long.

"IMPORT DECLARATIONS SHOULD BE AS ACCURATE AS POSSIBLE SINCE EVEN SMALL VARIATIONS IN VALUE OR TARIFF CLASSIFICATION COULD POTENTIALLY TRIGGER CUSTOMS CHALLENGES AND PENALTIES"
Karmen Yeung, China tax partner, KPMG

CHINA'S LEGAL LANDSCAPE
DEMANDWARE ANALYSIS

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- The challenges of the legal landscape and acquiring the necessary licences to begin trading can add months to the time taken to enter this attractive market. While many begin the process as 'cross-border trade', this process is largely unsustainable in the long run. Brands often use their 'Western-based' legal entity to provide products to local market in the early stages of market entry. However, in the long term it's important to establish relationships with providers who have local operations in China. These providers can take care of the delivery and return processes, and can offer local warehouses and fulfilment centres.

- In the long term, establishing a local entity or at least a local team is essential to getting the most out of this market. It will help retailers recognise and implement local best practices and understand the nuances of each region and demographic. As the penetration of smartphones reaches saturation, broadband connectivity expands and tier-two cities begin to exert greater economic force, this market will continue to change. Having a local team or local partner will help retailers react to changes and progress as central reform gears the Chinese economy more closely to consumer spending.

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