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SPOTLIGHT
CHINA'S BURGEONING ONLINE CONSUMER MARKET

2014

This publication

This document was published in June 2014. The data used in the charts and tables is the latest available at the time of going to press. Sources are included for all the charts. We have used a standard set of notes and abbreviations throughout the document.

Foreword
CHINA'S BURGEONING ONLINE CONSUMER MARKET

While growth rates in excess of 100% per annum may be a thing of the past, China's online sales continue to greatly exceed growth rates recorded in the physical market. In 2013, online shopping sales grew by 39.4% to RMB1.8 trillion, while the growth rate over the next four years is expected to record a compound annual growth rate (CAGR) of 22.3%, reaching RMB4.5 trillion by 2017 which will be the equivalent of 13.8% up from the current level of 9.4%.

Online sales platforms have greatly advanced the Chinese retail industry, captivating consumers by launching promotions, price discounts, apps and advertisements. As online sales platform leaders, such as Tmall, continue to introduce retailers to open virtual stores and narrow the price gap between domestic and overseas markets, consumers are encouraged to explore more of the online market, which makes some traditional stores seem increasingly outmoded.

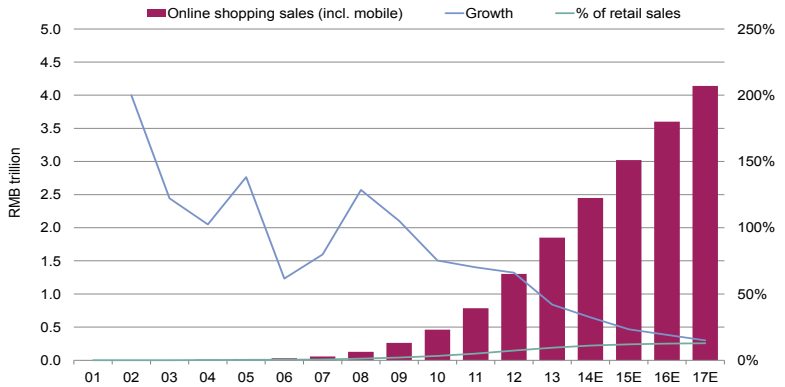
Despite online retail sales recording phenomenal growth in recent years and being viewed by many as the darling of the Chinese consumer growth story, online participants have a more nuanced view of the industry. Online retailers, while being able to reach a larger consumer base and with fewer fixed overheads in terms of retail rents and shop assistants, are faced with growing competition in this nascent market, and while some expenditures have disappeared, other have arisen. Retailers operating online stores have to spend money on warehousing and logistics costs, while smaller, lesser known retailers will have to spend a great deal of money on an ongoing basis to develop site traffic, all of which will eat into profit margins, especially as the market matures.

B2C

Although both the B2C and C2C models are expected to record consistent growth over the next five years and beyond, growth in the B2C model is expected to outstrip C2C as more retailers enter the market, competition continues to increase and promotion expenditures rise. This is in addition to the inherent distrust of product quality when sold by individuals rather than established and well renowned firms. The B2C model, while currently accounting for just more than one-third of online sales, is expected to rise to more than half of sales by 2017.

GRAPH 1

Growth of retail sales vs online shopping sales, 2011–2017E



Source: Iresearch, Savills Research

Executive summary

The key findings in this issue

- Online retail sales have experienced rapid growth, although growing maturity and a larger base of comparison will check growth rates going forwards. See pages 3/4
- While the increasing utilisation of online platforms will lower entry barriers for new retailers and start-ups, popular brands are expected to be the biggest winners as strong branding and reputation, as well as heavy investment in online environments, win and retain customers.
- Price gap between China and overseas pushed some consumers to seek online channels for cheaper prices.
- Omni-channel can be utilised by landlords to augment the physical experience in shopping malls.
- Retail landlords will have to focus on asset management, in all its varied forms, as a point of differentiation, with location or size of mall diminishing in importance. See page 8
- Blurring the barriers of online and offline experiences will be a key trend for future retail formats. See page 6/7

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ONLINE BUSINESS RETAILERS

"As online stores can benefit from larger geographic reach and economies of scale, they are considered to have high potential future growth."

James Macdonald, Savills Research

More and more retailers are embracing online sales and are turned it to their advantage, rapidly developing an online presence and creating multi-channel retailing to tap into the growing consumer market. In Shanghai, transactions on the Tmall and Taobao sites on 2013's Singles Day (11 November) were already equal to average daily retail sales in the physical market. In 2012, eight online retailers, including Tmall, JD and Amazon, were listed in China's top 100 chain stores, contributing 14.5% of total retail sales for those 100 retailers and 49.6% of the growth rate.

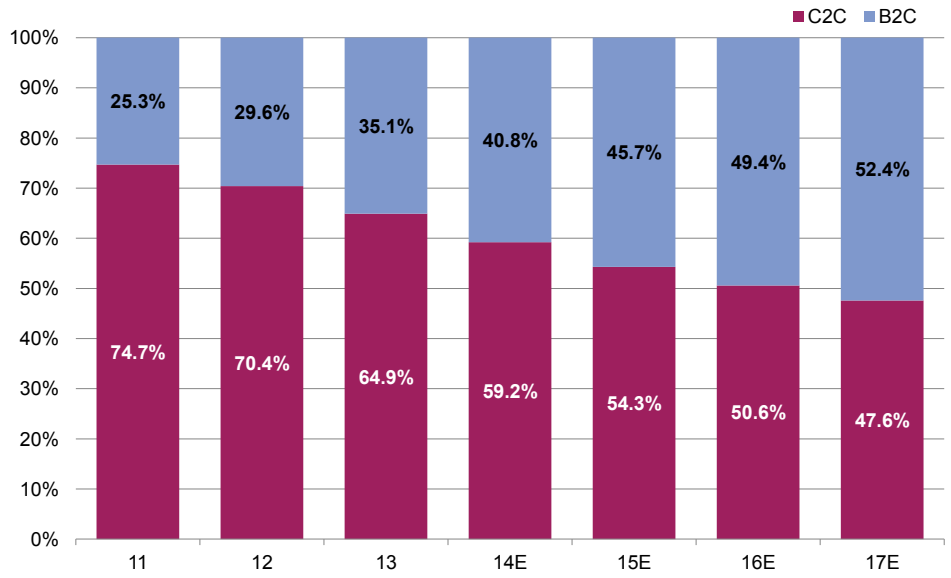
Retailers can choose to either establish a standalone online platform or develop one within a leading online platform, such as Tmall. Others will choose to manage both types of online stores. Bailian Group, China's leading department store operator, even developed its own payment system, applying it to both physical and online stores.

The degree of online penetration is highly dependent on the retailer's background. Domestic brands have been far more aggressive in expanding online, with many having opened stores in five to six online platforms. International brands, by contrast, are relatively conservative, with the exception of a few early entrants to the China market, such as Giordano and sports brands Nike. Many international retailers are very selective and focus on just Tmall and standalone online stores at present.

Tmall is currently the first choice for many brands, both domestic and international, who wish to tap the online market in China. With around a 50% share of China's online B2C market, its open platform has a convenient payment system, while also providing retailers with the flexibility to design their own online environments.

GRAPH 2

Breakdown of online sales, 2011–2017E



Source: Iresearch, Savills Research

Cost analysis

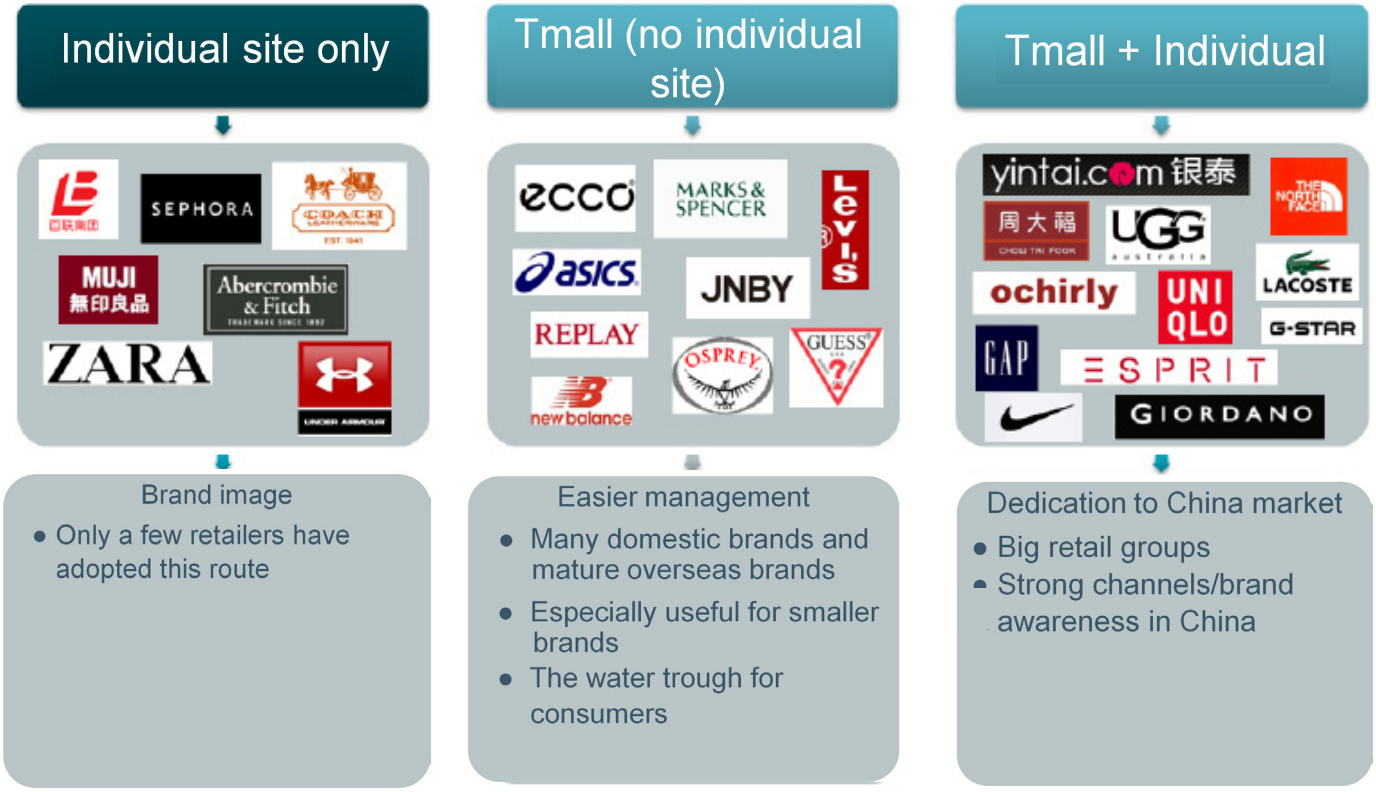
Leading online sales platforms charge a basic service cost equivalent to 5% to 10% of sales turnover. After the addition of promotion/advertisement and delivery costs, which tend to be significantly higher than physical stores, the cost of operating a Tmall store (excluding manpower) accounts for around 15% of turnover – not too dissimilar to the cost of a moderately successful physical store. The key difference is scalability and geographic reach, and therefore future growth potential.

Nationwide coverage and platform notoriety are the key selling points attracting both mature retailers and new entrants to establish a presence on Tmall. Online sales platforms are an essential channel for mature brands to distribute products, and an ideal stepping stone for new brands to understand the younger generation of Chinese consumers.

Despite a lot of hype about the explosion of e-commerce foretelling the end of bricks and mortar as we know it, the data does not yet fully support this. According to an analysis of sales on Tmall sites, some of the largest retailers are able to sell 200,000 to 400,000 items per month. However given average prices are roughly RMB100, equating to RMB650,000 to RMB1.3 million per day, this is not a significant figure considering the national coverage of online business. Bricks and mortar stores are still the bread and butter of many retailers' businesses, with online sales the metaphorical icing

GRAPH 3

Retailers' entry into online



Source: Savills Research

TABLE 1

Annual rental comparison of physical and Tmall stores

	800-sq m flagship store	120-sq m specialty store
First-tier city, prime location shopping mall	Rent: RMB12 million or 5–8% turnover Property management: RMB600,000	Rent: RMB2.2 million or 10–18% turnover Property management: RMB90,000
Second-tier city, prime location shopping mall	Rent: RMB4.5 million or 5–8% turnover Property management: RMB400,000	Rent: RMB0.9 million or 10–20% turnover Property management: RMB60,000
Department store	5–10% turnover	20–30% turnover
Tmall	Service: 5% turnover plus RMB60,000 per year (can be returned if sales target is met)	
360buy	Service: 8% turnover plus RMB6,000 per year excluding delivery	
Amazon	Service: 10% turnover excluding delivery	

Source: Savills Research

on the cake. The slowdown in store openings is more importantly a result of over zealous retailers assuming that the 20%+ growth rates would last for another decade and consequently opening up stores to service this increased demand. As the economy slows, consumers are becoming more frugal and retail sales have followed the fall in GDP growth rates, with retailers finding themselves overextended for this brave new world of slower growth.

At the same time as seeing slower sales, retailers are faced with ever more demanding consumers and fierce competition. While a standard store acting as a POS may work well in certain community malls and lower tier cities, consumers expect more in the leading prime retail markets. Stores have to become more welcoming to consumers, more trendily designed, have better trained and more knowledgeable shop assistants, and increasing offline-to-online (O2O) interactivity.

PRICE GAP

Irrespective of the price tag, be it daily necessities or RMB10,000 plus handbags, the key attraction of online shopping is still attractive pricing.

Online shopping has also expanded the reach of Chinese consumers beyond national borders. Both domestic and international online sales platforms are starting to offer overseas products with global delivery at competitive pricing. This allows Chinese shoppers to take advantage of the lower price of goods in overseas markets, although some of these savings are offset by the expensive shipping costs. Even taking into account the delivery fees, buying overseas still often looks worthwhile compared with domestic prices. A comparison of a range of prices of luxury and fast-fashion goods indicates that prices in China were approximately 17% higher than those of Hong Kong by the end of 2013, compared with 23% in 2012.

Taxation, pricing strategy and a strengthening renminbi are the main causes for the persistent price gap. In 2013, the exchange rate of RMB/US$ continued to grow by 3.0%, making many overseas products look cheaper to Chinese consumers. Domestic taxation also means an extra 30% to 200% price premium for the same products overseas.

Some brands have adopted higher pricing in China in an attempt to raise the brand image in the mainland. Nevertheless, as Chinese shoppers become savvier, have access to more information and travel more, they will discover the China tax which is being applied to goods purchased in China and will look for ways around paying these premiums, either by travelling overseas to buy products, having products delivered from overseas, or waiting for sales seasons, outlet shopping and seasonal promotions.

As access to products increases, there will be a rising arbitrage between price points, reducing the gap between offline and online prices and domestic vs overseas pricing (with the exception of taxes and duty variances). At present, international fast-fashion groups have already narrowed the gap between domestic and overseas prices, with an average price premium over Hong Kong of only 7.0%. Brands such as Uniqlo already have fairly uniform prices both in Hong Kong and mainland China, and also between their online and offline stores.

TABLE 2

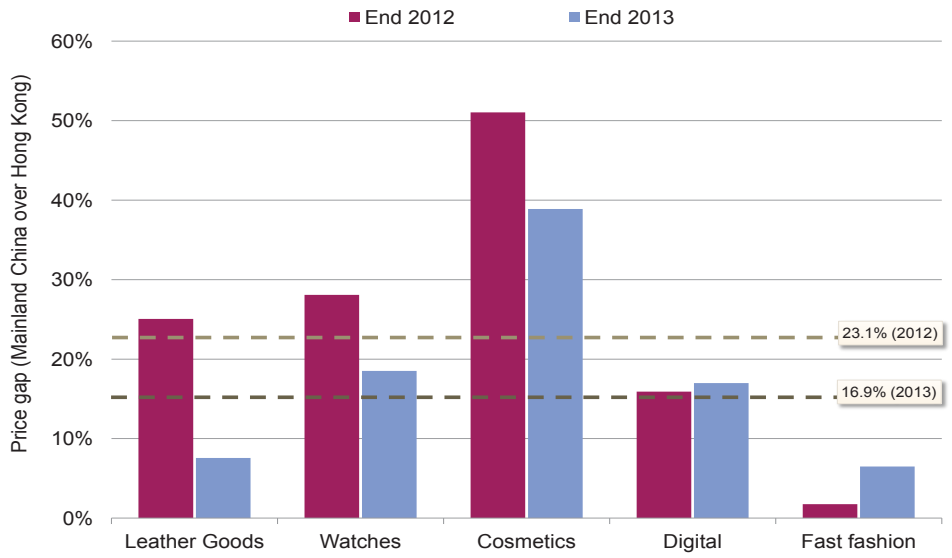
Consumption and import tax in China

Category	Consumption tax	Import tariff
Alcoholic drinks, alcohol		
Distilled spirits	20% +RMB0.5 per 500 g (or 500 ml)	10–180%
Rice wine	RMB250 per tonne	44.5–180%
Beer	RMB220–250 per tonne	0%
Other alcoholic drinks	20%	10–180%
Alcohol	5%	40–100%
Cosmetics	30%	10–150%
Jewellery and precious stones	5–10%	20–130%
Golf balls and tools	10%	12–50%
Luxury watches	20%	11–100%

Source: BofA Merrill Lynch, Savills Research

GRAPH 4

Mainland China vs Hong Kong price comparison



Source: Savills Research

OMNI-CHANNEL: LANDLORDS

Omni-channel can be utilised by landlords to augment the physical experience in shopping malls.

Omni-channel retailing may be a logical step for many retailers looking to boost total sales, but for shopping mall landlords, opening online platforms is much more complicated, as it is developing a whole new business strategy and business line. That said, some landlords (mostly domestic department stores) with a national network of projects and strong brand presence have started to operate their own online platforms, linking these to these to physical stores. Others have chosen to remain within the built environment, cautious about entering the online market as they are unable to compete with larger peers in terms of their geographical reach and ability to invest, manage and operate this very different business model. Time will tell which is the best strategy to adopt.

As many landlords have launched mobile apps for their projects, better utilisation of the data collected would be of greater assistance in maintaining customer loyalty.

The B2C platform brings many advantages: display of full product ranges, endless promotions, highlighting distinctive product and brand characteristics, developing customer loyalty through new communication channels. However, the biggest drawback is the inability to experience the product first hand.

Landlords should continue to emphasise and augment the advantages they can bring to retailers, namely the physical experience and retail environment which works upon the shoppers' senses – sound, smell, taste, touch and sight. Landlords have to evolve beyond the mindset of shopping centres as POS venues and focus on the other uses of shopping centres, such as gathering points for social activities. This can be partly achieved by increasing the allocation of retail space to F&B, lifestyle, service and entertainment venues, but they may have to go further than this is if they want to thrive in this new retail environment.

For fashion and accessories retailers, physical stores are still the most important medium to fully display their products and develop their brand image. A tastefully designed store which excites the senses is more likely to induce impulsive consumption and develop a meaningful impression with the consumer. Retailers wanting to give shoppers this experience will continue to drive demand in leading stores with a strong presence and proactive management team.

However, as the post 90s generation (the "i-generation" – i standing for internet, information, intelligence) grow up, join the workforce and become a key driver of consumption, retailers and landlords will have to

develop environments which are welcoming and familiar and native to this generation. A number of apps and websites support and bring to the forefront consumer reviews, promotional guides or coupon providers as a way of supporting sales of products and blurring the lines between online and offline.

Data windfalls

We live in an information age and data generated by the explosion in e-commerce usage is helping to inform retailers about consumer behaviour. Previously, retailers had to rely on cash registers and POS systems, loyalty cards, focus groups and surveys to try to understand their customers, and in the case of the last two, the results were based on consumers' intentions not their actual actions. POS systems are now being replaced by e-commerce sites which record every move consumers make, even when they don't buy something. Retailers can also monitor social media platforms to gain greater insight to consumer behaviour and experiences. Tangible benefits include:

- Personalisation

- Improving customer experience

- Pricing strategies

- Predictive analytics

- Managing supply chain using data

In-store promotions, payments and behaviour tracking

Consumers can scan merchandise using their smart phones before they put the items in their app carts. The scans also trigger in-store promotions, such as coupons delivered on smart phones. In addition, brands can use the app to provide more product information. When consumers are done shopping, they can hit the "check out" option and complete the order using their phones. Some apps can track a shopper's behaviour, such as the aisles frequented and the amount of time spent in the store, and match it with the consumer's final purchase. Retailers and landlords also can learn more about how their customers shop from the app.

Examples of omni-channel and the blurring of lines between online and offline

Problems with online deliveries – failed deliveries (people just don't like waiting in for deliveries)

Click and collect
Shoppers can visit online platforms, review products and prices, and then order a product to be picked up in store at a later date, and by doing this they are assured that the product is in stock. In the case of John Lewis, a UK retailer which only has roughly 40 stores in the UK, they also allow for pick up in their sister store, Waitrose, a supermarket chain with over 300 locations.

Online and smaller retailers have started turning to third-party providers with a network of small independent retailers across the country, that for a small fee, are willing to act as a pick-up point. They are happy for the extra income and foot traffic, and the spontaneous purchasers which come along with it.

Dead-drop lockers
Life can be hectic and if you are constantly on the road, socialising, in meetings or on business trips it can be hard to be in a specific location (home or office) at the right time when your online purchase is delivered. Amazon has come up with the novel idea of dead-drop lockers. Order online, choose an Amazon locker near where you will be in the next three days and wait until you get a message informing you that your order has been delivered to the designated locker. You will receive a code for the locker

In China there are already companies providing dead-drop lockers which act as redundancy delivery points if home delivery fails. One such service provider is 速递易.

ASSET MANAGEMENT

Asset management helps the project constantly respond to retail trends and consumer needs.

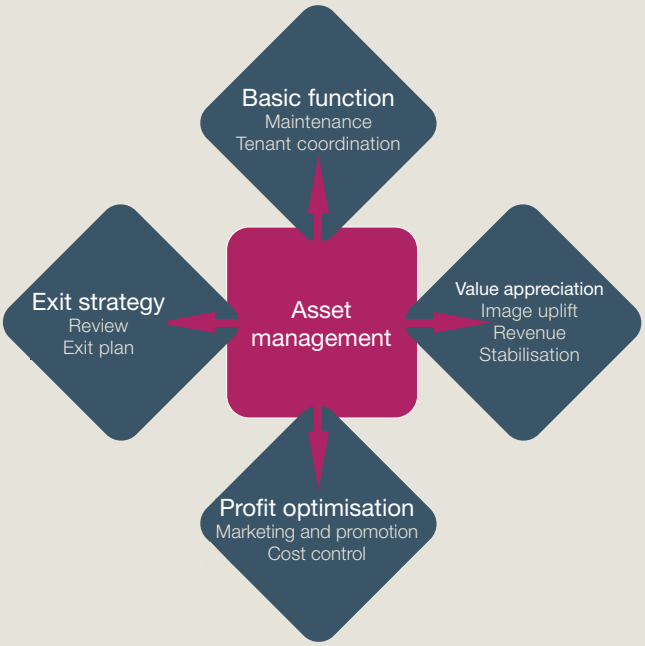
Online shopping, together with the economic slowdown and excess supply, has brought significant challenges to landlords. A strong asset management team can sometimes be the key between success and failure, now more than ever. This is something which has been underappreciated for a long time by all but the leading landlords.

Asset management helps a project retain and hopefully increase its value over a period of time, and covers not only property management (broadly characterised by building maintenance, cleaning and security), but also asset enhancement (reviewing the tenant mix, proposing capital improvement works, and advising the client on new leasing and marketing strategies), financial management, lease management (lease renewals, tenant relationship management, marketing promotions and other essential tenancy services), and positioning and strategic advice. Asset management should help to enhance and highlight the strengths of the project, while also mitigating some of the weaknesses, enabling the project to evolve along with tenant and consumer demands, and develop loyalty and an identity while extracting the most value out of the property.

The development of online platforms represents challenges and opportunities to asset managers, allowing them to utilise new online or mobile tools to promote their projects, analyse customer behaviour and retain their shoppers. Through the use of apps or social networking services (SNS), consumers can get first-hand information on shopping mall updates and immediately receive third-party reviews. A well planned narrative on an SNS can also bring more potential customers to a mall, creating a route by which to connect social experience both online and offline.

Since 2009, Savills has been appointed the asset management company for Mall 818 in Shanghai, assisting the landlord in adjusting leasing programmes, operating SNS and overall promotions.

GRAPH 5
Key functions of asset management



Source: Savills Research

OUTLOOK

Predictions that e-commerce will quickly replace the bricks and mortar side of the business are regularly bandied about. However, physical stores are unlikely to ever disappear and will continue to contribute the most significant sales avenue for most retailers for many years to come. Physical stores are seldom purely about selling products but form part of the marketing campaign and experience aspect of retail therapy. Online shopping is unlikely to drastically alter the face of the retail market, but is more likely to give it a face lift, keeping the market looking its best for the next 20 or so years, until the next innovation comes along.

For the retail real estate market, prime locations with high visibility and footfall are expected to weather the onslaught from e-commerce better than more decentralised locations, as they play an important role in building retailers' brand awareness and exhibiting products. Those with proactive management teams which work together with retailers to drive greater levels of communication and interaction with consumers will see tangible benefits in coming years, as retailers and consumers demand more than just point of sale (POS) stores.

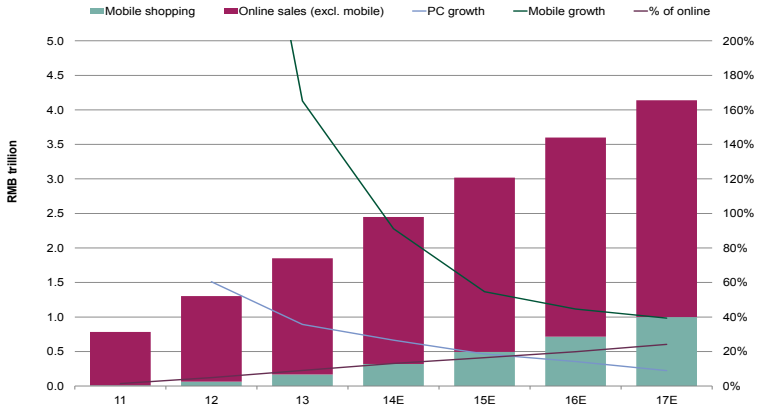
Retailers, landlords and online platforms should seek to combine online (promotion, convenience, virtual payment) and offline (experience, service, display, payment) services. Both online players and physical landlords will have to join forces to maximise each other's resources.

One of the best means to bridge the gap between the online and offline worlds is via mobile devices, which have become the most common interface between the physical and Internet worlds. Mobile usage in China has skyrocketed in recent years, just like many other countries in the world. While by global standards national figures lag behind, in built-up urban areas, particularly first-tier cities, adoption and usage is comparable to international peers. Mobiles are not only used for placing orders and processing payments, but are also utilised to share product reviews and information (often in store), track shipments and receive promotions/ coupons. As mobile devices become faster, smarter and more secure, their adoption within every facet of life is likely to increase with respect to Internet surfing, social media, media (music, TV, films, books), games, communication (calls, emails, texts), photos and indeed online transactions (payments, shopping, bills, taxis). Mobile phones are now an essential tool in urban life and they are never far away from a consumer's side, enabling constant interaction between the online and offline worlds.

The Internet has already changed the way consumers interact and view retailers. Retailers and landlords should not think in terms of how to attract consumers to either of the platforms but should instead think about the best way to meet the needs of the consumer using the full arsenal of tools available to them, whether it be offline or online or a combination of the two. With ever increasing retail supply and competition in online market places, only those who truly understand and meet consumers' demands will succeed.

GRAPH 6

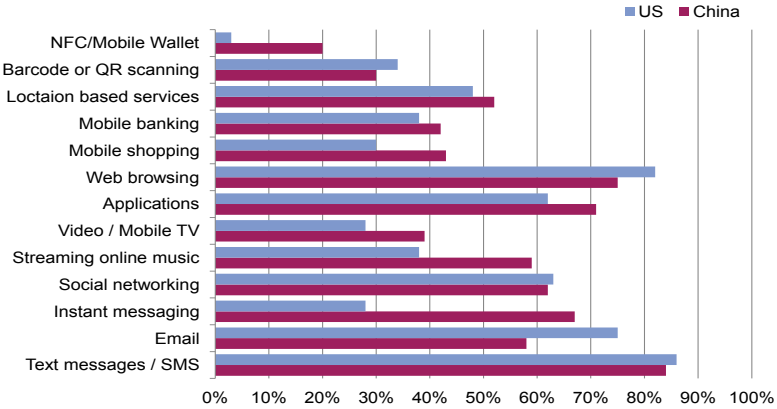
Mobile retail sales, 2011–2017E



Source: Savills Research

GRAPH 7

What do we do with our smart phones? 2012



Source: Nielsen, Savills Research

Our Services

Landlord Representation

Provide optimal solutions to maximise the potential returns through a successful tenant mix and line-up

Working with management teams to ensure schemes are attractive to both consumers and retailers

Retail management

Services include marketing, leasing, customer service, financial management, property management, etc

Providing an array of solutions to facilitate effective management in order to maintain market sustainability and profitability

Retail Consultancy

Initial project planning and concept design through to tenant mix and rental strategy by providing detailed research and advise

Working alongside architects and developers on design and concept ideas

Tenant Representation

Comprehensive range of services for companies entering or expanding within China while aligning client needs with goals and objectives

Detailed knowledge of local market dynamics, shopping behaviour and locations

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