savills
第一太平戴维斯

Savills World Research
China

SPOTLIGHT
CHINA 20 RETAIL CITIES

This publication

This document was published in March 2017. All economic data is from the end of 2015. Store number data is from the first half of 2016 unless otherwise specified.

Savills China retail cities study, which began in 2014, uses 16 series to determine leaders in two categories: “economic index” based on city’s macro economic figures and “retailer index” based on how many stores that 50 international brands opened in the city. Each of the series are weighted and aggregated to give a final score to each city.

A Transformative Market

Changes of consumer behavior, divergence of retailers strategies and competition between cities.

The retail market is of growing importance in China's economy. Consumption has increased by 9.6 percentage points (ppts) as a percentage of Gross Domestic Product (GDP) since bottoming out in 2007, standing at 44.7% of GDP in 2016.

China is now undergoing an economic transition, featuring a slowing down of investment and export growth. Since 2015, the hike of residential prices in key cities and slowing economic growth have made consumers more conservative in spending than before. Thanks to the development of the e-commerce market, mobile technology and cross-border buying, consumers are now able to buy products at globally competitive prices, putting pressure on physical stores in all segments.

The expansion rate of different retail categories best reflects changes in consumer behaviour. Among the eight categories and 60 brands we have tracked, mass fashion, where domestic prices are historically closest to global averages, achieved the strongest growth in our 20 key cities. Non-fashion categories such as cinema, entertainment and F&B brands are still growing, as are retailers catering to consumers' daily needs or with greater affordability. The luxury and jewellery sectors, which can expect to see their products sold at 20 to 50 percent above the global average due to taxes, taxes and pricing issues are focusing more on improving performances of existed stores and downsizing or closing some stores.

There are also winners and losers among the 20 cities we have tracked over the past three years. Shanghai and Beijing, the top two metropolitan cities in China, remain well ahead of other cities in terms of retailer penetration scores. However, their economic lead has narrowed due to slower growth and the higher cost of doing business. Larger second-tier cities have also benefitted from central government plans aiming to develop more leading cities, especially in the country's central and western regions, helping to maintain investment and economic growth.

From a regional perspective, the north has seen very few highlights in the past two years, with both economic growth and new store demand weakening. Central cities are up-and-coming retail markets, with notable regional hubs recording strong economic activity and retailer penetration. Changsha, the capital of the Hunan province, is one such central city that improved strongly in both these areas, becoming one of our top cities in this issue.

▼ Image: Guangzhou

Retailer

Retailers are eager to balance online and offline strategies with a slower pace of openings.

The long-term outlook for China's retail market remains positive, underpinned by rising incomes, continued urbanisation and sustainable economic growth. However, brick-and-mortar landlords will encounter difficulties capitalising on rising sales in a changing market.

Having an online presence is now necessary for retailers across almost all sectors. Burberry and Zara have set up self-operated online platforms and joined Tmall, a third party platform, to sell and deliver products. Korean brand 8 Seconds launched on Tmall four months prior to opening its first physical store in Shanghai. Some brands, such as US department store Macy's and Japanese drug store Matsumoto Kiyoshi, also operate Tmall stores despite having no physical locations in China.

While Uniqlo and Skechers were ranked top sales brands in women's wear and shoes, respectively, during Alibaba's "Single's Day", it is easy to overlook the fact that some brands face greater competition on online platforms. In a physical market, a brand needs to stand out among 20 to 100 competitors, targeting a consumer group that is relatively specific and stable in the area. By contrast, in a virtual market there can easily be over 1,000 competitors fighting for the best position on a website which attracts over 400 million consumers with huge differences in taste and spending power.

Store management has never been more challenging. With a slower pace of new openings, retailers are eager to balance online and offline sales strategies. We can expect to see a growing percentage of sales and costs coming from fewer stores in the future as brands invest more in their key locations to ensure the best quality of design, service and product.

Big box

Growth in the big box segment appears to have plateaued, with store expansions increasing just 0.5 ppts year-on-year (YoY) to 1.6% in 1H/2016. The fastest growth for this segment occurred in less developed third- and fourth-tier city markets, as supermarket brands scale back expansion plans in larger cities, resulting in fewer openings and smaller store sizes.

French supermarket company Carrefour saw uneven growth, with store openings in Shanghai, Suzhou and Guiyang, while it reduced its store count in Beijing. Hong Kong-listed retailer Parkson Group has made good on its announcement made earlier this year to target lower-tier city markets, closing stores in Dalian, Qingdao and Chongqing, while opening stores in Harbin and Nanning. Walmart has also adopted a new strategy to improve its China business by pushing into second- and third- tier city markets, launching smaller branded shopping malls and its membership wholesale club. At the same time, the world's largest retailer also looked to boost its stake in JD.com, China's second largest e-commerce site, in hopes of increasing its online sales numbers.

17

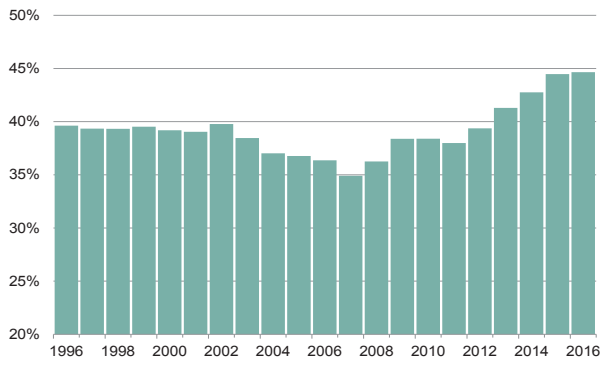
of the 20 key cities saw closure of department stores

4%

increase of domestic luxury consumption

While department stores used to dominate China's retail market, they have struggled to attract traffic due to aged facilities, outdated management strategies and a lack of leisure and F&B options catering to younger consumers. As a result, 17 of the 20 cities in this report saw department store closings. However, the long-standing relationship between department stores and retailers, and the loyalty of customers from certain demographics, remain and are especially valuable in the current tenant market. Future prospects for department stores are not all grim, should operators manage to adjust their strategies. Parkson and E-Land recently launched a jointly owned store brand, Parkson Newcore,

FIGURE 1: Retail sales as percentage of GDP, 1996 – 2016



Source: Savills Research, CEIC

TABLE 1: Store increase in the key 20 cities by selected active brands, 1H/2016 vs 1H/2015

moussy	65%
sandro	43%
H&M	25%
	18%
COACH	16%
TIFFANY & CO.	4%

Source: Savills Research, Company websites

in cities such as Shanghai and Chengdu. The partnership allows both brands to minimise costs, allowing them to offer greater discounts on products. Lotte will also participate with CITIC to launch a new concept for department store projects across China.

Luxury

The luxury market has been the hardest hit by the economic slowdown. However, demand for luxury goods seems to be returning to China. According to a report by Bain & Co. and Altagamma, domestic luxury consumption increased 4% YoY in 2016. Annual reports by a few brands, such as Jimmy Choo and Coach, also indicate strong growth of mainland China sales.

Nonetheless it is still too early to say the market has fully recovered. High-end fashion and accessory brands have scaled back expansion plans, downsizing or even closing stores in the prime retail areas of some cities, including Shanghai and Guangzhou. Even strong brands remain cautious, with some, such as Moncler, announcing only one new store opening in mainland China in 2017.

Rare store openings by some brands in lower-tier cities were not enough to balance out the current trend as the average store number of luxury and jewellery brands decreased by 1.8% and 1.4% YoY, respectively, at the end of 1H/2016. The sector is the only one to record declining store numbers in both first- and second-tier cities.

New stores are now offering a higher standard of design and concept to attract consumers. Tasaki, which historically opened smaller stores in department stores, is seizing the opportunity in China's pearl accessories market by opening larger stores in prime shopping malls in key cities, such as Beijing, Shanghai and Chongqing.

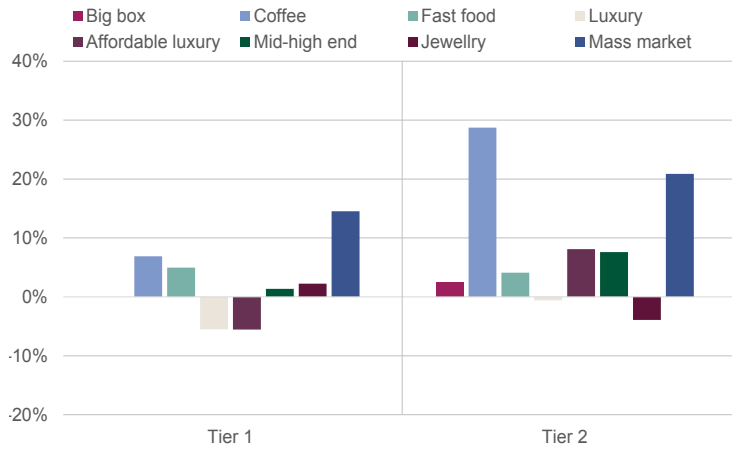
▼ Victoria's Secret, Huaihai Road (M), Shanghai

Mass and mid-end market

Mass and mid-end fashion and apparel brands continue to see healthy levels of growth, with the segment recording a store expansion rate of 17.9% and 5.2% YoY, respectively, in 1H/2016. Though fewer stores opened in the segment this year compared to the same period in 2015, this is largely due to the general economic slowdown and increasing maturity of existing store networks.

Most international fashion brands remain bullish in this segment, encouraged by the rapidly growing middle class and the shift in consumer behaviour away from luxury, high-end products towards more

FIGURE 2: Growth of store number per retailer per city, 2016 vs 2015



Source: Savills Research, Company websites

1.8mn

restaurants listed in Dianping.com in the key 20 cities

affordable sports and lifestyle brands. The market saw new entrants, such as Tom Tailor, actively expand through franchising and self-management. The pace of expansion in this sector is highly varied, with Moussy increasing its store count to over 90 in the 20 cities, a growth rate of 65% YoY, while Zara only grew by 9%.

Mid- to high-end brands saw, on average, new stores per retailer increase in both first- and second-tier cities. According to Alibaba and BCG, there will be 100 million families in China classified as upper middle class and wealthy (families with monthly incomes over RMB12,500) by 2020. New entrants are looking to capitalise on this trend with PVH taking back its Tommy Hilfiger franchise in China in early 2016. Ben Sherman also re-entered China through new partnership with MRH, while Victoria's Secret is in the process of opening flagship stores in select cities.

F&B

The expansion of leading coffee and fast food retailers across China has slowed, with growth in these segments falling from 18.6% to 15.7%, and 7.8% to 4.5%, respectively. This slowdown can be explained by an influx of F&B options in leading cities, causing market over saturation. The increase in F&B listings on China's largest online listing site, Dianping, can help explain this phenomenon. The number of restaurants listed on Dianping increased from approximately 1.1 to 1.8 million during the past 12 months, an increase of 72%.

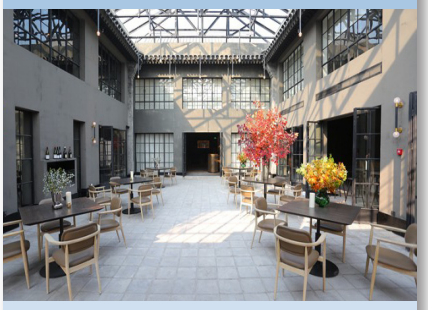
By 1H/2016, leading coffee brands had an average of 128 and 24 stores in first- and second-tier cities, respectively. Fast food chains still dominate in terms of total store count, with 180 and 42 stores per first- and second-tier city, respectively.

International restaurants with higher price points than fast food are still focusing on a very select number of cities, but expect further expansions. In 2016, Pret a Manger operated three stores in Shanghai, while Outback Steakhouse has six stores in Shanghai and two in Shenzhen.

F&B is a highly competitive and localised market. According to Dianping.com, Chengdu and Chongqing have the largest number of restaurants among the second-tier cities, similar to that of Guangzhou and Shenzhen. However, many of these remain local, non-franchised restaurants catering to consumers' tastes for local cuisine, indicating that these markets may not hold the best potential for expanding international chains.

TABLE 2: Retailer Innovations

Off the crowds



Georg Jensen opened "Georg Jensen Hus" in a traditional courtyard house in Beijing. The store is located in a downtown area well known for its old Hutong residences, with few international brands, as footfall is limited.

The 1,000 sq m store includes a showroom for the brand to introduce its cuisine. The peaceful environment will help promote the brand's image to a local client base.

Historical periohery

Fangsuo is a collection of refurbished lane houses in Shanghai's former French Concession, hosting "The Mix-Place", a 1,500 sq m lifestyle project combining a bookstore, a café and art and fashion spaces.

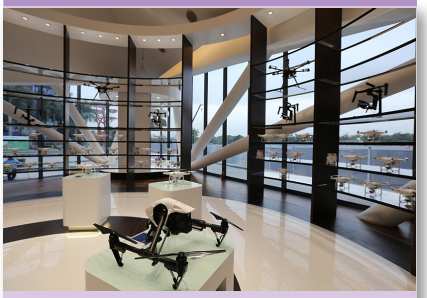
Each of the four historical houses offers different types of retail products and experiences, targeting different customers but centring on the brand's lifestyle theme.

Best value

Hema Xiansheng, Alibaba's supermarket brand, has already opened four stores in Shanghai and is still looking for new locations. With Alipay (Alibaba's mobile payment system) adopted as the only accepted payment system, the store increases operational efficiently by utilising new technology such as electronic price tags and an automatic delivery system.

The supermarket offers a wide variety of imported food and beverages, with competitive prices and convenient delivery services, including a 30-minute delivery time. Customers also have the option of having fresh foods prepared by on-site chefs.

Technology focus



In its first physical store in Shenzhen, DJI provides 800 sq m of space for its customers to test various types of drones. The store aims to promote drone technology, which is already widely used in professional industries, to wider consumer groups.

Hi-tech companies are increasingly acknowledging the importance of physical stores. These stores give brands the ability to display products in ways that cannot be replicated online. More brands are beginning to follow in the footsteps of Apple, opening larger offline stores to provide space for consumers to experience and understand their products.

Source: Savills Research

Property perspectives

New projects are introducing new designs and facilities and incorporating innovative concepts in order to attract consumers.

The fast pace of development in China has resulted in an abundance of malls and retail centres. While the depth of China's retail market is huge, it is not bottomless. An immense pipeline of new supply will see the market face greater competition in coming years, causing a greater divergence in performance among different submarkets and projects. It will be essential for landlords to pay more attention to tenant mix strategies and additional service innovations to attract consumers and improve mall performances.

Entertainment attractions

Property owners are searching for new strategies to differentiate their projects from competitors in order to generate and sustain traffic. One method that has recently gained traction among developers and landlords is the inclusion of small-scale entertainment facilities and attractions that cater to children, young adults, and families.

Indoor attraction centres enhance the traditional shopping experience by providing consumers with two to three hours of fun and activities, which they can then combine with a bit of shopping and dining in the same retail podium. Aware of the necessity for brick-and-mortar retail to evolve, many developers have included entertainment attractions in the designs of their newer projects. An increasing number of landlords are searching for attractions branded by globally recognised companies, as one-of-a-kind operators that proactively market their location are able to attract the largest volume of new customers.

From the point of view of the brands, the development of entertainment retail marks an important milestone in the growing sophistication and development of the Chinese consumer. Chinese shoppers no longer go to stores and malls just to buy goods; they are looking to get a more complete retail consumer experience. Brands have sought to capitalise on this through the development of entertainment product lines. Many foreign brands have made large splashes into the Chinese market in recent months. Sega Joypolis, a digital entertainment venue from Japan occupied over 5,000 sq m of space in Qingdao's The MixC and Shanghai's Global Harbour. Taroko, a comprehensive sports and entertainment venue brand from Taiwan, is actively expanding in mainland China, bringing new concepts to its stores.

The growth of China's middle-class, and the new second-child policy, has also increased demand for kids' products. In order to attract families and parents with young children, malls are looking for fashion and lifestyle brands with kids' product lines. Retailers offering cooking and art classes for children, as well as large child entertainment zones are becoming more popular, as growing competition pushes management teams to find new and creative ways to increase traffic.

Shifting tenant mixes

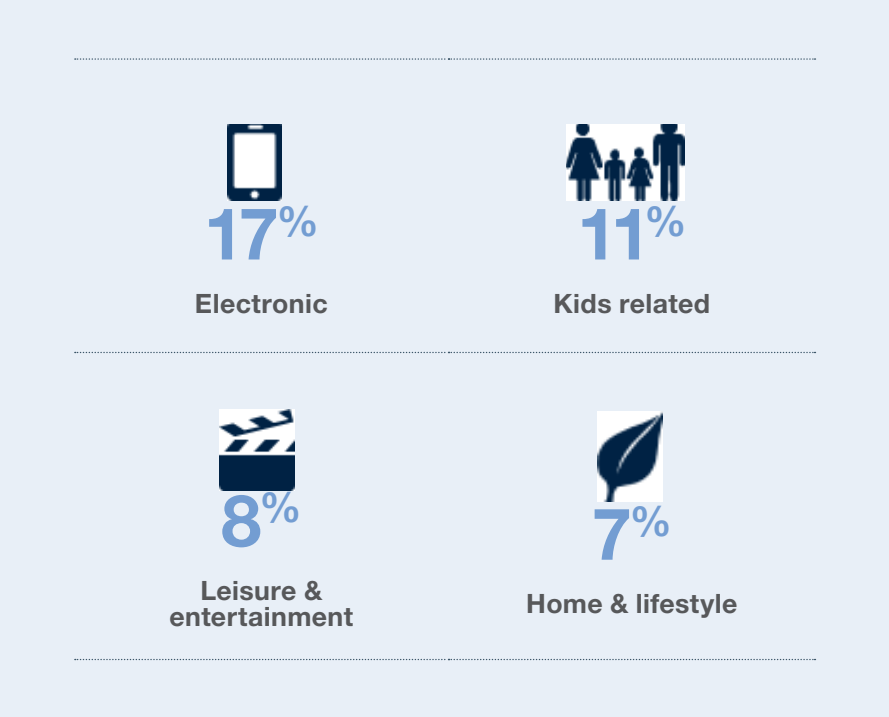
The expansion of entertainment offerings is just a part of a larger trend of tenant mix changes occurring in many cities. Landlords are spending money to renovate older facilities, reconfiguring unit layouts and becoming more creative with promotions and advertising campaigns.

In addition, landlords are increasingly welcoming retailers who can bring fresh elements to their properties.

Our analysis on retail tenants in selected shopping malls shows that in 2016, space occupied by leisure tenants increased by 8% in Shanghai. By the same measure, F&B increased by 3% while fashion decreased by 5%.

Fashion and accessory tenants, historically the largest occupiers and main revenue generators in a mall, are losing store space to other tenants, particularly F&B and leisure tenants. Technology has helped, rather than hindered, sales figures from these emerging tenant groups. F&B retailers have improved their take-out business through convenient online ordering and delivery services, while leisure & entertainment operators have used mobile ticket purchasing apps to increase sales. Large space entertainment venues have also used online platforms to attract a younger demographic to their sports club, dance studios and handicraft classes.

TABLE 3: Tenant space growth in Shanghai's shopping malls, 2016



Source: Savills Research

Ranking of 20 Retail Cities

Second-tier cities are narrowing the economic gap, but retailers still show a strong preference for leading cities

Our retail cities study, which began in 2014, uses 16 series to determine leaders in two categories: "economic index" and "retailer index". Each of the series are weighted and aggregated to give a final score to each city.

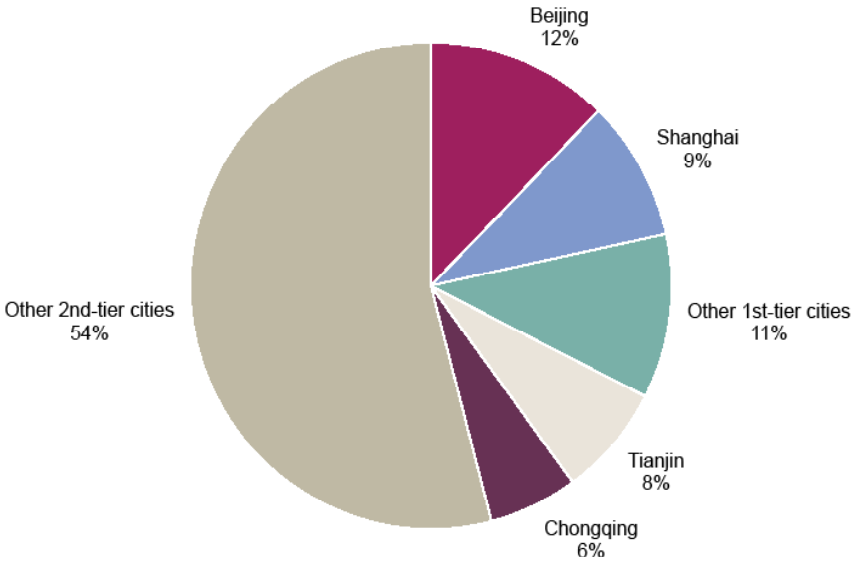
City economy

Shanghai and Beijing jostled for the top spot, scoring similarly in economic performance. However, the economies of China's two leading cities possess their own unique paths to development and success. Shanghai lowered targets for manufacturing (secondary industry) to 25% of its total economy, and plans to strengthen its emerging hi-tech manufacturing sector, such as robotics and aviation, to support the city's service-driven economy. Beijing has already turned itself into a tertiary industry hub because of its political and cultural attraction. Tertiary industries now account for 80% of the capital city's economy, far exceeding any other city in China. It also extended its lead over Shanghai in tourism; tourism income was 32% higher than Shanghai in 2015, compared to 20% two years ago.

The economic ranking of the 20 cities has been relatively stable over the past two years, as city scores experienced little fluctuation in relative ranking. However, the top three second-tier cities – Chongqing, Tianjin and Hangzhou – continued to increase their scores, closing in on Guangzhou, the lowest-ranked first-tier city. Chongqing and Hangzhou are the only two cities in the top 20 that maintained GDP growth over 10% in the first half of 2016.

The creative and tech industries have flourished in recent years, taking centre stage in the development of many cities. These new businesses are not only reshaping the structure of the economy, but also fundamentally affecting the way that retail markets operate. The development of technology and logistics have allowed consumers to shop simply with a "click," increasing the range of product availability and reducing costs. On the back of this trend, cities with dynamic, hi-tech business environments, such as Beijing, Shenzhen and Hangzhou, should expect to outperform in the near future in terms of both economic growth and per capita spending.

FIGURE 3: Share of tourism income of the 20 key cities, 2015



Source: Savills Research, CEIC

31%

Tourism income of Beijing is much higher than Shanghai

It is also important to note that the more a city integrates new technology and e-commerce platforms, the clearer consumer behaviour trends become. As buyers become comfortable using online channels, retailers have access to more data, which they leverage to create new marketing strategies and sales channels. However, new technology is also a disruptor, which will continue to affect consumer behaviour. It will remain important for brick-and-mortar retailers, even successful ones, to remain proactive with these changes in order to engage and draw customers to their stores.

Tourism is a sector many local governments have chosen to emphasise in order to stimulate consumption and boost stable economic growth, with varying levels of success. While Shanghai has retained the largest GDP among Chinese cities for several years, and is the second largest tourism destination in terms of income, the city's tourism market has faced new challenges in recent years. The city's tourism income has fallen further behind Beijing, from 20% (2013) to 32% (2015), while its lead over Guangzhou has narrowed from 50% (2013) to 22% (2015). The municipal government has announced a number of large tourism projects in 2015/16, including Haichang and KOP's projects in Lingang, and Legoland in Qingpu. Disney also announced plans to expand its park by 2018, after successfully receiving 5.6 million visitors since opening in June 2016.

Retailer penetration

A city's retailer index is based on the analysis of store networks of 50 international brands, including F&B and fashion. Scores are awarded based on the calculation of store number per brand per city. Same as the result in 2015, Shanghai and Chengdu retain their positions as the top first- and second-tier cities, respectively. The retailer index ranking of second-tier cities is prone to greater fluctuation than the economic ranking each year. Part of the reason for this is the relatively small number of international stores in second-tier cities, causing new

store openings to have a larger impact on the final scores.

Taking the analysis a step further, and in order to better understand how the cities compare to each other, we also analysed the store network of a number of cinema and F&B operators as an approximation for the leisure market size. We then cross-referenced this figure against the number of fashion stores per one million people. The results can be seen below. We have then grouped the 20 cities into five key groups that we feel have similar characteristics borne out of these two figures, and our understanding of the dynamics of these markets. A brief introduction of these five groups can be found below.

Gateway cities

As with the economic index, Shanghai and Beijing showed significantly higher scores in the number of international fashion and accessory retailers than the other 18 cities. International brands typically consider these two cities as the "best" place for global standard flagship stores and entry points into the mainland market. The large populations and market demand also create potential for further expansions into decentralised communities.

Shanghai, ranked first on both charts, has the largest number of stores per retailer across all sectors we covered, with the exception of luxury brands. Brands such as Louis Vuitton, Bottega Veneta, and Loewe have all adjusted their store networks by reducing store sizes or closing locations. However, Shanghai still showed strong attraction to international brands in the mass and mid-high market. Adidas, Muji, Forever 21, and 8 Seconds all opened new flagship stores over 1,000 sq m.

Beijing regained the lead in the luxury sector. During the past 12 months, Bulgari, Delvaux and Damiani all opened new stores in the city. The nation's capital also attracted a number of European designer brands making their China debuts in the past 12 months, including Bora Aksu and Luisa Spagnoli. Electric vehicle companies Tesla and Segway also opened stores in the city.

Unexpectedly, both gateway cities' leisure indices were quite average among the 20 cities. Beijing generated 7% of China's total movie box office revenues in 2015, the largest share among all cities. As China's cultural centre, Beijing boasts an exuberant opera and art exhibition market, with cultural and creative industries recording higher added value than Shanghai. However, the number of cinemas per 1 million citizens in the city is fewer than Shanghai, indicating potential for further expansion in the sector.

TABLE 4: Ranking of retailer index, 2016

Source: Savills Research,

Shanghai is the most internationalised city in China, and now has over 400 Starbucks, nearly double the number of Beijing, which ranked No 2 in total coffee shops. The casual dining trend from western countries is also spreading to China's larger cities. Data from Dianping.com showed that Shanghai has largest number of restaurants. However, after taking into account its larger population, the city actually has an average amount of restaurants per capita, approximately 7.3 per 1,000 residents. This is far fewer than the "culinary heavens" of Guangzhou and Chengdu. The F&B market in Shanghai might be saturated in certain areas, but there certainly remain opportunities for expansion.

Consumer cities

Shenzhen and Hangzhou scored high on the leisure saturation index, and have above average fashion scores. The two cities are also among the best economic performers in recent years, due to strong hi-tech and internet industries.

Supported by strong consumer spending, retailers' expansions into these two cities remain steady, with all sectors of the fashion industry recording growth. Hangzhou's retailer index ranking rose to sixth, after Louis Vuitton and Prada opened new stores in late 2015. However, the change in city-wide store numbers was less prominent, partly due to limited new supply in the city's core areas.

The average store number per luxury retailer in Shenzhen is similar to that of second-tier cities. Convenient transportation links to Hong Kong, where the price of luxury goods is significantly lower, continues to affect the city's consumption of luxury products. Mass-market brands are much stronger in the city (fourth highest store count per retailer after Shanghai, Beijing and Chengdu). Leading fast-fashion brands such as H&M, Zara and Uniqlo all opened new stores in the past 12 months. As one of the IT centres of China, Shenzhen also welcomed a number of new digital brands' store openings, such as DJI and HTC Vive.

Balanced cities

Chengdu, Nanjing, Xi'an and Shenyang have relatively balanced retail markets. After the first-tier cities, these four cities are known for their developed leisure and fashion markets. International retailers such as Vera Wang and Spao often regard Chengdu as the third entry point in China after Shanghai and Beijing. The city also welcomed a second Ikea store in 2016, becoming only the third city in China to have two Ikea stores.

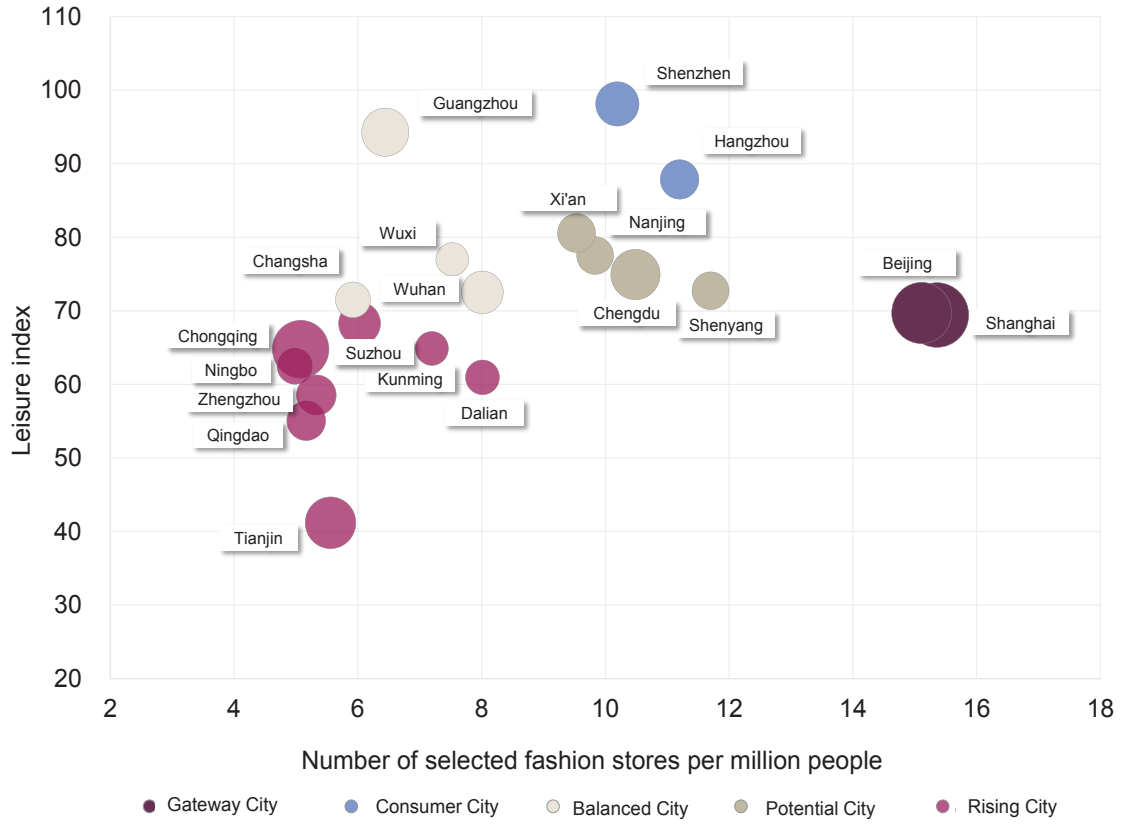
As the most populated city in North East China, Shenyang has also maintained the highest penetration of fashion retailers among key second-tier cities for three consecutive years, with Louis Vuitton operating three stores in the city. However, disappointing economic growth experienced by the entire north east region in recent years has dimmed the city's attraction to retailers. The luxury sector saw a 5% decrease of stores per retailer in 2016. As a result, Hangzhou and Nanjing have significantly closed the gap with Shenyang in terms of total stores, as these markets continue to attract growing interest from retailers.

Nanjing became the first city in China to have Hamley's and House of Fraser after Chinese companies acquired the two UK brands. The two brands opened in Nanjing's prime street, Xinjiekou in 2016 with a total space of 35,200 sq m.

Potential cities

Guangzhou, Changsha and Wuhan continue to hold appeal to fashion retailers as they all recorded much higher leisure

FIGURE 4: Leisure index and the number of fashion stores per million residents



Note: Size of bubble indicates the city population (Chongqing only accounts for urabn area)
Source: Company websites, Dianping, Entgroup, Savills Research

saturation than fashion penetration. Of the three cities, Changsha is the only city that has seen positive expansion rates across all sectors. The city is expected to further move up the ranking in the future as a number of high-profile retail developments are currently underway, which will likely bring more international brands to the city.

Guangzhou ranked second after Shenzhen on the leisure index, while its international fashion market has struggled despite the city's strong levels of consumption. Though many local residents still shop for upscale brands in Hong Kong, opportunities remain for international retailers targeting the mass- and mid-market fashion segments. In 2016, H&M opened a new 2,000 sq m flagship store in Guangzhou and also brought its sister brand Cos to the market. Hollister also entered the Guangzhou market in 2016, launching its 13th store in China.

Though garnering less interest from retailers than the three provincial capitals, Wuxi's retail market also has potential. The smallest of the 20 cities in terms of population, Wuxi also ranks at the bottom of both indices charts. The city's mature tourism industry and leisure markets will attract some retailers, but expansion is likely to remain relatively limited.

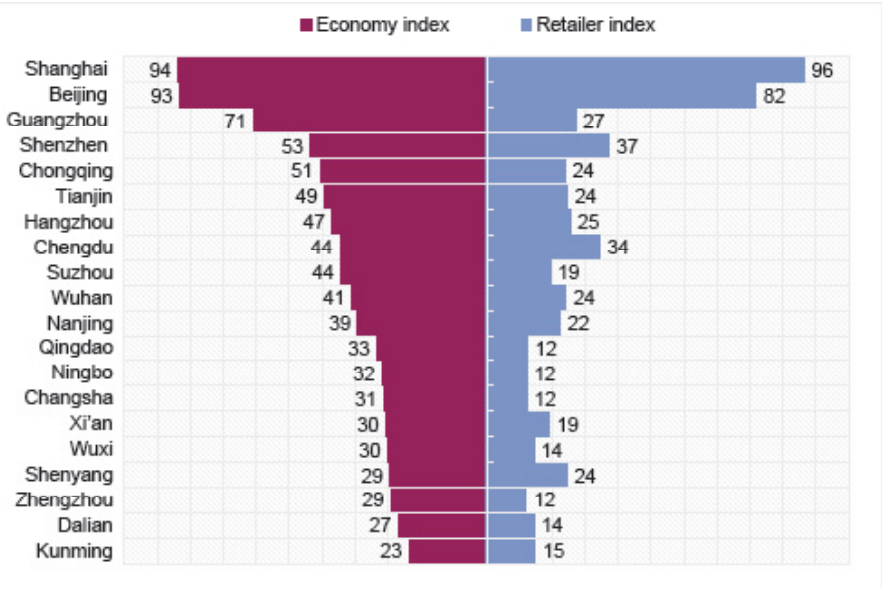
Rising cities

Eight cities, including Chongqing, Suzhou, Ningbo, Kunming, Zhengzhou, Dalian, Qingdao and Tianjin, are considered rising stars, with leisure indexes and store numbers far below the average.

The two municipalities, Tianjin and Chongqing, are ranked seventh and tenth respectively in terms of retailer penetration, however, the number of stores per million people is significantly lower than the average for second-tier cities, given their larger populations. Looking at neighbouring second-tier cities highlights this point even more. Shenyang, which is not too far from Tianjin, has 11.7 stores per million residents, more than double the amount in Tianjin. Chengdu has 10.5 stores per million residents, again more than Chongqing (5.1 stores), despite Chongqing having a relatively reasonable score in terms of its leisure industry ranking.

The key challenge for retailers in the rising cities is how to grow. Prime areas tend to be safe bets, but will cost, while emerging areas present greater uncertainties than other cities, as the retail landscapes of rising cities continues to change, and better quality projects displace previous industry leaders. Retailers looking to expand typically choose to collaborate with a reputable developer and pick prime projects in these cities.

FIGURE 5: City economic index vs retailer index, 2016



Source: Savills Research, CEIC, Company websites

400+

Number of Starbucks stores in Shanghai

3

cities in China have over 2 Ikea stores

8" 3,500sqm

8 seconds new store in Shanghai is one of the largest leasing cases in 2016

69

National level innovative spaces in Shenzhen

7%

of China Box offices come from Beijing

Hot Sectors

Amusement parks

Theme park development in China has made headlines after the launch of Disney's Shanghai theme park and Chinese conglomerate Wanda's own Wanda City in Nanchang in May. These two high-profile parks are the latest examples of the accelerated development of the Chinese theme park market over the last few years.

According to Aecom, Chinese amusement parks drew approximately 120 million visitors in 2015, making China one of the most developed theme park markets in the world in terms of total attendance. However, these numbers are relatively diminutive when compared to the vast size of China's population, meaning that there is huge potential for the country's theme park sector, especially as China's middle class continues to grow and spend more on travel and leisure.

While theme parks have existed in China since the 1990s, the market is in the process of being transformed by the entry of large international players such as Disney, who bring a level of skill and experience that will surely raise the expectations of local theme park visitors. Domestic players will have to adapt to meet these rising expectations, injecting greater capital investments into their projects while simultaneously fighting for a share in an increasingly competitive market. Many will not survive.

Despite the risks, Chinese theme park developers remain bullish on the market. Wanda announced plans to open six more theme parks within the next three years, hoping to shut out slower-moving overseas competitors such as Disney and Universal. Other domestic brands such as Chimelong Group and Songcheng Worldwide also have several projects in the pipeline, expanding upon their existing theme park portfolios.

Theme parks will ultimately buoy China's retail sector. Cities hosting parks and the areas around them will be primed to capitalise on the substantial number of visitors expected to flock to these destinations. Inside parks, operators are expected to balance larger upfront costs by introducing more retail and concession options in order to generate quicker returns on investment. As theme parks tend to be far from urban centres, new retail and F&B options will have to be developed to cater to the demands of park visitors. There could also be a spillover effect as some park visitors elect to spend a few days in neighbouring areas, boosting the local retail sector.

Athleisure

Walking down a busy Chinese street, it is hard not to notice one of the latest fashion trends sweeping the nation: athleisure.

So called for the combination of athletic and leisure wear, athleisure began to take off in the United States a few years ago when young professionals shifted away from traditional styles in favour of a more comfortable, "no-frills" look, wearing work-out style clothing – yoga pants, sweats, sneakers, etc.– outside of the gym.

In China, the athleisure trend is growing on the back of a fitness revolution spreading through the Chinese middle class. China's urban dwellers are increasingly working higher-paid, white collar jobs that allow for more leisure time to be spent focused on stress relief and greater health awareness. Growing interest in an active lifestyle, combined with rising incomes and a strengthening consumer mentality, has generated huge demand for health and fitness products, especially amongst Millennials, who have been quicker than older generations in embracing sports activity and the higher performance levels provided by athletic apparel.

The high-end athleisure market is dominated by a handful of established overseas brands such as Nike and Adidas who discovered the market potential a decade ago and already have a strong distribution network and consumer base. However, the strong performance of this sector has generated new competition from many up-and-coming local brands, especially in lower-tier cities where salaries tend to be lower, making the affordability of domestic brands more attractive. Not

wanting to be outdone, many overseas brands have escalated their marketing campaigns, hoping to maintain their current place in the sports wear market, while simultaneously promoting more leisure and apparel lines to capitalise on the emerging athleisure trend.

Emerging overseas brands catering to younger generations are also bullish towards the China market. Under Armour has added more than 100 stores in China since 2015, while Lululemon secured spaces in Beijing and Shanghai after testing the market in these gateway cities.

The government has thrown its support behind the sports industry, which it expects to exceed RMB3 trillion in sales and employ 60 million people by the end of 2020. Plans to host the 2022 Winter Olympics in Beijing have also catalysed new interest in sports and health, which should help the expansion and revenues of sports and leisure brands in the future.

Online to offline stores

Brick-and-mortar stores developing online to offline (O2O) business models are

▼ Image: Apple store, Nanjing Road (E), Shanghai

becoming increasingly common in China. O2O refers to a strategy of merging digital and real world shopping into a single consumer experience. Using coupons and mobile payment options first popularised by e-commerce, retailers can engage with consumers online and attract them to physical stores where transactions then take place. Online channels can improve the efficiency of shopping for consumers, allowing them to place an order before arriving at a store to physically see and try on a desired product before making their purchase. If pick up is not desired, O2O stores offer delivery services to customers in order to facilitate online purchases.

In the last few months, many large retail brands have made significant bets on the O2O market's growth. In particular, Alibaba, which began by sinking US$4.63 billion into electronics retailer Suning last August in order to gain access to more than 1,600 brick-and-mortar stores, 5,500 customer service centres, and 4.55 million sq m of logistical space, which it plans to use to make the purchase and delivery of electronic and home appliances easier for customers on its online platforms. Then in April, the internet company brought Ele.me, a Shanghai-based food delivery service company, into its O2O business platform with an investment of US$1.25 billion.

Alibaba is leading the charge by many internet-based and traditional retailers to stay relevant in an increasingly competitive market by adopting a cross-sector operational model. The tech giant invested heavily in its own fresh food brand Hema Xiansheng, which operates physical stores, while offering take-out ordering services. Dangdang, China's largest online bookstore, opened its first physical bookstore of 5,000 sq m in Changsha and plans to open 1,000 stores around China. The bookstores offer the same pricing and same-day-delivery as its online sales platform. Customers who make purchases through Dangdang's APP will also be able to pick up their items, if they wish, at designated stores where they can enjoy the full consumer experience.

Traditional retailers are also increasingly launching their own APPs to attract customers to physical store locations. In addition to offering digital coupons and online payment methods, APPs such as Tiangou give shoppers prizes and discounts for sharing their purchases on social media platforms, which friends and followers can then purchase to be picked up at stores or delivered.

The prominence of O2O stores is expected to increase on the back of rising business-to-consumer (B2C) e-commerce sales. Annual B2C sales in China increased by approximately 25% between 2015 and 2016, from US$298 billion to US$376 billion, with sales expected to surpass US$839.5 billion by 2021. However, not all goods and services will be scalable under the new model, and investors will need to keep an ear to the ground in order to differentiate between the winners and losers to prevent themselves from investing into the wrong sectors.

Healthy eateries

The number of healthy dining options is on the rise in China, underpinned by rising incomes and shifting consumer demand. Young urban professionals are increasingly flexing their purchasing power, eating out more frequently and spending a larger percentage of their salaries compared to earlier generations. This demographic is also increasingly health conscious, adopting healthier and more active lifestyles, including paying greater attention to nutrition. On top of this, recent food safety scandals have made buyers more selective of the products they purchase. Green and organic foods have capitalised on consumer concerns by promoting themselves as safer alternatives.

The government has also taken initiatives to push the food industry in a new direction. On October 1st 2016, a new food safety law came into effect, making food companies responsible for unsafe ingredients and raising fines for violations. Municipalities, such as Shanghai, have also launched programmes promoting non-polluting agriculture to ensure the quality of food products. For a growing proportion of Chinese wanting to be assured of the quality of their food, these reforms could not have come soon enough.

On the back of this food consumption trend, the number of healthy eateries is on the rise in China. While once restaurants specialising in organic or healthy food were rarities catering to small expat populations, demand has quickly grown among local consumers. According to a CNBC report, while market penetration of organic food is still comparatively small, accounting for just 1.01% of the total food market in 2015, it has nearly tripled since 2007, to become an industry worth approximately RMB1 trillion.

Emerging F&B retailers looking to cater to this new consumer preference for healthier dining options are on the rise in urban centres. These brands such as Hunter Gather in Shanghai and Soodle in Guangzhou typically appeal to a younger generation of Chinese office worker and families with higher incomes and a desire for food quality assurance. Established brands such as Element Fresh already have stores in nine cities around China. Landlords are beginning to look for F&B retailers that provide healthy dining options,

in order to attract younger customers with deeper pockets and a greater tendency to spend at their locations.

Co-working

In the latest example of how new office trends are reshaping the retail industry, mall owners are beginning to open their doors to co-working centres. Co-working office space, which began as an affordable, flexible alternative to traditional offices for freelancers and start-ups, is now transforming how a new generation of professionals work, collaborate and socialise. The growing popularity of co-working offices has created new opportunities for landlords to revitalise retail areas, creating ecosystems that support the shifting work-life balance and office demands of a growing millennial workforce.

While the co-working-mall centre remains an emerging concept in Europe and the United States, it has begun to receive strong attention in China. Singaporean developer CapitaLand recently announced it would collaborate with Beijing-based UrWork, offering shared office spaces in its malls across China, beginning with a 4,100 sq m centre in Wuhan. This will not be UrWork's first mall location, as the brand already operates a 1,800 sq m space in Beijing's Hongkun Plaza Shopping Mall. Developer Longfor Properties has also sought to integrate retail with co-working, launching its own concept, a 2,044 sq m Easywork space, in its Beijing Paradise Walk Mall.

The co-working-retail format brings many benefits to the tenant. These spaces cater mainly towards established retail companies and start-ups developing retail technology and products. In addition to office space, these centres may provide areas for these brands to display their products to retail shoppers and investors. Floors of retail projects are also typically larger than office buildings and have fewer columns and higher ceilings, which fit more with the open space designs favoured by co-working. For co-working companies looking to lower upfront costs, a retail layout may be better suited to their design plans by lowering fit-out costs, while the rents in the upper floors of malls in prime areas are also typically lower than nearby office rents.

For landlords, co-working centres will generate a new buzz of activity, with the new tenants contributing to retail sales and foot traffic. Co-working operators, who typically lease large floor plates for longer lease periods (10 years or more), also provide a solution to fill space, especially on the upper floors of projects. For retail landlords hoping to stay ahead of the rapidly evolving retail industry, co-working's potential to generate new customers and business lines may soon make it a fixture in many retail podiums. Co-working centres also provide flexible space for landlords who can lease them out for other retail events and showcases to existing tenants. Property owners also have the option of investing into successful start-ups that occupy their space or providing small rent-free incubator spaces in the hopes that one of these tenants may grow into a large successful company that might one day become a full-time retail tenant.

▼ Image: Jiefangbei, Chongqing

Please contact us for further information

Savills Research

James Macdonald
Head of Research
China
+8621 6391 6688
james.macdonald@savills.com.cn

Chester Zhang
Associate Director
China
+8621 6391 6688
chester.zhang@savills.com.cn

Savills Retail

Siu Wing Chu
Head of Retail
China
+8621 6391 6688
siuwing.chu@savills.com.cn

Joey Chio
Director
East China
+8621 6391 6688
joey.chio@savills.com.cn

Lesley Wang
Director
North China
+8610 5925 2086
lesley.wang@Savills.com.cn

Iris Lin
Associate Director
West China
+8628 8147 1803
iris.lin@Savills.com.cn

Dorian Zhi
Associate Director
South China
+86755 8828 5720
dorianDL.zhi@Savills.com.cn

Savills plc
Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 700 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.