



What the **Experts** say

# Ten Highlights of China's Commercial Sector 2019

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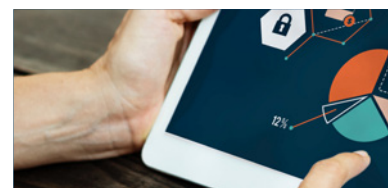
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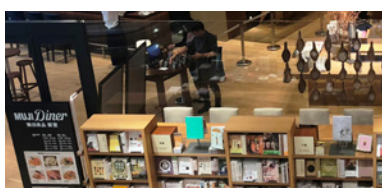
# Ten Highlights of China's Commercial Sector 2019



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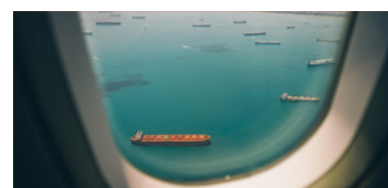
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# Foreword

China's commercial sector is changing drastically and continually. New consumer behaviors and technological advances have and will continue to disrupt the market landscape. To secure their commercial positioning, enterprises need to be more efficient, innovative, and relevant to adapt to customer needs. This has motivated a multitude of forward-thinking companies to transform, or join forces in alliances with others. This trend is expected to continue growing through 2019.

2019 is set to be a year of change and challenge for businesses. Global economic uncertainties will continue to exert downward pressure on the Chinese economy and affect consumer sentiment. We expect to see profound transformation taking place in the commercial sector to accommodate the new competitive environment. Meanwhile, the Chinese government's eagerness to encourage domestic consumption and expand imports will open up new opportunities for local and foreign enterprises.

For the 16th consecutive year, Fung Business Intelligence and the Expert Committee of the China General Chamber of Commerce jointly present their Ten Highlights report to provide enterprises and investors with a comprehensive, insightful view of China's latest commercial developments. Over successive years, the report has been an important reference point for global retailers, commercial enterprises and individuals aiming to understand the latest commercial trends and issues in China.

In this report, we present the key trends identified by 160 top-tier experts in China's commercial sector – together with additional Fung Business Intelligence analysis – to draw key insights into China's commercial developments over the coming year.

We would like to thank all panel members on the Expert Committee of the China General Chamber of Commerce for sharing their insights. We also thank our colleagues at Fung Business Intelligence for their contributions and assistance.

**Chang Ka Mun**  
Managing Director  
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# About the Organizations

## **The Expert Committee of the China General Chamber of Commerce**

The Expert Committee of the China General Chamber of Commerce (ECCGCC), a sub-division of the CGCC, comprises over 160 prominent experts from various government departments, research institutes and universities, leading corporations, professional associations, consultancy firms and newspaper offices, which include the Ministry of Commerce, the Chinese Academy of Social Sciences, China Chain Store and Franchise Association, the Development Research Centre of the State Council, the Renmin University, the Capital University of Economics and Business, and the Beijing Technology and Business University, etc.

The ECCGCC serves as a platform for the experts to exchange ideas on the development of commercial enterprises and the distribution sector.

## **The China General Chamber of Commerce**

Founded in 1994, the China General Chamber of Commerce (CGCC) is a quasi-government association endorsed by the State Council. The CGCC has around 70,000 members, encompassing enterprises from retail, distribution, services and tourism sectors, local commercial chambers, national professional associations, intermediary organizations and individuals.

Commissioned by the Chinese Government, the CGCC consists of 14 committees, working on areas such as retailing, wholesaling, public relations and industry analyses, etc.; it also supervises 40 national associations, and over 30 newspapers and magazines published both inside and outside China.

## **Fung Business Intelligence**

Fung Business Intelligence collects, analyses and interprets market data on global sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to track and report on these issues with a particular focus on business trends and developments in China and other Asian countries. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments around the world through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consultancy services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

## **The Fung Group**

The Fung Group is a privately held multinational group of companies headquartered in Hong Kong whose core businesses are trading, logistics, distribution and retailing. The Fung Group employs 39,900 people across 40 economies worldwide, with total revenue of over USD22.51 billion as of December 2016. Fung Holdings (1937) Limited, a privately held business entity headquartered in Hong Kong, is the major shareholder of the Fung group of companies.

# Expert Panel Members

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# Executive Summary

01

## **Innovation leads to high-quality consumer market growth; empowers domestic consumption to drive China's overall economic growth**

The Chinese economy has been able to maintain steady growth despite mounting economic uncertainties, due in part to ongoing trade tension between China and the U.S., together with downward pressure on the domestic economy. The Chinese government has stepped up efforts to push forward supply-side structural reforms, promote innovation, encourage high-quality development and mitigate financial risks. Additionally, the government has strengthened the role of domestic consumption in driving economic growth. All of these initiatives are set to facilitate the growth of the Chinese consumer market.



02

## **China adopts an e-commerce law to improve market regulation**

With the aim of providing a sound legal framework to better regulate China's rapidly growing e-commerce sector, the long-awaited E-Commerce Law of the PRC ("E-commerce Law") was passed on 31 August 2018 and came into force on 1 January 2019. The E-commerce Law establishes regulations concerning operators, contracts, dispute settlement and liabilities, as well as market development. Key provisions of the Law include: clarifying operational details for e-commerce players, strengthening consumer rights and intellectual property protection, regulating unfair competition and specifying requirements for electronic contracts, electronic payments and express deliveries. In addition to its key provisions, the E-commerce Law also states that China supports the development of cross border e-commerce (CBEC) and emphasizes the importance of establishing a mechanism to facilitate CBEC transactions and streamline operations.





# 03

## Service consumption proliferates; catering industry embraces digital marketing; community businesses become increasingly competitive

With the trend towards consumption upgrading in the new retail era, the demand for personalized, diversified and quality products and services continues to rise. In particular, service consumption has continued to grow in terms of the variety and range of services offered. Online-to-offline (O2O) catering and community businesses are among the catalysts for the service consumption boom. As the Chinese catering industry has entered a new era of data-driven marketing, increasing numbers of restaurants and food service providers will utilize big data to generate market insights and make more accurate business decisions. Indeed, community retailing – which offers shopping and dining convenience to neighborhood shoppers and residents – has become increasingly competitive, but opportunities abound with new development prospects.



# 04

## Business model upgrading and transformation revolutionize the retail sector

China's retail sector is in the midst of rapid transformation. Rising competition and changing consumer expectations pose business challenges for traditional retailers. To cope with this ever-changing retail environment, increasing numbers of retailers are actively seeking new solutions – such as technological innovation and digital transformation – to upgrade their business models. For some, success is achieved by introducing new retail concepts and formats to the market. Pop-up retailing is trending in the industry because set-up costs are far lower than for permanent stores. Pop-up stores are increasingly used by e-commerce operators and online retailers to connect with customers in a more direct and dynamic way.



# 05

## Boosting imports to address consumer demand for quality living; global sourcing enhances consumption upgrading

Against a backdrop of growing protectionism and a pushback against globalization, China's pledge to increase imports marks an important step for the country to promote the multilateral trading system, while transitioning to the stage of high-quality development. Expanding imports can better satisfy new consumer demand, especially for quality products and services, thereby achieving consumption upgrading and supply-demand optimization. To meet the new needs of consumers, retail operators are increasingly adopting a global sourcing strategy to differentiate their product offerings.



# Executive Summary

06

## **Government to bolster growth of the real economy; further optimizes the business environment, cuts taxes and fees**

China's economy has been facing increasing downward pressure amidst external uncertainties. To bolster the real economy's growth, the Chinese government has launched a series of measures to lower the tax burden and operating costs for businesses. These include: reducing value-added tax rates on sales and imports of goods, raising the minimum threshold for paying personal income tax, lowering non-tax costs such as social insurance premiums paid by employers, employers' contribution rates for employees' pensions and cutting electricity costs for commercial enterprises. To further alleviate the cost burden on businesses and help enhance growth of the real economy, the government has reportedly devised further new tax and fee cut measures, which are set to roll out in 2019.



07

## **Digital transformation of retail accelerates; supply chain digitalization to help drive economic growth**

With O2O integration gaining momentum, enterprises are increasingly leveraging big data and other breakthrough technologies to bring online and offline experiences seamlessly together and improve operational efficiencies. Technology also plays a crucial role in transforming the supply chain. A digitalized supply chain enables seamless upstream-downstream connectivity – from factory to consumer – which in turn enables the flow of real-time consumer data from retail to upstream manufacturing across the supply chain, to be translated immediately into business decisions.

Digitalization of retail – especially data sharing – not only enhances the connectivity and integration of supply chains, allowing enterprises to swiftly respond to changing customer demand, but also greatly facilitates the transformation of the supply chain industry to contribute to drive economic growth.



# 08

## Department stores, hypermarkets and supermarkets continue to reinvent and innovate; capital investment in the convenience store sector proves to be a double-edged sword

To stay competitive in a challenging market environment and to better adapt to new market dynamics, increasing numbers of traditional retailers, including department store and hypermarket/supermarket operators, have made vigorous efforts to upgrade, revamp and explore new business opportunities with the help of advanced technologies and other means, such as the abundant capital resources available to the market. At the same time, investors have been particularly keen to invest in the convenience store (CVS) sector, further accelerating its development. CVS operators have to be cautious, though, as investors may withdraw their investment at any time, affecting store operations and eventually leading to store closures.



# 09

## Rural e-commerce sees rapid growth; plays a key role in poverty relief and rural revitalization

Sustained improvement in infrastructure development, coupled with extensive government support, has resulted in rapid rural e-commerce growth in recent years. Increasing numbers of local enterprises have accelerated e-commerce expansion into rural areas. This has facilitated distribution of products within and between rural areas. At the same time, e-commerce has also played a crucial role in poverty relief and rural rejuvenation, enabling the government to address the three overarching rural issues, namely the future of the domestic agricultural industry; farmers' livelihoods, and facilitating further development of China's vast countryside.



# 10

## Shifting from price wars, logistics players compete on service quality to satisfy consumer upgrading

Intensified competition has forced many logistics and courier companies into price wars in recent years. However, with customers increasingly willing to pay a premium for quality and reliable services, logistics players are turning their focus to elevating their service quality and moving away from price as a determining factor. In response to the diverse needs of customers, many logistics companies have introduced a variety of personalized and diversified professional services. Meanwhile, some domestic logistics companies have increased investment in smart technologies, leading to the rise of smart logistics.



# Implications and Key Tips for Foreign Investors



## **Empowered consumers are in control**

- the millennials and “Generation Z” now together represent the most promising consumer segment in China
- businesses should understand and anticipate their needs to engage with them more deeply



## **Creative retail formats gain more clout**

- new retail formats and concepts have become increasingly popular in China
- enterprises need to be more creative in terms of setting up their store formats, providing unique shopping experiences and excitement for shoppers



## **Deploy mobile device-powered and social media-centric O2O strategies**

- omni-channel retailing/ O2O integration has and will continue to dominate the retail scene
- enterprises should provide seamless and holistic customer experiences across all channels, in real-time



## **The consumption upgrading and service consumption boom creates new demands and opportunities**

- enterprises should provide more quality and value for more products, and expand service offerings



## **Experience matters most; reinventing bricks-and-mortar stores is vital**

- physical stores still remain the most important touch point for consumers
- brands and retailers need to leverage technologies and keep reinventing their bricks-and-mortar businesses



## **Build a truly digitized and responsive supply chain**

- upgrading consumer demands and growing needs for greater choice and availability of products and services are challenging traditional supply chains
- enterprises should adopt digitized supply chains to align real-time sales data with design and production



## **Engage in enterprise-wide digital transformation**

- enterprises should engage in enterprise-wide digital transformation, focusing on digitalizing operations, core offerings, as well as online and offline shopping experiences



## **Keep abreast of the regulatory changes**

- the Chinese government has been keen to support the development of the commercial sector
- enterprises should be aware of policy changes and be flexible in adjusting their strategies when necessary

2019 is set to be a year of both intense challenges and abundant opportunities. Mounting uncertainties in the global market, driven in part by ongoing trade tension between China and the U.S., have made the overall economic environment hard to predict for the year. China's economic growth may soften due to external shocks, further dragging down retail sales growth. That said, the Chinese government's eagerness to encourage consumption and expand imports should provide ample opportunities for commercial enterprises.

Internally, the growing influence of Chinese millennials and "Generation Z" – who are poised to become the most influential consumer segment in the next decade – is prompting enterprises to rethink their strategies. Likewise, emerging business models enabled by advanced technologies are a new source of innovation and will provide additional prospects for businesses.

To secure their place in this competitive environment, enterprises have to be aware of the trends impacting the market and adapt quickly to changes.



### Empowered consumers are in control

The millennials, together with Generation Z who were born after 1995, now represent the most promising consumer segment in China. They have huge consumption potential with wealth accumulated and inherited from previous generations, and they have high aspirations for a better life – with particular desires for individuality, personalization and convenience-driven shopping experiences. To win these new customers, businesses should understand and anticipate their needs to engage with them more deeply, while offering high-quality and unique products and services.



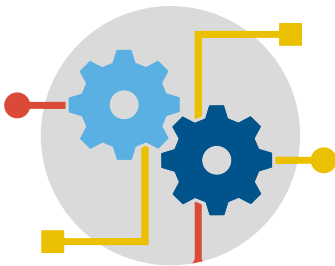
### Deploy mobile-powered and social media-centric O2O strategies

Evolving consumer expectations and the new, competitive environment are changing how and where consumers browse and buy. Purchases in the past were transactional, but now shopping is focused on experience and excitement. At the same time, omni-channel retailing/ online-to-offline (O2O) integration has and will continue to dominate the retail scene. Enterprises should provide seamless and holistic customer experiences across all channels – in store, on the Internet and through mobile devices – in real-time. They need to redefine their operational framework that integrates online and offline businesses, enrich product offerings and enhance the shopping experience. Very importantly, they should come up with O2O strategies that are mobile device-powered and social media-centric to suit the needs of Chinese customers, particularly young consumers who expect "digital" to be an inherent part of their lives.



### **Experience matters most; reinventing bricks-and-mortar stores is vital**

Despite the explosive growth of online retailing, physical stores still remain the most important touch point for consumers. The interactions in-store between sales people and consumers are pivotal, as it allows for relationship building and provides personalized customer experiences. To remain competitive, brands and retailers need to keep reinventing their bricks-and-mortar businesses by offering interactive experiences, personal interactions and instant gratification. In today's digital age, the wide adoption of technologies to enhance the in-store shopping experience is inevitable, as it is vital.



### **Engage in enterprise-wide digital transformation**

To keep pace with China's rapidly evolving commercial landscape, enterprises should engage in enterprise-wide digital transformation, focusing on digitalizing operations, core offerings, as well as online and offline shopping experiences. They should actively find ways to best leverage data analytics by ensuring data are reliable, accessible, and continually generating valuable insights; and establish a modern technology environment to support the deployment of technologies both online and offline. For example, businesses can devise clear and achievable technology roadmaps, train managers and staff to recognize the importance of digital transformation and how this can revolutionize the ways companies operate.



### **Creative retail formats gain more clout**

New retail concepts that offer such unique shopping experiences and excitement for shoppers have become increasingly popular in China. Selected examples include pop-up stores with technology-enabled features and gaming elements, along with hybrid shop formats with “retail plus lifestyle” or food and beverage elements. In today's new market dynamics, enterprises need to be more flexible and creative in terms of setting up their store formats. They should constantly reinvent their businesses, and most importantly, leverage technologies to refine their supply chains and upgrade their operations. As part of this process they need to come up with innovative strategies to create unique value and exclusive benefits for customers.



## **The consumption upgrading and service consumption boom creates new demands and opportunities**

Strong domestic consumption driven by growing consumer purchasing power has become a major driving force steering China's economic growth. Chinese consumers now have higher aspirations for a better life – their spending focus is shifting from price to quality of products and services, and from product consumption to service consumption. However, such new consumer demands have yet to be fully met. There is still an imbalance and a mismatch between the consumption upgrading trend and the supply of quality products and services. Enterprises must tap the opportunity by providing more quality and value for money products, while expanding service offerings to meet new requirements.



## **Build a truly digitized and responsive supply chain**

Rapidly upgrading consumer demands and the ever-growing needs for greater choice and availability of both products and services are challenging traditional supply chains. These call for the adoption of digitized supply chains which enable enterprises to incorporate real-time sales data into product design and production, allowing manufacturing and production to order. This can not only maximize efficiencies from design to production and to distribution, but also increase the likelihood that enterprises will have the right product mix, thereby minimizing markdowns and out-of-stock difficulties. Another advantage is that enterprises can manufacture products that better suit consumer preferences.



## **Keep abreast of the regulatory changes**

Over the years, the Chinese government has been keen to support the development of the commercial sector. For instance, it has adopted a series of measures to cut import tariffs and boost imports, in the hope of facilitating the country's supply-side structural reform. In addition, the long-awaited E-Commerce Law of the PRC, effective 1 January 2019 – which sets forth the obligations and responsibilities of all types of e-commerce operators, while extending legal protection for consumers – is set to better regulate the fast-growing e-commerce sector. Enterprises should be aware of policy changes and be flexible in adjusting their strategies when necessary.

# 01

## Innovation leads to high-quality consumer market growth; empowers domestic consumption to drive China's overall economic growth



In 2018, the Chinese government stepped up efforts to push forward supply-side structural reforms, promote innovation, encourage high-quality development and mitigate financial risks. These initiatives were introduced against the backdrop of an increasingly complicated global market, due in part to ongoing trade tension between China and the U.S., together with downward pressure on the domestic economy. As a result, the Chinese economy maintained steady growth in 2018. Additionally, the government has strengthened the role of domestic consumption in driving economic growth and reaffirmed some major development themes: innovation, integration, use of big data and artificial intelligence, better shopping experiences and convenience, high-quality products and green consumption. All of these themes are set to facilitate the growth of the Chinese consumer market.





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*The role of consumption in driving economic growth will continue to strengthen with the government's determined efforts to boost consumption such as boosting imports and reducing tax burden on individuals to encourage spending."*

*Ren Xingzhou, Research Fellow, former Director General, Institute of Market Economy, Development Research Centre of the State Council*

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## **Domestic trade review: major developments in 2018**

**GDP growth was stable at 6.7% yoy in the first three quarters of 2018**

In the first three quarters of 2018, China's GDP amounted to 65.1 trillion yuan; real GDP growth was 6.7% year-on-year (yoy), slightly lower than 6.9% yoy in the first three quarters of 2017. The service sector has continued to grow at a faster pace than the secondary sector, with service sector value-added contributing 53.1% of China's GDP in the first three quarters of 2018, gaining 7.7% yoy in real terms, 0.1 percentage point (ppt) higher than over the same period in 2017. By contrast, secondary sector value-added increased just 5.8% yoy in real terms over the same period. The role of consumption in driving economic growth strengthened in the first three quarters of 2018: consumption made up 78% of GDP growth, 13.5 ppts higher than over the same period in 2017. Our experts expect GDP growth in FY18 to be about 6.7% yoy.

### **Both retail sales and online retail sales growth moderated**

China's nominal retail sales of consumer goods rose 9.2% yoy to 30,983.4 billion yuan over the period January to October 2018, growing 1.1 ppts slower than over the same period in 2017. By month, growth of consumer goods retail sales remained stable at between 8.5% and 10.1%. Our experts expect retail sales growth in FY18 to remain at about 9.2% yoy, down from 10.2% yoy in 2017. The decrease in retail sales is partly explained by the decelerating growth of automobile-related sales. Automobile sales in China are heavily influenced by government regulations, particularly the strict control on license plates for cars in major cities.

From January to October 2018, sales of automobiles decreased by 0.6% yoy, 6.9 ppts lower than over the same period in 2017. Excluding the automobile sector, retail sales of consumer goods grew 11.2% yoy in the period January to October 2018.

It is noteworthy that the sales growth of daily consumables continued at a rapid pace. Retail sales of daily use products and cosmetics registered growth of over 10% yoy in the period January to October 2018 when compared to the same period in 2017, achieving yoy growth of 13.0% and 11.4%, respectively.

Total online retail sales of goods and services reached 7,053.9 billion yuan in the period January to October 2018, up 25.5% yoy. Online sales of goods amounted to 5,414.1 billion yuan, up 26.7% yoy, 2.1 ppts down from the same period in 2017. Online retail sales growth of physical goods decelerated due to a larger base, but its share of online retail sales further increased, accounting for 17.5% of total consumer retail sales, up from 14.0% over the same period in 2017. Moreover, online retail sales growth was faster than for physical store sales. In the period January to October 2018, the contribution of online sales of goods as a constituent in the growth of total retail sales was 43.7%, 10.1 ppts higher than over the same period in 2017.

### **Growth of rural retail sales exceeded urban sales, but the gap narrowed further**

Rural retail sales have been growing faster than urban retail sales over recent years, but the gap continued to narrow in 2018. Rural retail sales rose 10.3% yoy to 4,451.6 billion yuan in the period January to October 2018, 1.7 ppts lower than over the same period in 2017, while urban retail sales expanded 9.0% yoy to 26,531.8 billion yuan, 1.0 ppt down from the same period in 2017.

The faster growth in rural retail sales was partly attributed to higher rural household income growth. In the first three quarters of 2018, the per capita disposable income of rural households increased nominally by 8.9% yoy (or 6.8% yoy in real terms) to reach 10,645 yuan, while the per capita disposable income of urban households rose 7.9% yoy in nominal terms (or 5.7% yoy in real terms) to reach 29,599 yuan. The rapid development of rural e-commerce, including the government's initiatives to improve rural consumption, also helped boost rural retail sales.

#### Catering sales growth moderated; small catering enterprises saw higher growth

Catering sales growth moderated slightly in the period January to October 2018; nominal catering sales rose 9.6% yoy to 3,376.9 yuan, 1.3 ppts down from the same period in 2017. Meanwhile, small catering enterprises continued to outperform large catering enterprises. Growth for catering enterprises below the designated size and individual catering enterprises was up 10.4% yoy in the period January to October 2018, higher than the catering sales growth in general.



## What the Experts say

The Chinese economy has been able to maintain steady growth despite mounting economic uncertainties as the U.S.'s unilateralism and protectionism loom. Trade tensions between China and the U.S. have continued since the second half of 2018. However, the Chinese government has increased efforts to encourage domestic consumption and mitigate financial risks. Our experts believe that the Chinese government will further strengthen the role of consumption in economic development, playing a crucial role in meeting the country's 1.4 billion people's growing requirement for a better life, while encouraging innovation in the commercial sector. Total retail sales of consumer goods are expected to grow at 9% yoy in 2019.

Our experts highlight the following key trends regarding domestic trade and commercial sector development in 2019:

#### Consumption remains a major driver of economic growth

Domestic consumption is set to grow at a steady pace with the government's determined efforts to boost consumption. Such policies are manifested for example through reducing the tax burden on individuals to encourage spending. Effective from 1 October 2018, the Standing Committee of the National People's Congress adopted an amendment to the *Individual Income Tax Law* to raise the minimum threshold for paying personal income tax. The reduction of personal income tax will allow taxpayers to retain more out-of-pocket money, a move set to help boost consumption. Other measures and initiatives are also aimed to do likewise. In September 2018, the general offices of the Central Committee of the Communist Party of China and the State Council issued *Several Opinions on Improving the Mechanism of Promoting Consumption and Further Stimulating Residential Consumption*; while in October 2018, the General Office of the State Council issued the *Implementation Plan for Improving the Mechanism of Promoting Consumption Systems (2018-2020)*, highlighting the need to facilitate the growth of key niche markets, create a pleasant consumption environment and stimulate consumption potential.

### Convenience stores comprised the fastest-growing retail format

The convenience store sector remained the fastest-growing retail format in the first three quarters of 2018, attributable to consumers' increasing demand for convenient and rapid services. More consumers were eager to purchase from convenience stores and unmanned stores in residential communities. In the first three quarters of 2018, enterprises above the designated size saw sales grow by 6.6% yoy; sales growth of convenience stores topped other retail formats, reaching 12.3% yoy. Growth of retail sales of supermarket, discount stores and professional stores were 7.3% yoy, 6.1% yoy, and 8.6% yoy, respectively.

### Smaller-sized enterprises continued to grow rapidly

Smaller-sized enterprises gained in popularity and became major driving forces of consumption. This was especially true for small-format stores appealing to neighborhood shoppers and residents such as small and micro shops, convenience stores and small catering businesses. In the period January to October 2018, enterprises below the designated size and individual enterprises saw rapid sales growth of 10.8% yoy, higher than the total retail sales growth of 9.2% yoy in general, contributing to the rapid growth of mass-market consumption.

### Increased imports to boost consumption

The China International Import Expo (CIIE), the world's first import-themed national-level fair, was held in Shanghai from 5 to 10 November 2018. The CIIE is part of China's overall import promotion strategy. President Xi Jinping announced at the CIIE opening ceremony that China is to further reduce tariffs and increase imports. Indeed, recently, the government has adopted a series of measures to cut import tariffs and boost imports. In May 2018, the State Council announced import tariff reductions on a range of consumer goods including apparel, cosmetics, cleaning products, home appliances, fitness products and some healthcare products. The tariff cuts went into effect on 1 July 2018. In September 2018, the State Council further announced lower tariffs on imported products including machinery, electrical equipment and textile products as from 1 November 2018. It is expected that the import of consumer products will increase significantly in 2019. This will better satisfy consumer demand for imported products and encourage consumers to spend more at home and less abroad.

### Innovation becomes more evident in the consumer market

Innovative retail formats, new business models, better shopping experiences and services, and innovative marketing campaigns will all continue to drive the development of the consumer market. Service consumption will further gather pace as a result; various services subsectors including culture, travel, sports, healthcare and senior care are expected to see robust growth momentum in 2019.

### Regulatory environment improves further

The government has upheld and will continue to enforce market regulation and ensure a better consumption environment. For instance, the newly adopted E-commerce Law effective on 1 January 2019 establishes regulations concerning operators, contracts, dispute settlement and liabilities, as well as market development. The Law puts online sellers on a more even playing field with offline retail players while encouraging further integration of online and offline retail channels. This will greatly improve the operational environment for enterprises.

# 02

## China adopts an e-commerce law to improve market regulation



On 31 August 2018, after a fourth reading by the Standing Committee of the National People's Congress of the PRC (NPC), the long-awaited *E-Commerce Law of the PRC* ("E-commerce Law") was adopted. Effective on 1 January 2019, the E-commerce Law establishes regulations concerning operators, contracts, dispute settlement and liabilities, as well as market development.

The E-commerce Law comes at the right time. China's e-commerce market, the largest in the world, has attracted global attention with its explosive growth and transformative effect on the commercial sector. In the first three quarters of 2018, the transaction value of

China's online retail market amounted to 6,278.5 billion yuan, up 27.0% yoy. Driven by the proliferation of advanced technologies such as mobile Internet and big data, e-commerce is penetrating rapidly into key segments of the value chain comprising production, distribution and consumption. At the same time, the market is characterized by unfair competition, counterfeit products, false advertising and inadequate supervision, to name some of its flaws. The E-commerce Law, which aims to create a fair, competitive market and protect the legal rights and interests of all parties, is set to better regulate China's extremely fast-growing e-commerce sector.



*The E-commerce Law is the first comprehensive legislation in the distribution sector to regulate China's rapidly growing e-commerce sector. It can ensure fair competition and improve the operational environment for e-commerce operations."*

*Sun Ming, Director, Department of Market Operation, Ministry of Commerce of the PRC*

## Key provisions of the E-commerce Law

### Clarifying operational details for e-commerce players

The Law groups "e-commerce operators" into e-commerce platform operators (e.g. Tmall, Taobao), merchants on e-commerce platforms (e.g. vendors operating stores on Taobao), and those doing business on their own websites or via other web services (such as merchants selling on WeChat). It states that all e-commerce operators should go through relevant industry and commerce registration procedures, and obtain business licenses if required. In addition, all operators need to issue official tax receipts and file tax returns. The Law requires that e-commerce platform operators must verify business licenses, conduct identity checks on merchants, and submit both identification and tax information to tax authorities. These will result in higher compliance costs and additional taxes which e-commerce platform operators may pass on to consumers, putting online sellers on a more even playing field with offline retail players.

### Strengthening consumer rights and IP protection

Consumers will have greater legal protection under the E-commerce Law. E-commerce operators need to

obtain user consent from consumers on the collection, processing and use of personal information. If a consumer refuses to receive certain promotional emails or so-called "push" notifications, the e-commerce platform operator must allow consumers to disable the notification function.

The E-commerce Law also protects consumers against fake or misleading reviews. Fake reviews, including positive reviews written by hired agents as well as by customers in exchange for monetary rewards, are banned. To ensure consumers receive accurate information, the Law calls for the establishment of an e-commerce credit record and rating system to regulate credit rating activities.

Moreover, e-commerce platform operators are jointly responsible for the sale of fake or wrongly-described goods on their platform and are required to establish rules to protect intellectual property (IP) rights. Previously, only individual merchants were responsible. Under the E-commerce Law, if an IP right holder believes a merchant on a platform has infringed its IP rights, the IP right holder can notify the relevant platform operator and require the operator to take necessary action promptly, such as removing, blocking or disconnecting the relevant webpages, or terminating the relevant transactions and services.

## Regulating unfair competition

The E-commerce Law highlights fair competition obligations for all e-commerce operations, with special emphasis on those with dominant market positions. Operators with advantages in the market such as players with large numbers of users are prohibited from abusing their positions to exclude or restrict competition. This provision aims to level the playing field between smaller e-commerce players and larger platforms such as Tmall and JD.com.

The Law further underscores fair competition by prohibiting platform operators from imposing unreasonable restrictions, conditions and other terms on merchants using their platforms. They cannot force merchants to sell exclusively on their platforms. These obligations correspond with the provisions of the *Anti-Monopoly Law* of the PRC.

## Specifying requirements for electronic contracts, electronic payments and express deliveries

Since most e-commerce transactions involve e-contracts, the E-commerce Law stipulates that in the course of e-commerce activities, the parties to an electronic contract are presumed to possess the necessary capacity for civil conduct relating to individual duties and rights. Electronic payment service providers, on the other hand, are required to provide secure payment services and conform with the government's financial information security requirements. As to express deliveries, the Law specifies the rights and obligations of all parties involved in the delivery process – logistics service providers, product owners and consumers.





## What the Experts say

The E-commerce Law is the first comprehensive legislation in the distribution sector to regulate China's rapidly growing e-commerce sector. The legislative work for the Law started in December 2013, and since then, no less than four drafts have been submitted to the NPC for review. The scope of the Law is broad, encompassing different aspects of e-commerce and covering all major e-commerce business activities. This demonstrates the country's determination to come up with all-inclusive legislation. Our experts believe that the Law can ensure fair competition, encourage sound development of the e-commerce sector and improve the operational environment for companies, while having a profound impact on the e-commerce sector's long-term development.

In addition to its key provisions, the Law also states that China supports the development of cross border e-commerce (CBEC) and emphasizes the importance of establishing a mechanism to facilitate CBEC transactions and streamline operations, covering customs clearance, taxation, inspection quarantine, payment and exchange settlement as well as logistics. In March 2016, the government announced new policies on CBEC, setting out new tax rules for CBEC businesses and a positive list of permitted imported goods. Products on the list are exempt from submitting related import licenses to China Customs but are required to go through inspection and quarantine procedures. The submission of the Commodity Inspection and Quarantine Clearance Notice is required when imported products enter bonded zones. Moreover, first-time imported goods in certain categories such as cosmetics, infant formula and medical equipment need pre-market approval. To ensure a smooth

transition to the new requirements, the government has granted and extended a transition period for the implementation of the new regulations; it has also raised the annual quota on CBEC purchase for individual buyers as well as the limit on a single transaction, effective on 1 January 2019.

Meanwhile, the government has accelerated the establishment of CBEC Comprehensive Pilot Zones to facilitate CBEC operations and carry out trial experimental measures in terms of technology standards, operational procedures, supervision and information construction.

The E-commerce Law reinstates many of the existing legal principles and rules governing the various aspects of e-commerce. Under the Law, parties that fail to perform their obligations are required to assume legal liabilities and are subject to fines. This will prompt e-commerce operators to more closely focus on compliance; instead of competing on price alone, they will more likely enhance the quality of products and services. Our experts believe that the Law can facilitate the creation of a favorable legal environment for businesses; this marks an important milestone in the building of a reliable legal system.

While our experts agree that the Law will provide a sound legal ground for the development of the e-commerce sector, they also point out that the country still lacks specific and up-to-date legislation to regulate new business innovation in the commercial sector and new developments such as online and offline integration. For the future, an improved legal and regulatory environment remains the key to growth and prosperity in the ever-evolving commercial sector.

# 03

## Service consumption proliferates; catering industry embraces digital marketing; community businesses become increasingly competitive



With the trend towards consumption upgrading gathering pace in the new retail era, the demand for personalized, diversified and quality products and services continues to rise. In particular, service consumption has made great strides in terms of the variety and range of services offered. Online-to-offline (O2O) catering and community businesses are among the catalysts for the service consumption boom.





*Service consumption has made great strides in terms of the variety and range of services offered. Meanwhile, demand for various housekeeping and lifestyle services such as sports, culture, travel, healthcare and education has increased significantly recently.”*

*Zhang Yujing, PhD, Assistant Research Fellow, Department of International Trade Research, Academy of China Council for the Promotion of International Trade*

## **Service consumption is flourishing**

China's fast-growing consumer market, particularly for mass consumption, has fueled the rapid development and expansion of various services subsectors, stimulating service consumption across the country. For example, an aging population coupled with full implementation of the two-child policy has resulted in surging demand for various housekeeping services, especially maternity and newborn child services, senior home care services, house cleaning services and similar others. Besides the traditional service sector, new service businesses in sports, culture, travel, healthcare and education have also shown a particularly robust growth momentum, buoyed by the ongoing consumption upgrading trend, along with new business models, innovation and initiatives in the retail industry.

Currently, service consumption in China already makes up more than 40% of total household consumption, demonstrating how Chinese consumers are turning inexorably to consuming more services. With an enriched variety and quality of services, it is expected that lifestyle services will continue to make rapid advances and become one of the fastest growing consumption-linked sectors.

To facilitate this fast development and unleash potential consumption in the service sector, the central government and relevant ministries have introduced a series of initiatives to boost domestic service consumption. For example, in September 2018, the general offices of the Central Committee of the Communist Party of China and the State Council issued

*Several Opinions on Improving the Mechanism of Promoting Consumption and Further Stimulating Residential Consumption.* Considering service consumption as one of the major powerhouses sustaining the country's growth, the Opinions highlight seven consumption growth drivers, including service-related fields such as cultural, entertainment and sports consumption, healthcare, elderly care and housekeeping service consumption, along with education and training consumption.

## **O2O food services drive upgrading in the catering industry; actively embrace digital marketing**

With the unprecedented O2O multichannel development in China, O2O services are taking over the catering industry. To provide customers with on-demand and convenient catering services, many catering enterprises have embraced O2O catering by collaborating with third-party online food delivery platforms or setting up their own online catering services apps. Increasing adoption of digital technologies by food service providers to create seamless shopping experiences across online and offline channels have not only facilitated digital transformation and upgrading in the catering industry, but also underpinned the growth of online food delivery services. According to market research agency Analysis, Chinese online food delivery services platforms Meituan-Dianping and Koubei generated 171.3 billion yuan and 167 billion yuan in transaction values respectively in the first half of 2017, making these the two largest online food delivery companies in China.

Beyond providing customers with convenient and reliable food service experiences, the O2O model also enables catering businesses to obtain extremely large and valuable big data – encompassing consumer behaviors, preferences and needs as well as providing companies with more actionable insights vital for marketing strategies. As the Chinese catering industry has entered a new era of data-driven marketing, it is foreseeable that increasing numbers of restaurants and food service providers will make an aggressive push into digital marketing. Through analyzing and utilizing big data, catering enterprises can adjust their business strategies accordingly, and significantly improve their operational efficiency. The advent of smart and automated technologies also helps catering enterprises greatly reduce their need for manual labor such as for servers and cashiers, thereby enhancing overall productivity and minimizing labor costs.

### **Community retailing is the next “blue horizon”; last-mile competition heats up**

Accelerated urbanization in China has fueled the demand for retailing services in urban communities. By 2030, China’s urbanization rate is expected to reach near 67%, with up to 14 million rural residents moving into cities each year. The massive rural-to-urban migration will give rise to some 20,000 new residential communities in urban areas, underpinning the growth of community malls catering to local communities’ daily needs.

Realizing the fast growth of community retailing, increasing numbers of real estate developers such as China Vanke Co., Ltd., Jinke Property Group Co. Ltd. and SCP Group have stepped up investment in commercial property by building more community malls in various neighborhoods and within walking distance of residential communities. These malls – often seen as venues that provide last-mile convenience for residents – are gaining increasing popularity due to their diverse goods and services, with offerings including convenience stores, supermarkets, specialty stores, restaurants, clinics and parking spaces, among other facilities, as well as proximity to residential areas. Differentiated from traditional shopping malls, community malls facilitate “easy living” by offering consumers quicker and convenient physical access to shopping, dining and easy-to-find parking spaces.

As competition heats up, some community mall developers are deliberately differentiating themselves by providing new businesses such as specialist clinics, general hospitals, pet shops, post-natal care services, medical beauty services and wedding planning services. At the same time, they are enhancing service quality to attract and retain customers, as well as improve customer demand and local reliance.





## What the Experts say

Considering the ongoing Chinese consumption and lifestyle trend, our experts are convinced that new services and businesses will become more sought-after and play a key role in driving the upgrade of community malls. It is expected that more community malls will be converted into one-stop lifestyle centers that suit everyday needs of customers. Meanwhile, public service centers, which provide a variety of public services such as license and ID registration, marriage registration, consultation and recreation services are set to become the new anchors for community malls. Adding character and community atmosphere to the malls, such service centers will enhance the competitiveness of these community malls, making them more appealing to neighborhood shoppers and residents.

Moreover, our experts expect community retailing to see new development prospects: these will be actuated by increasing adoption of big data analytics by community mall developers, better connecting all stakeholders including malls, tenants (including brands) and consumers, as well as other service providers. This unique community retailing ecosystem will facilitate further transformation and reinvention of the sector.



# 04

## Business model upgrading and transformation revolutionize the retail sector



China's retail sector is in the midst of rapid transformation. Rising competition and changing consumer expectations pose business challenges for traditional retailers. To cope with this ever-changing retail environment, increasing numbers of retailers are actively seeking new solutions – such as technological innovation and digital transformation – to upgrade their business models, and for some, introduce new retail formats to the market.





*Cross-sector collaboration is a major trend in China's retail sector. It facilitates the development of multi-format business models such as "retail + food and beverage", "retail + entertainment", "retail + culture", "retail + medical" and "retail + IP".*

*Su Youyu, Vice Secretary General, China Commerce Association for General Merchandise*

## **New business models and retail concepts flourish**

### **New retail concepts proliferate**

Since 2017, innovative business models and new retail concepts have proliferated in the market. These new innovations share some common characteristics – focusing on supply chain optimization, online-to-offline (O2O) integration and digital transformation to enhance operational efficiencies and reduce costs. The grocery sector is among the earliest retail segments to see many new business models and retail concepts. Some pioneers include Alibaba's fresh food-focused supermarket chain Hema Xiansheng, Yonghui Superstores' YH Super Species and JD.com's 7Fresh futuristic supermarket. These new retail concepts adopt the "supermarket + catering" model, and use various "black technologies" such as facial recognition, smart shelves and self-service payment terminals to optimize store operations and improve customer experience. In 2018, some of these new retail concepts have further evolved and have been modified. For instance, YH Super Species has incubated two new businesses based on its "supermarket + catering" concept – Yonghui Private Kitchen provides catering and personal chef services, and has introduced its Super Research Institute to provide backend staff training.

### **Cross-sector collaboration opens up new opportunities; facilitates the creation of multi-format business models**

Poor differentiation is a common problem currently facing many retailers. Some retailers suffer from

homogenization across almost the entire spectrum, from product design and curation to formulating pricing and marketing strategies, prompting them to diversify their businesses or form partnerships with players in other sectors to engage in cross-sector collaboration. Such partnerships often allow enterprises to leverage each other's strengths and come up with interesting business models, thus better satisfying the needs and expectations of consumers. Cross-sector collaboration also facilitates the development of multi-format business models such as "retail + food and beverage", "retail + entertainment", "retail + culture", "retail + medical" and "retail + IP".

Currently, there are some significant cases of cross-sector collaboration in the retail sector. A typical example is Muji. The Japanese lifestyle retailer has diversified into the hospitality sector by launching Muji Hotel in Shenzhen in January 2018 and in Beijing in March 2018. Besides offering accommodation services, the Muji hotel division has incorporated other Muji products and services including Muji retail store, Muji Café and Muji Books. In October 2018, JNBYHOME, a home products brand under JNBY Group, announced it would join hands with Wadangwashe Hotel to open a new hotel in Hangzhou by the end of 2018. This marks a significant step for JNBY to diversify its businesses. Another example is Suning.com. Since September 2018, Suning.com has started to sell home electronics products in RT-Mart's stores in mainland China. The cross-sector collaboration enables Suning to extend its offline reach while generating larger revenues; for RT-Mart, the partnership helps the hypermarket chain improve sales of its home electronics products.

### Private labels make rapid advances

With consumers increasingly searching for high-quality and value-for-money products, traditional retailers – especially supermarket and hypermarket operators, as well as e-commerce operators – are stepping up efforts to launch their own private labels to better meet consumer needs and expectations. In May 2018, wholesale and food specialist METRO China launched its new flagship brands METRO Chef, METRO Professional and METRO Premium. It is estimated that by 2020, Metro's own private label products will increase to more than 4,600 stock keeping units (SKUs), and sales will increase from 14% in 2017 to 20% in 2020. Hema Xiansheng is also vigorously developing its portfolio of private labels with the launch of Hema Weidao, Hema Gongfang and Dihuangxian, among other initiatives. Hema Xiansheng hopes to increase the proportion of its private label business to around 50% of total sales over the next three years.

Other examples of private label development include Wumart's launch of its new private label line Meirixian for fresh food products in July 2018. YH Super Species launched private brand U Select in February 2018, and later standardized the names of its 40-plus private labels under U Select. Walmart China launched its private brand Great Value in October 2017 while RT-Mart launched a private label line for apparel in July 2017.

Meanwhile, some Internet or e-commerce operators have launched their own private labels to provide high-quality goods to customers. Examples include NetEase which launched its private label Yanxuan in 2016; Alibaba launched its private label retail site Taobao Xinxuan in May 2017; Mia.com launched its private label Tutou Mama Zhenxuan in June 2017; and JD.com launched its private label Jingzhao in 2018. Social e-commerce platform Xiaohongshu also launched its private label REDelight in 2018. Some operators adopt the original design manufacture (ODM) model through which they partner with manufacturers of big brands to design and produce the products; they also oversee the entire production process, from supplier and raw material selection to product design and production as well as marketing and sales. Some players also leverage their big data capabilities to introduce products that better suit the needs and preferences of their customers.

### On-demand delivery services become prevalent

In response to the consumption upgrading trend, coupled with consumers' desire for better products and services, some retailers and e-commerce operators are keen to provide additional services to attract consumers, such as on-demand delivery. Considering the high costs of setting up their own delivery fleets, many companies choose to team up with third-party O2O local lifestyle service platforms such as JD Daojia,



Ele.me and Meituan-Dianping. This trend has become increasingly prevalent in tier-1 and tier-2 cities, and is set to expand to other lower-tier cities in the near future.

## Rise of a new retail format: Pop-up stores

Pop-up stores have become increasingly popular in the retail industry over recent years. One major advantage of pop-up retailing is that set-up costs are far lower than for permanent stores with their long-term leases. Also, pop-up stores serve different purposes – selling products (for some, limited edition products) while enhancing brand awareness and gaining market insight. Recently, some brands have opened pop-up stores backed by innovative marketing content to promote products and raise their market awareness. In one example, footwear brand Staccato jointly opened a pop-up store in April 2018 with short-video social media platform TikTok in Shenzhen.

Pop-up stores are also becoming an increasingly popular channel for e-commerce operators and online retailers (without a physical presence) to connect with

customers in a direct and dynamic way. Some operators also use the pop-up format to test new technologies, concepts and collections while gaining market insight. These stores usually adopt numerous cutting-edge “black technologies” which can help them better engage with customers and draw offline traffic to their online sites. Both Alibaba and JD.com have opened technology-powered pop-up stores to showcase their online products. Since March 2018, JD.com has set up a series of JOY SPACE pop-up stores nationwide in collaboration with retailers from different sectors including cosmetics, apparel, home electronics and home furnishing.

At the same time, the online pop-up store is also trending further. In the luxury sector, on top of launching brick-and-mortar pop-up stores, some brands are trialing the pop-up concept online to test their marketing initiatives and better connect with young consumers. Luxury brands such as Burberry, Valentino and Calvin Klein launched their online pop-up stores during the Qixi Festival, China's equivalent to Valentine's Day, which in 2018 fell on 17 August.



## What the Experts say

Our experts believe that the transformation and upgrading trend will continue into 2019 and play a significant role in driving the development of China's retail sector. To keep pace with the rapidly evolving market landscape, retailers will continue to reinvent their businesses – leveraging advanced technologies to refine their supply chains and upgrade their operations, to come up with innovative business models.

In today's consumer-driven environment, retail practitioners have to more clearly focus on the basics of retailing – providing high-quality goods and services, as well as personalized and unique shopping experiences, while strengthening core competencies through technological innovation and digital transformation.

# 05

## Boosting imports to address consumer demand for quality living; global sourcing enhances consumption upgrading



The China International Import Expo (CIIE), the world's first import-themed, national-level fair, was held in Shanghai from 5 to 10 November 2018. CIIE, which is part of China's overall import promotion strategy, attracted more than 3,600 enterprises and international organizations from 172 countries and regions, with over 400,000 domestic and overseas purchasers. Some US\$57.83 billion worth of deals were agreed for the year ahead at CIIE. President Xi Jinping announced at CIIE's opening ceremony that China will take concrete steps to boost imports by lowering tariffs, facilitating customs clearance, reducing institutional costs and speeding up the development of new business formats such as cross-border e-commerce (CBEC). President Xi estimated that China's total

imports of goods and services in the next 15 years will exceed US\$30 trillion and US\$10 trillion, respectively.

Against the backdrop of growing protectionism and increasing pushback against globalization, China's pledge to increase imports marks an important step for the country to promote the multilateral trading system, while transitioning to the stage of high-quality development. For the future, resource reallocation and trade rebalancing around the world will have profound implications in China in terms of upgrading of the domestic industrial structure, supply-demand balancing, consumption upgrading, CBEC development and supply chain optimization.





*The inaugural China International Import Expo is a significant part of China's overall import promotion strategy. It marks a significant milestone for the country to boost imports and create new supply, particularly the supply of quality products."*

*Ding Junfa, Professor; Vice Chairman, China Federation of Logistics & Purchasing*

### **Increased imports to achieve consumption upgrading and supply-demand optimization**

After 40 years of reform and opening-up, China is evolving from an export-oriented economy into one driven by consumption. With consumers' growing purchasing power, consumption is itself now a major driver of economic growth. It is important to note that Chinese consumers now have higher aspirations for a better life – consumer spending focus is shifting from price to quality of products and services, and from product consumption to service consumption. However, these new consumer demands have yet to be fully met. There is still an imbalance and a mismatch between consumption upgrading and the supply of quality and high-end products.

Expanding imports can better satisfy new consumer demand, especially for quality products and services. This can also facilitate the introduction of new products and services, and advanced technologies into China, important factors for China to enhance industrial competitiveness and resource allocation, while facilitating national supply-side structural reform.

Recently, the government has adopted a series of measures to cut import tariffs and boost imports. In May 2018, the State Council announced that China will slash import tariffs on a range of consumer goods including apparel, cosmetics, cleaning products, home appliances, fitness products and some healthcare products. The tariff cuts went into effect on 1 July, 2018. In September 2018, the State Council further announced lower tariffs on imported products including machinery, electrical equipment and textile products as

from 1 November, 2018. This is the sixth round of tariff cuts involving consumer products since 2015. The overall tariff level is reportedly reduced to 7.5% in 2018 from 9.8% in 2017, while the tariff cuts are estimated to lower enterprise and consumer costs by nearly 60 billion yuan.

### **Cross-border e-commerce facilitates overseas brands to enter China market**

Cross-border e-commerce (CBEC) has witnessed remarkable growth over recent years. Chinese consumers are becoming increasingly accustomed to buying imported goods through the CBEC channel, particularly via integrated CBEC platforms. According to a report jointly published by China Chamber of International Commerce, Deloitte and AliResearch in October 2018, the import proportion of total CBEC sales rose significantly to 10.2% in 2017 from 1.6% in 2014. The report also stated that China's total imports grew by 15.9% yoy in 2017; popular consumer products such as cosmetics, watches, clothing, home products and food products all witnessed positive growth rates, with cosmetics and infant formula seeing the highest growth at 48.6% and 40.4%, respectively.

The government has been very supportive towards CBEC development. Since 2012, the government has established comprehensive pilot zones to better regulate and facilitate CBEC import business. As of December 2018, China had 35 CBEC comprehensive pilot zones. The State Council has also urged relevant government departments to support innovation development in the comprehensive pilot zones by streamlining logistics, warehousing and customs clearance processes and facilitating information sharing.

The government's positive policies have made CBEC a relatively easy, quick and direct pathway for overseas brands and retailers to enter the China market, at relatively favorable tax rates. Moreover, stable development of the bonded warehouse model and other gradually maturing operating models have further transformed the CBEC shopping experience, making it an effective channel complementary to the general trade model to meet customers' growing demand for imported goods.

### **Global sourcing provides ample development opportunities**

China is now the world's second-largest consumer economy, fast evolving from its role as the "factory of the world"; consumption is playing a far greater role in the country's economic growth. To meet the new needs of consumers, particularly in terms of product quality and variety, retail operators are increasingly adopting a global sourcing strategy. During the CIIE, Suning.com agreed to spend 120 billion yuan on overseas procurement and introduce 5,000 overseas brands to China. Alibaba pledged to import US\$200 billion worth of foreign goods from more than 120 countries and regions over the next five years. JD.com signed purchase contracts amounting to nearly 100 billion yuan. Traditional retailers such as Yonghui Superstores, Bailian Group, Carrefour (China) and Walmart (China)

also signed global purchasing agreements with companies around the world, further strengthening their supply chain capabilities.

In recent years, many well-established companies have specifically focused on international sourcing activities as part of their globalization strategy. For example, Suning has adopted a "global procurement strategy" since 2014 to expand its global supply chain network; Suning's buyer team sources quality products from 147 countries and regions via the company's more than 100 overseas sourcing offices. Suning's CBEC business now covers several countries and regions including Japan, the U.S., Australia, Korea and Hong Kong. Similarly, JD.com has formed strategic partnerships with around 20 countries for product procurement. To facilitate its CBEC business, JD.com has ramped up investment in cross-border logistics infrastructure – it has built more than 110 overseas warehouses to facilitate cross-border shipping. JD.com also operates over 1,000 shipping routes globally, providing logistics services in 224 countries and regions and provides same-day or next-day delivery in tier-1 or tier-2 cities. Additionally, JD.com leverages advanced technologies such as blockchain, the Internet of Things (IoT) and big data to track and trace products, allowing the movement of CBEC goods to become more transparent to consumers.





## What the Experts say

China's consumption upgrading trend has and will continue to provide growth momentum for global consumer markets. Also, as China continues to advance towards a consumption-driven development model, the need for high-quality overseas products will increase further. This will provide excellent opportunities for commercial enterprises. On the one hand, the influx of large numbers of imported products will force domestic companies to improve the quality and design of their products. On the other hand, the opening-up of the country and further global resource reallocation will encourage local retailers to accelerate their transformation process, thereby increasing their brand influence on the global stage.

To thrive in an increasingly competitive retail market, our experts urge commercial enterprises to constantly explore the needs of customers and create new supply to meet new requirements. For instance, department store operators can shift from

a concessionary model relying on commissions as the predominant source of income to engaging in merchandise direct sales and setting up self-owned multi-brand stores selling directly-sourced products. Enterprises should also keep innovating and offer more high-quality and value for money products. This will encourage Chinese consumers to spend more at home and less abroad.

Our experts also highlight the importance of supply chain digitalization to facilitate supply-demand balance. To cater to the needs of digitally-empowered customers, it is important for enterprises to deploy technologies across the entire supply chain. This not only enables seamless upstream-downstream connectivity – allowing enterprises to use real-time data analytics to influence upstream activities – but also facilitates the creation of global supply chains to bring high-quality products from around the world to China, thereby meeting customers' ever-growing requirement for a better life.

# 06

## Government to bolster growth of the real economy; further optimizes the business environment, cuts taxes and fees



The Chinese economy maintained steady growth in 2018. However, downward pressure on the Chinese economy remained acute amidst external uncertainties. The macro environment remained challenging for businesses. Given this backdrop, the Chinese government has launched a series of measures to help bolster the real economy's growth. In particular, the government has announced that it will lower tax burdens and operating costs for businesses by further reducing taxes and cutting administrative fees.



*The government's initiatives to cut taxes and fees will improve wages and household incomes, which in turn may stimulate consumer spending. These will play a positive role in boosting marketing vitality."*

*Cao Lisheng, Deputy Secretary General, China General Chamber of Commerce*

At the beginning of 2018, the State Council released the Government Work Report which set out the target of cutting taxes and fees for businesses by 1.1 trillion yuan. Following the State Council's announcement, various government departments have since introduced a series of tax and fee reduction initiatives. It is estimated that the total reduction in taxes and fees for 2018 would reach 1.3 trillion yuan. The implementation of the measures will help companies save costs as well as play a positive role in boosting market vitality.

Selected major tax and fee cut initiatives implemented include:

### **Value-added tax ("VAT") rates lowered**

The government has further lowered the cost of doing business by easing the tax burden on companies in 2018. Total tax savings in 2018 was estimated to exceed 800 billion yuan. The tax relief for businesses mainly came in the form of reduced VAT rates: these were lowered across China from 1 May 2018. Some key changes to VAT rates are shown in Exhibit 1.

#### **Exhibit 1: Selected VAT changes in China effective 1 May 2018**

- The 17% and 11% VAT currently payable on the sales and imports of goods will be lowered to 16% and 10%, respectively;
- The input tax credit for the purchase of agricultural products will be reduced from 11% to 10%;
- Agricultural products purchased for use in the production, sale or contract processing of goods that are currently subject to 16% VAT will enjoy an input tax credit of 12%;
- The annual turnover threshold to register as a general VAT taxpayer has been uniformly increased to 5 million yuan for all businesses. Businesses operating below this threshold will be able to register as small-scale VAT taxpayers. Previously, the annual turnover threshold for industrial companies was 500,000 yuan, while the annual turnover threshold for trading companies was 800,000 yuan.

The revised VAT measures are expected to effectively help businesses save on tax costs.

## Minimum personal income tax threshold raised

To further reduce the tax burden on individuals and lower company labor costs, China's top legislature adopted an amendment to the *Individual Income Tax Law* to raise the minimum threshold for paying personal income tax from 3,500 yuan to 5,000 yuan per month effective from 1 October 2018. The amendment has also added six special expense deduction categories for items such as children's education, continuing education, medical treatment for serious illnesses, housing loan interest and rent, as well as elderly support expenses.

The reduction of personal income tax will allow taxpayers to retain more out-of-pocket money, which is set to help boost consumption and bolster the real economy.

## Lower non-tax costs for businesses

Besides lowering taxes, the government has also rolled out a series of measures to reduce companies' non-tax burden by lowering fees and charges. In particular, the government has reduced the social insurance premiums paid by employers, which are currently a significant expense for businesses in China. Exhibit 2 lists some of the initiatives the government has adopted to lower business non-tax costs.

## Efforts to support small and micro enterprises

Small and micro enterprises account for the majority of business in China and are a major driver of economic growth. In 2018, the government introduced a series of tax incentives and fee reduction measures to support these enterprises' development. Selected measures are highlighted in Exhibit 3.

### Exhibit 2: Measures to reduce the non-tax burden on companies

- Interim policies on reducing employers' contribution rates for employees' pension, unemployment insurance and work injury insurance will be extended to 30 April 2019;
- Interim policies on reducing employers' contribution rates for public housing accumulation funds will be extended to 30 April 2020;
- Companies in eligible regions can lower their work-related injury insurance premiums by an additional 20% or 50% from 1 May 2018;
- Payment of employment security funds for disabled people will be capped at a maximum of twice the average local wage, down from three times the average local wage previously;
- Construction fund contributions for major water conservancy projects required to be paid by certain companies will be cut by 25% as from 1 July 2018;
- Discharge fees for pollutants are abolished nationwide.

### Exhibit 3: Selected measures adopted to support small and micro enterprises

- Prohibits the collection of commitment fees and capital management fees from loans to small and micro enterprises;
- The maximum annual taxable income for small and micro enterprises entitled to a 50% reduced corporate income tax rate have been raised from 500,000 yuan to 1 million yuan for the period 1 January 2018 to 31 December 2020;
- Small and micro enterprises can claim value-added tax exemption between 1 September 2018 to the end of 2020 on interest income from loans of up to 5 million yuan, up from the previous 1 million yuan.

## Cutting electricity costs for commercial enterprises

Under China's current electricity pricing system, commercial electricity rates are generally far higher than industrial electricity and residential electricity rates. The high cost of commercial electricity has significantly increased business operating costs. Many businesses have said that high electricity costs have hindered their companies' operating and innovative efficiencies.

The government has released a series of measures to reduce industrial and commercial electricity rates. The 2018 Government Work Report specifically set out a target for lowering industrial and commercial electricity rates by an average of 10%. To achieve this target, the National Development and Reform Commission ("NDRC") has subsequently issued a series of documents and measures such as the *Notice on Matters Concerning Lowering Industrial and Commercial Electricity Rates* and the *Notice on Adjusting the VAT rate in the Electric Power Sector to Lower Industrial and Commercial Electricity Rates* to

ensure that electricity prices will be reduced. Some of the measures implemented include lowering the VAT rate for the electric power sector from 17% to 16%; cancelling certain monopolistic charges currently levied by power grid enterprises; and cleaning-up unreasonable price increases in the electricity supply system. At the same time, local governments and power grid enterprises have taken action to follow through on the implementation of the NDRC policies to ensure that electricity rates will be lower. The State Council has also paid special attention to this issue and has solicited the assistance of the Ministry of Industry and Information to carry out a third-party assessment on whether policies to reduce electricity charges have been properly implemented on a nationwide basis.

Taking into consideration all the policies and measures currently released and implemented, it is estimated that the annual reduction of electricity charges for industrial and commercial enterprises will be more than 100 billion yuan in aggregate, exceeding the targeted 10% reduction.



### What the Experts say

The commercial sector plays an important role in promoting economic and social growth and development. To further spur business sector development, the government has been diligently working to ensure that existing tax reduction measures are fully implemented. At the same time, it has also reportedly started to devise further new tax and fee cut measures, which are set to roll out within 2019. Our experts believe that such measures will further alleviate the cost burden of businesses and help enhance growth of the real economy.

Our experts point out that the government has clearly acknowledged the important role the private sector has played in driving growth and spurring innovation. President Xi Jinping convened a symposium for the private sector in November 2018 in which he clearly expressed the government's unwavering support for private enterprises. President Xi reaffirmed the importance of the private sector with an assurance that the government will continue to support and protect the interests and development of private businesses by further optimizing the business environment and cutting taxes and fees for private enterprises.

# 07

## Digital transformation of retail accelerates; supply chain digitalization to help drive economic growth



With online-to-offline (O2O) integration and business innovation gaining momentum in 2018, digital transformation is becoming a priority for commercial businesses. Indeed, transformation is a matter of survival in an increasingly competitive environment. Looking to 2019, more retail companies are set to incorporate technologies into their business operations. This, in turn, will drive supply chain transformation and fuel economic growth.





*Technology is revolutionizing retail. With increasing adoption of cutting-edge technologies such as artificial intelligence and big data analytics, digital transformation is set to accelerate in 2019. More retail companies will incorporate technologies into their business operations.”*

*Peng Jianzhen, Vice Secretary General, China Chain Store & Franchise Association*

## **Use of digital technologies picks up steam**

O2O integration has and will continue to dominate retail development in China. The pursuit of O2O strategies has become a preoccupation for most brands and retailers. Increasing numbers of enterprises are leveraging big data and other breakthrough technologies such as artificial intelligence (AI), the Internet of Things (IoT), cloud computing, blockchain, augmented reality (AR) and virtual reality (VR), 5G mobile technology and Global Positioning System (GPS) technology. These seamlessly bring online and offline experiences together, while improving operational efficiencies. On the one hand, bricks-and-mortar retailers are pursuing digital expansion to provide seamless shopping experiences for customers; on the other hand, e-commerce giants are harnessing the power of digital technologies to increase their offline presence and further expand their business ecosystems. This has led to the rise of smart stores – those with numerous technology-enabled elements that can facilitate O2O integration and enhance the customer shopping experience.

Alibaba's iconic supermarket chain Hema Xiansheng is a case in point. It utilizes huge volumes of big data on consumers while introducing other technologies to optimize store offerings. It uses big data to predict consumer demand, decide what products to promote and when and what to restock on shelves. This has enabled Hema Xiansheng to become more customer-centric and optimize three core business elements—customers, merchandise and physical setting.

Rival JD.com, by contrast, leverages huge amounts of data generated from its vast customer base – along with AI algorithms – to assist partnering brands to embrace

digital transformation. Brands can use JD.com's data analytics to choose the right store locations, types and quantity of products to stock or replenish; they can devise pricing strategies and better understand and respond to the needs of customers.

## **Digitalization facilitates supply chain transformation and drives economic growth**

Technology plays a crucial role in transforming the supply chain. A digitalized supply chain enables seamless upstream-downstream connectivity, which enables the flow of real-time consumer data from retail to upstream manufacturing across the supply chain, to be translated immediately into business decisions. More retailers and e-commerce operators alike are deploying digital technologies across the whole supply chain from product development and production to logistics planning and warehousing management and to distribution and customer engagement. Their aim is to achieve more precise supply-demand matching and meet the needs of digitally-empowered customers. A typical example is pure-click fast fashion retailer Handu (Handu.com). Handu has put in place a demand- and data-driven supply chain, allowing the online retailer to synchronize retailing with manufacturing. By utilizing real-time sales data and customer feedback to predict trends and demand, Handu can adapt production as needed. To further push forward its consumer-to-business (C2B) model – driven largely by big data analytics – Handu has launched its self-developed AI project “Zhizi” to perform multi-dimensional analysis on its huge amounts of product data accumulated over the years. Handu expects the digitalization of downstream retail services to facilitate agile manufacturing and enhance supply chain flexibility.

Recently, some Internet and e-commerce players have set up dedicated online platforms to sell their own private labels. These platforms often sell a selection of curated products based on consumers' preferences and past purchase data. Many of these platforms adopt the original design manufacture (ODM) model through which they partner with manufacturers of big brands to design and manufacture the products. This model enables e-commerce platforms to link directly with upstream manufacturers, overtaking the traditional manufacturing-distribution model.

In the grocery sector, the use of data and cutting-edge technologies has greatly optimized the sourcing, inventory replenishment and delivery processes, in addition to demand forecasting and introducing customized products to customers. Alibaba's fresh food-focused supermarket chain Hema Xiansheng utilizes its data capabilities to source different products from all over the world for each of its store, with reference to the store's customer demographics, customer preferences and purchase history. Miss Fresh, an e-commerce platform specializing in fresh produce, sources products directly from farms based on customer analytics. It also uses data and other advanced technologies to predict orders and automatically replenish items, while improving cold chain logistics processes to ensure product quality and safety.

Digitalization of retail – especially data sharing – not only enhances the connectivity and integration of supply chains, allowing enterprises to swiftly respond to

changing customer demand, but also greatly facilitates the transformation of the supply chain industry and drive economic growth. For instance, Alibaba's LST (or Ling Shou Tong) platform provides digitalization and other business services to many mom-and-pop stores in China, helping them to embark on digital transformation in areas such as product procurement, logistics and marketing. This also enables key stakeholders along the supply chain to improve efficiency, thereby facilitating an upgrade of the entire supply chain industry and drive economic growth.

### **Government encourages supply chain innovation and upgrading in the distribution sector**

Recognizing the importance of supply chain integration to facilitate the country's supply-side structural reform and promote consumption upgrading, the government has released several guidelines and notices to foster supply chain innovation and upgrading in the distribution sector. Following the promulgation in October 2017 of the *Guiding Opinions on Promoting the Innovation and Application of Supply Chains* by the General Office of the State Council, the Ministry of Finance and the Ministry of Commerce jointly released the *Circular on Establishing a Modern Supply Chain System for the Distribution Industry in 2018* during May of that year, highlighting the need to accelerate construction of a model supply chain system for the distribution industry.





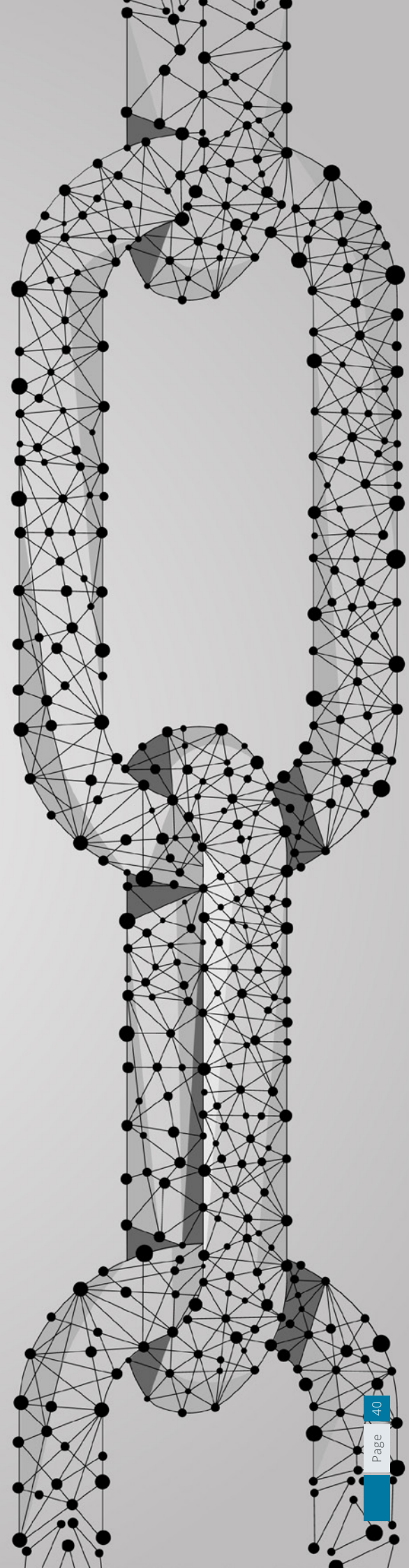
## What the Experts say

With the government's support for supply chain innovation and application, coupled with fast development of O2O integration and rapid uptake of technologies and big data by businesses, our experts are optimistic about the creation of a digital economy – driven largely by digital transformation in the retail sector. This will provide new opportunities for economic growth in 2019.

While our experts believe the adoption of leading-edge technologies in the retail and commercial sector will accelerate, they also warn that investment costs and maintenance fees for required technological applications will remain high. Some innovations such as unmanned stores are costly and unsustainable. Over the past year, there have been cases where such stores or related smart shelves have been shut down or sold off. Selected examples include the closure of about 500 “GoGo Small” smart shelves in early 2018 and the sale of Lingwa, one of earliest companies operating a smart shelf business, to unmanned convenience store operator Bianlefeng in February 2018.

As indicated by the retail digitalization initiatives from e-commerce giants, whether it is Alibaba's “New Retail” strategy, JD.com's “Unbounded Retail” concept or Suning's “Smart Retail” strategy, the essence of technology deployment centers on using data mining and predictive analytics to identify and address problems customers may experience as well as satisfy their changing demands. The key differentiators are quick response time, supply and demand flexibility and convenience.

In the current highly dynamic environment, enterprises need to quickly adapt existing approaches to digital transformation. They need to embrace change proactively, and with a more strategic mindset. This may call for a reorganization of the company structure and a restructuring of business processes.



# 08

## Department stores, hypermarkets and supermarkets continue to reinvent and innovate; capital investment in the convenience store sector proves to be a double-edged sword



For many traditional retailers, 2018 has been a year of transformation. Rising operating costs and fierce competition from e-commerce players, coupled with the changing needs of consumers have posed business challenges for traditional retailers. This has been particularly so for department store and hypermarket/ supermarket operators. According to Linkshop data, in the first half of 2018, 19 of the 54 listed department store operators saw a decline in sales revenue; 22 recorded a decline in net profits while five recorded negative profits. To stay competitive in a challenging market environment and to better adapt to new market dynamics, some traditional retailers have made vigorous efforts to upgrade, revamp and explore new business opportunities, often using the abundant capital resources available in the market.



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*In response to the new market dynamics, increasing numbers of traditional retailers have made vigorous efforts to upgrade and reinvent themselves. Many have enriched their product and service offerings, while incorporating more experiential elements. They are gradually winning customers and realizing stronger sales growth.”*

*Zeng Lingtong, Director, China Retail Human Resource Research Center*

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### **Department stores engage in multi-format operations**

In today's "new consumption" era, increasing numbers of department store operators are adopting a multi-format approach to make shopping experiences more exciting and engaging. They have incorporated more experiential elements such as food and beverages (F&B) outlets, cinemas, children's play areas, educational services, spas and exhibitions; the aim is to enhance unique experiences and adapt to consumers' changing needs. For instance, in November 2016, Nanjing New World Department Store re-positioned itself from an outlet mall to become a "trendy mini mall" by remodeling existing premises and introducing more F&B tenants, as well as entertainment venues and other lifestyle related shopping elements in the upgraded shopping mall. It has also introduced an in-store themed street zone, "New Territories 88", combining shopping with elements such as recreation, artistic presentations, lifestyle and culture. This has reportedly helped the retailer achieve a close to two-fold growth in revenue and about 20% yoy growth in foot traffic. The "New Territories 88" model was adopted by Changsha New World Department Store in July 2017 and renamed "MAX Commune".

Another example is Golden Eagle Retail Group. It has actively expanded its business scope in recent years with the launch of its G · LIFE series in 2016, which covers various modules including G · MART (premium supermarket), G · TAKAYA (bookstore), G · PET (pet service and care center), G · BEAUTY (beauty variety store), G · HEALTH (healthcare products) and G · BABY (infants and children).

### **Hypermarkets/ supermarkets aim smaller; convenience store (CVS) sector in rapid growth**

With ever-increasing rental and labor costs, together with consumers' increasing demand for convenience, personalization and fast services, small-format stores such as convenience stores (CVS) and community stores have been increasingly favored by many hypermarket/ supermarket chain operators. Some have introduced their own small-format stores. For example, Walmart China re-launched its small-format store "Smart Choice" in Shenzhen in April 2018 and opened a further three stores in the district with another in Guangzhou in November. Wumart Stores also launched its first small-format community store in Hangzhou in August 2017.

Meanwhile, investors have been keen to invest in the CVS sector, further accelerating its development. Based on preliminary statistics from AI Finance & Economics for the period July 2017 to November 2018, at least eight regional CVS operators received injections of funds – Good Neighbor, Fook, Furong Xingsheng, Linji, Yundoo, Everyday and Zhongshang raised almost two billion yuan, while unmanned CVS Xiaomai Store raised around 300 million yuan in two rounds of funding in the second half of 2017.

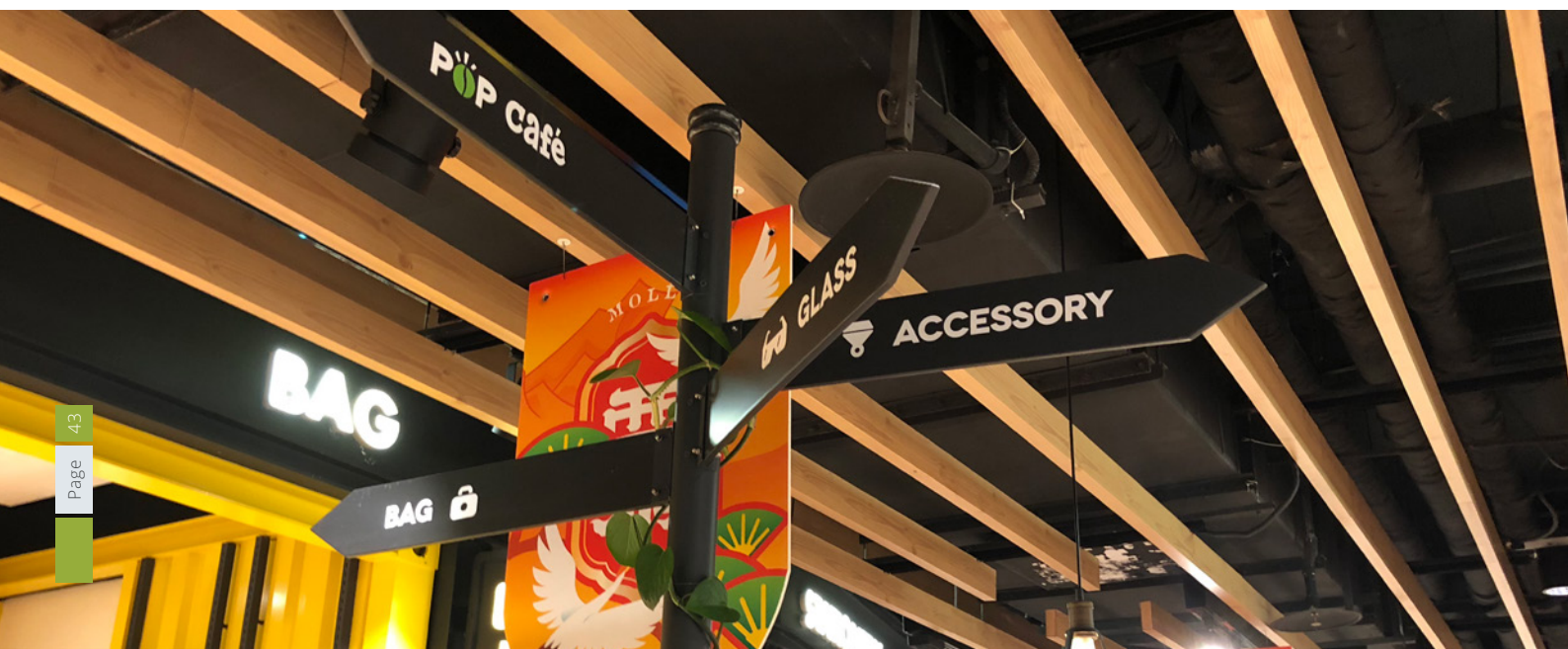
Such developments have contributed to the CVS sector's fast store expansion. According to the "China's Convenience Store Sector Report 2018" published jointly by China Chain Store & Franchise Association and the Boston Consulting Group, the total number of CVS in China increased by 13% yoy to reach over 100,000 in

2017, up from 94,000 in the previous year. The opening of CVS is more commonplace in selected emerging tier-2 cities as well as in Beijing, a city with plenty of opportunities for CVS development. Statistics from the Ministry of Commerce show that growth of 5,000 key retailers reached 4.6% yoy in the first half of 2018, of which CVS growth was the fastest among all retail formats, reaching 7.6% yoy.

Despite the CVS sector's rapid development, some headwinds remain. Amid large amounts of capital investment in the sector, CVS operators need to address pressing challenges such as building responsive supply chains, nurturing talent and choosing the most appropriate store locations. Additionally, they have to be cautious: investors may withdraw their investment at any time, affecting operations and eventually leading to store closures. A prominent example is Linjia Convenience Store. The CVS operator announced abruptly in August 2018 that it would cease operating its 168 stores due to vulnerable capital sufficiency, as its parent company Shanlin Finance, a Shanghai-based peer-to-peer lending company, encountered financial concerns.

## Traditional retailers embrace digital transformation

To succeed in the digital age, both department store and hypermarket/ supermarket operators have accelerated their digital transformation processes. A typical example is Intime Department Store. It is one of the earliest instances of companies in the department store sector transforming digitally. By forming a strategic partnership with Alibaba in early 2017, Intime leverages Alibaba's comprehensive data resources that cover almost every aspect of customers' daily lives to implement its online-to-offline (O2O) strategy. All of Intime's business operations are carried out and supported by AliCloud. The system can recognize Intime's members and analyze their purchasing behavior, as well as support real-time O2O data synchronization, thereby allowing Intime to optimize customer experiences and support its O2O strategy. Another example is supermarket chain, RT-Mart: it partnered with Alibaba in June 2018 to complete the digital transformation of 100 stores using Alibaba's new retail technologies. Wumart Stores, by contrast, installed electronic shelf labels to replace traditional paper labels in 48 of its hypermarkets in the eastern China region in April 2017.





## What the Experts say

2018 has been a challenging and yet a transformative year for many traditional retailers. They have taken bold initiatives to innovate, upgrade and transform their businesses with the help of advanced technologies and other means, such as capital injection and re-modeling. This trend is set to continue into 2019. Our experts believe department store operators will increase efforts to introduce more experiential elements to enhance customer experience, while hypermarket players will aim for smaller-sized formats by launching more convenience stores and community stores. The growth momentum of the CVS sector is expected to continue, as small-format stores continue to drive retail growth with convenience and proximity remaining key consumer priorities. That said, CVS operators should strengthen their operating and financial capabilities to avoid over-reliance on external investors. Our experts also predict that, in 2019, there will be a new wave of mergers and acquisitions in China's fragmented CVS sector, where most leading CVS chains are regionally based. This will drive dramatic shifts in the sector.

# 09

## Rural e-commerce sees rapid growth; plays a key role in poverty relief and rural revitalization



Broadband penetration in China's rural areas has now surpassed 90%, with nearly 100 million villagers able to access the Internet. Meanwhile, underpinned by the swift development of road construction, coverage of rural express delivery services has also reached more than 90%. Sustained improvement in macroeconomic conditions and infrastructure development has been coupled with effective policy implementation to drive rural e-commerce growth to combat poverty in underdeveloped villages and rejuvenate the countryside. These factors have enabled the central government to address three overarching rural issues, namely the future of the domestic agricultural industry, farmers' livelihoods and facilitating development of China's vast countryside.





*As part of the government's rural revitalization plan, e-commerce plays a vital role in alleviating poverty among rural villagers and enabling greater prosperity. Meanwhile, the rapid development of rural e-commerce also facilitates distribution of products between rural and urban areas – bringing more industrial products to villages and agricultural products to cities.”*

*Fu Longcheng, Vice Chairman, China General Chamber of Commerce; Director, Expert Committee of the China General Chamber of Commerce*

## **Concerted efforts pay off; rural e-commerce sees rapid growth**

The State Council has put in place a number of key policies to promote rural e-commerce in recent years to reflect the importance of rural development. Several government departments, including those responsible for commerce, agriculture and poverty relief have followed up by initiating pilot programs in support of rural e-commerce. Significantly, the government's initiatives to foster rural e-commerce play an active role in promoting economic transformation, facilitating trades, increasing employment and boosting income levels in rural areas. Since 2014, the Ministry of Commerce and other government departments have initiated pilot schemes to promote e-commerce in rural villages. Over the past five years, the government has invested about 20 billion yuan to support e-commerce in 1,016 counties.

Meanwhile, many enterprises have actively participated in the pilot programs; by applying innovation into their business models to accommodate rural e-commerce, participating enterprises have posted sustained growth measured by transaction volumes. Guided by the government's policies, local enterprises including Alibaba, JD.com, Suning, All-China Federation of Supply and Marketing Cooperatives and China Post have accelerated e-commerce expansion into rural areas. For example, as of the end of 2017, Alibaba has set up 242 “Taobao Towns”, 2,118 “Taobao Villages” and 490,000 “Taobao Shops” across 24 provinces and cities nationwide, laying a sound foundation for rural e-commerce development.

With extensive government support, e-commerce players have continued to scale up their operations in

rural areas. Their fast-growing presence in the countryside is playing an increasingly important role to boost rural economic growth. In 2017, e-commerce sales from China's rural areas reached 1.2 trillion yuan, surging 39.1% yoy, the first time that rural e-commerce sales crossed the 1 trillion yuan mark. The number of online stores in rural areas also grew significantly by 20.7% yoy to 9.9 million, creating more than 28 million jobs. In the first half of 2018, rural e-commerce sales soared 34.4% yoy to 632.2 billion yuan, with farm product sales jumping 39.6% yoy to 90.6 billion yuan, while a larger proportion of sales came from fruit, tea and nut products.

## **E-commerce plays a crucial role in poverty relief and rural rejuvenation**

Rural e-commerce development is tied closely with the country's policy on poverty relief and rural rejuvenation, aiming to alleviate poverty among rural villagers and enabling greater prosperity. The government's anti-poverty drive and rural revitalization strategy will continue to be vital in boosting farmers' incomes, promoting agricultural modernization and rural development, while leading China to become a moderately well-off society. At the 19th National Congress of the Communist Party of China, the government announced the *Plan for Rural Revitalization Strategy (2018-2022)*, stating that the government will step up efforts to advance rural e-commerce development and increase infrastructure investments that support and nurture e-commerce businesses operating in rural areas. Considering e-commerce as a boon to unprivileged villagers in rural areas, the government has concluded that “rural e-commerce development, poverty alleviation and rural revitalization” are the key highlights for rural development.

The government has, so far, launched e-commerce pilot programs in 737 national-level impoverished counties, accounting for 72.5% of the total national-level counties planned for e-commerce pilot programs and 88.6% of the total poorest national-level counties across the nation. From 2014 to 2018, there were 15, 90, 157, 237 and 238 national-level impoverished counties respectively launching e-commerce pilot programs each year, accounting for 26.8%, 45%, 65.4%, 91.2% and 91.5% of the total national-level counties struck by poverty and planned for e-commerce pilot programs, further illustrating the continued growth of e-commerce in rural areas.

In 2017, e-commerce sales from all the 832 most impoverished national-level counties amounted to 120.8 billion yuan, 13 pts in growth rate terms compared to e-commerce sales in the country's other rural regions. Additionally, the government's e-commerce and anti-poverty drive in rural areas has helped strengthen regulation against counterfeit and substandard products in the rural market. The policy has also promoted distribution of better rural products, including agricultural produce, handicrafts and tourism-related souvenirs, contributing to employment and income growth in the countryside.



## What the Experts say

Our experts believe that the central government will continue to take ambitious steps to reduce poverty and further promote the revitalization of rural areas. Currently, most farm produce in China comes from rural areas with a population of between 600 million and 700 million. Strong demand for farm and industrial products represents very large business opportunities for the rural market itself. As part of the government's rural revitalization plan, e-commerce is playing a vital role in unleashing that huge market potential. With continuous improvements in countryside infrastructure, rural e-commerce is expected to gain greater momentum and follow new trends.

### **From top-down to market-led approach**

A top-down approach that relies heavily on government guidance and investment is expected to switch gradually to a market-led approach under rural e-commerce initiatives, requiring greater involvement and investment from market players and enterprises. Under a market-led approach, the government will focus on improving laws and regulations for e-commerce supervision, while enterprises will accelerate their e-commerce push in rural areas and focus on brand cultivation, logistics services and agricultural product distribution in pursuit of sustainable growth.

### **Facilitating distribution of products between villages and cities**

Rural e-commerce will further facilitate distribution of products between rural and urban areas – bringing more industrial products to villages and agricultural products to cities. E-commerce players' expansion into the remote countryside will not only prompt more rural villagers and farmers to distribute agricultural products to urban areas – boosting their product sales and incomes – but also pave the way for further development in other fields, including brand cultivation, supply chain refinement, cold chain logistics and product traceability services.

### **From trading websites to integrated online service platforms**

With increasing numbers of rural residents accommodated by online shopping, e-commerce players are looking to expand their services in rural areas through e-commerce website transformation – moving from mere engagement in trading goods to creating integrated platforms that provide a variety of trading and personal services. These integrated online service portals can also connect online users to local government and community websites which provide a wide range of services from financing and tax payment services to travelling, visa processing, security management and mobile payment services, among others. The development of integrated online services platforms is expected to bring more convenience to rural residents and businesses, further boosting e-commerce sales in the countryside.

### **E-commerce players veer towards the central and western rural regions**

E-commerce players will continue to expand at speed into China's central and western rural regions. In addition to the highly sought-after urban-manufactured products such as apparel and accessories, home appliances, personal electronics and household products, strong demand has also arisen for e-commerce services in the central and western rural areas. This has driven other market players, such as e-commerce businesses partners and experts as well as R&D companies to also move into the central and western rural regions, strongly contributing to local e-commerce growth.

### **Rural e-commerce market to experience consolidation and upgrading**

China's rural e-commerce market remains highly fragmented. Currently, there are over 30,000 e-commerce companies engaged in rural businesses across the country, with most being medium- and small-sized operations. Our experts believe the rural e-commerce market will undergo consolidation and upgrading in the coming year – medium- and small-sized businesses will either be phased out or transformed, while major e-commerce companies will reaffirm their dominant position in the market. This will inevitably improve the market structure with enhanced operational scale, efficiency and profitability.

# 10

## Shifting from price wars, logistics players compete on service quality to satisfy consumer upgrading



China's logistics industry has grown exponentially in recent years, with the express delivery sector showing the strongest growth momentum. For the first three quarters of 2018, China's express delivery volume topped 30 billion orders, with over 100 million packages delivered per day. In the 2018 11.11 Global Shopping Festival, more than 1 billion packages were delivered on just one day, 11 November 2018, to set an express delivery volume record for the country's biggest online shopping event.

While facing ever-increasing numbers of orders, logistics companies are still able to fulfil orders at a much faster pace to meet growing consumer demand for quality and reliable services. For example, Alibaba's logistics arm Cainiao and its courier service

partners took just 2.6 days – compared with nine days five years ago – to complete delivery of 100 million orders during the 2018 11.11 Global Shopping Festival. Many consumers across the country were able to receive their orders as early as 30 minutes after the shopping festival started. Similarly, JD Logistics, the logistics unit of JD.com, offered overnight delivery services, allowing shoppers to place orders at night and receive their goods on the morning of the following day. Our experts believe faster order fulfillment, especially featuring reduced time for last-mile delivery as well as continuous improvement in service quality is due specifically to digitalization of the logistics industry, or in other words, the rise of smart logistics.





*Logistics operators are increasingly shifting away from low price strategies and turning their focus to elevating their service quality and offering more value-added services. They hope to better meet rising customer expectations for quality and experience.”*

*Zhang Jing, Senior Economist, Circulation Industry Promotion Centre, Ministry of Commerce of the PRC*

## **Smart logistics boost the speed and quality of delivery services**

Besides enhancing efficient delivery, smart logistics can also improve service quality, allowing logistics companies to offer high-quality and differentiated services to attract and retain more customers, instead of merely keeping prices low to compete.

According to China's State Post Bureau, 34.7 billion express delivery orders were completed in the first three quarters of 2018, up 26.8% yoy, while the express delivery sector's total revenue amounted to 424.6 billion, up 24% yoy. Although the transaction volume and turnover of China's logistics industry have been growing rapidly, many logistics operators are low-profit-margin companies beset by high operating costs and needing to maintain low prices amid fierce competition.

Constructing and adopting smart logistics systems are key to addressing such pressing issues.

In recent years, many domestic logistics companies have increased investment in smart technologies, with related research and development costs of some companies already exceeding 5% of turnover. For example, SF Holding has attached great importance to the development of its smart logistics systems. The company has drawn on various cutting-edge technologies to improve its operational efficiency and reliability. These include the use of artificial intelligence to drive better decision making; the Internet of Things (IoT) to improve logistics visibility by staying connected with fleets; smart devices to maximize the benefit of big data and achieve digitalization; and other automatic technologies to reduce manual operating costs. Other domestic logistics companies, including Yunda Express, Deppon Logistics, YTO Express and STO Express have also increased investment in developing smart logistics and they have widely adopted smart-driven

technologies. Smart logistics technologies have indeed already become a core competitive edge for logistics players in a highly competitive market.

## **Quality service, not low price, matters most to consumers**

Intensified competition has forced many logistics companies into price wars in recent years. However, with customers increasingly willing to pay a premium for quality and reliable services, logistics players are turning their focus to elevating their service quality and moving away from price as a determining factor. A strong reputation for quality services and exceptional customer experience, rather than low prices, are now important differentiators for logistics companies to set themselves apart from rivals.

Another reason why logistics companies are shifting away from low price strategies is because their prices are already so low that they can barely make a profit, allowing no room for further price reductions. Data from China's State Post Bureau showed that the average price of express delivery services has decreased by 31% over the past five years, from 18.5 yuan per piece to 12.7 yuan per piece. With such low profit margins, some logistics companies reportedly had to raise their prices during the 11.11 Global Shopping Festival to maintain service quality and avoid losing money.

To stay competitive in the market without exerting further pressure on their profitability, many logistics companies have started competing primarily on service quality and offering value-added services, aiming to meet rising customer expectations for quality and experience. As a case in point, in the first half of 2018, YTO Express launched several initiatives to improve service quality and ensure reliable and timely delivery. As a result, YTO Express has successfully improved customer satisfaction, with the customer complaint rate falling 25.9% yoy to 4.94 per million transactions.

## Developing core competencies and providing more professional services

Most successful logistics companies have strong core competencies that they can exploit to outcompete their rivals. Realizing the importance of building differentiating strengths, some well-established logistics companies in China have expanded into the supply chain sector, tapping supply chain financing and other services along the supply chain in a bid to provide customers with more dedicated and high value-added services. SF Express is a typical example. SF Express offers a diverse range of express and logistics services, including SF Same Day Delivery, SF Next Morning Delivery, SF Standard Express, a logistics cargo service, a heavy freight express and an economy logistics cargo service in mainland China, Hong Kong, Macau and Taiwan. For international markets, the company offers its standard express service, SF Standard Express, SF Economy Express, SF E-Parcel, international heavy freight, SF Buy, direct signature service and SF Overseas Fulfillment/ Warehouse services, among others. Apart from focusing on its core express delivery and warehousing businesses, SF Express offers a range of value-added services, such as packaging, reverse logistics and customs declaration services. For financing, the company has launched its own payment platform named SF Pay.

In response to the diverse needs of customers, numerous logistics companies have introduced a variety of personalized and diversified professional services. For example, SF Express and STO Express have launched cold chain logistics services, meeting the growing demand for cold chain services in the food and pharmaceutical industries. In addition, in 2018, SF Express and YTO Express rolled out a two-hour intra-city delivery service to attain first mover advantage in the intra-city delivery sector. It is expected that increasing numbers of logistics companies will soon follow suit to tap the intra-city delivery service sector, since no special skills and techniques are needed to run the business; competition for providing intra-city delivery services is expected to be fierce over the coming year.





## What the Experts say

Our experts believe breakthrough technologies will shape the development of the logistics industry in 2019. Increasing numbers of logistics companies will adopt smart logistics. They will capitalize on advanced technologies to modernize their logistics sorting and pick systems, transmission systems and big data platforms that support their information processing capabilities. Many are building automated warehouses and applying automated technologies and unmanned systems for delivery, including autonomous cargo drones. Such developments will become increasingly common among leading players.

With high value-added supply chain services a valuable competitive differentiator – indeed, an essential criterion to gauge the overall competencies of a logistics company – some leading domestic enterprises have strengthened their supply chain capabilities and enhanced their supply chain service offerings over recent years. This trend is expected to continue into 2019; competition in the supply chain sector is set to intensify.

Last but not least, our experts state that the trend towards business collaboration among logistics players will become more apparent in 2019. Since 2018, a number of domestic logistics companies, including SF Express and YTO Express, have started to forge alliances with their peers as well as upstream and downstream parties along the supply chain. They aim to create a synergistic effect for mutual benefit. Forming strategic partnerships and collaborations to achieve business growth will remain a norm for the industry in the coming year.

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