China’s Department Store Survey 2016

Department store strategies in the “New Retail” regime

March 2017
<table>
<thead>
<tr>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Background and Objectives</strong></td>
<td>03</td>
</tr>
<tr>
<td><strong>About the survey</strong></td>
<td>03</td>
</tr>
<tr>
<td><strong>Key takeaways</strong></td>
<td>04</td>
</tr>
<tr>
<td><strong>01. Operation models and business practices</strong></td>
<td>05</td>
</tr>
<tr>
<td><strong>02. E-commerce business</strong></td>
<td>18</td>
</tr>
<tr>
<td><strong>03. O2O strategies</strong></td>
<td>24</td>
</tr>
</tbody>
</table>
Background and Objectives

- China’s department store sector has been going through a hard time under the “new normal”. A number of major department store operators have witnessed a significant slowdown in sales over recent years amid deteriorating market conditions and increasing competition from other retail formats such as shopping malls, and specialty stores, etc. as well as e-commerce players. In addition, severe homogenization and rising operational costs also contributed to rampant store closures.

- Recognizing the challenges facing the sector, an increasing number of department store operators have striven to reinvent and transform their business models and formats over recent years.

- To learn more about the latest development prospect and strategies of department store operators in China, Fung Business Intelligence joined hands with the China Commerce Association for General Merchandise (CCAGM) for the second year to conduct a survey among key department store operators in China. The survey covers three broad areas, namely, operation models and business practices, e-commerce initiatives and O2O strategies.

About the survey

- Self-completion questionnaires were sent to key department store operators in China by CCAGM and Fung Business Intelligence in the months of November and December 2016. A total of 64 valid responses were received during the period. Over half of the surveyed department stores are domestic private companies, while 39.1% are state-owned enterprises and 4.7% are wholly-owned foreign enterprises.
Key takeaways...

01. Operation models and business practices

- Department store operators in China are keen to diversify their businesses; nearly 70% of the surveyed department store operators have already engaged in multiple retail formats.
- Over 76% of the operators believed that incorporating experiential consumption in-store is crucial. F&B and kids-related activities are the most common types of experiential elements added in-store.
- Adding experiential elements is more effective in attracting customer traffic rather than boosting sales. Over 41% of the surveyed department store operators said that experiential elements have led to a significant increase in customer traffic, while only 7.3% of the operators said that experiential elements could significantly increase sales.
- One-fourth of the surveyed department store operators have launched their own private labels, while over 76% of the surveyed department store operators have engaged in merchandise direct sales. The proportion of merchandise direct sales was highest in apparel, cosmetics and F&B. The majority of the surveyed operators (45.8%) reported that merchandise direct sales accounted for 5% or less of their total revenue.

02. E-commerce business

- Almost half of the department store operators in our survey have started their e-commerce business, of which 75% conducted e-commerce business only via their own transactional website, one-fifth sold on their own website as well as third-party e-commerce platforms.
- Recognizing the importance of mobile strategies, around half of the surveyed department stores with e-commerce business have launched mobile apps. Push marketing and product promotion were the most common functions of mobile apps.
- Social media has become a highly popular marketing and selling tool among the surveyed department store operators. 95% of the operators use social media to promote their products, while two-third used social media to market and sell their products.

03. O2O strategies

- O2O strategies have become an industry consensus. Half of the surveyed department store operators have deployed O2O strategies in their business. 32.1% have yet to start deploying O2O strategies but are planning to do so.
- In terms of the types of O2O initiatives adopted, 96% of the survey department store operators supported in-store mobile payment such as Alipay and WeChat Pay, and 98.4% offer free WiFi. Interestingly, many department store operators (84%) used their online websites to drive traffic to their offline stores.
- To facilitate better O2O integration, many department stores have leveraged digital technologies to improve in-store experiences. Over 98% of the surveyed department store operators have set up free wifi, while 73% have set up QR codes to support O2O initiatives. 84% of the operators have used data analytics to gather insights on customers.
1. Diversifying the scope of businesses is trending

In recent years, increasing numbers of department store operators have striven to diversify their retail businesses. Many have engaged in other retail formats. Our survey shows that 69.8% of the surveyed department store operators have expanded their businesses to other retail formats over the past year (Exhibit 01). Of which, the majority of operators have tapped into one (47.7%) or two (31.8%) other retail formats (Exhibit 02).

Supermarkets/ hypermarkets and shopping malls are the two key retail formats that the surveyed department store operators have tapped into (Exhibit 03).

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
According to the survey, 40.4% of the surveyed department store operators reported that they plan to expand their business scope and engage in other retail formats (Exhibit 04). 59.1% of the operators said they plan to tap into one or two (22.7%) other retail formats (Exhibit 05). Shopping malls and factory outlets are the most popular choices (Exhibit 06).
Exhibit 04: Percentage of surveyed department store operators plan to tap into other retail formats

Yes, plan to tap into other retail formats

40.4%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Exhibit 05: Number of other retail formats that surveyed department store operators are planning to tap into

Other retail formats planning to tap into

1

1............59.1%

2

2...........27.7%

3

3............9.1%

4

4............9.1%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
Exhibit 06: Retail formats that surveyed department store operators plan to tap into

- Shopping malls: 43.5%
- Factory outlets: 30.4%
- Supermarkets/Hypermarkets: 26.1%
- Convenience stores: 26.1%
- Professional stores: 21.7%
- Specialty stores: 13.0%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
2. Providing experiential elements

Majority of the surveyed department store operators believed that incorporating experiential consumption in-store is crucial.

Moving towards a lifestyle-cum-shopping destination is a strategic initiative of many department store operators. The intention to introduce more experiential elements in-store is manifested in the survey.

76.6% of the operators have added experiential shopping elements in-store (Exhibit 07). The majority of operators have added two to four experiential elements in their stores (Exhibit 08).

Exhibit 07: Percentage of surveyed department store operators that have adopted experiential elements

Yes, with experiential elements 76.6%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Exhibit 08: Number of experiential elements added among surveyed department store operators

<table>
<thead>
<tr>
<th>Number of experiential elements added</th>
<th>Among operators who have added experiential elements...</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>9.3%</td>
</tr>
<tr>
<td>2</td>
<td>30.2%</td>
</tr>
<tr>
<td>3</td>
<td>25.6%</td>
</tr>
<tr>
<td>4</td>
<td>32.6%</td>
</tr>
<tr>
<td>5</td>
<td>2.3%</td>
</tr>
</tbody>
</table>

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
When asked about the types of experiential elements added in-store, most operators cited food & beverages (F&B) (79.6%) and kids-related facilities (71.4%). Other experiential elements mentioned by operators include lifestyle services (e.g. beauty and hair salon) (51.0%) and entertainment (e.g. cinema, KTV) (42.9%) (Exhibit 09).

**Exhibit 09: Types of experiential elements added in-store by surveyed operators**

![Graph showing percentages of experiential elements](image)

- Food & beverages: 79.6%
- Kids-related facilities: 71.4%
- Lifestyle services (e.g. beauty and hair salon): 51.0%
- Entertainment (e.g. cinema, KTV): 42.9%
- Others: 8.2%

*Source:* “Department store survey 2016”. CCAGM and Fung Business Intelligence.

**Adding experiential elements is more effective in attracting customer traffic rather than boosting sales.**

41.5% and 53.7% of the surveyed operators claimed to see either significant increase or slight increase in customer traffic respectively after adding experiential elements in-store (Exhibit 10). By contrast, only 7.3% of the surveyed operators said that experiential elements can significantly increase sales (Exhibit 11).
Exhibit 10: Did you see an increase in customer traffic after adding experiential elements?

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Exhibit 11: Did you see an increase in sales after adding experiential elements?

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
3. Increasing the proportion of merchandise direct sales

To increase product differentiation, increasing numbers of department store operators have placed great emphasis on increasing the proportion of direct sales; 76.6% of the operators in the survey have engaged in merchandise direct sales (Exhibit 12). Among the major categories sold in department stores, the proportion of merchandise direct sales was highest in apparel, cosmetics and F&B (Exhibit 13).

Among the surveyed department store operators who have engaged in merchandise direct sales, 45.8% of the operators reported that merchandise direct sales accounted for 5% or less of their total revenue (Exhibit 14).

Exhibit 12: Penetration of merchandise direct sales among surveyed department store operators

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Exhibit 13: Major product categories of merchandise direct sales of surveyed department store operators

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
Almost 40% of the surveyed department store operators claimed that they have increased their proportion of merchandise direct sales compared to the previous year (Exhibit 15).

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
4. Private label increasing seen as a differentiator

Over 40% of department store operators have increased the proportion of private label products in their assortment over the past year.

Department store operators tend to increase private label products in their assortment. One-fourth of the surveyed department store operators have launched their own private labels (Exhibit 16). Of which, over 40% of the operators with their own private labels claimed that they have increased the proportion of private labels in their portfolio over the past year (Exhibit 17).

Exhibit 16: Percentage of surveyed department store operators with and without their own private labels

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
Among operators with their own private labels

-8.3% 50.0% 41.7%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Share of private label sales to total sales remains low albeit a tendency for department store operators to increase private labels in the assortment

In terms of sales, most of the surveyed department store operators (86.7%) said that private labels accounted for less than 10% of their total sales, which was 11.7% higher than that of last year (Exhibit 18).

Taking too long to obtain market recognition, lack of suitable talent and high investment costs were the top three challenges department store operators faced when developing private labels (Exhibit 19).
Exhibit 18: Proportion of private label products to total sales

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Exhibit 19: Major challenges of developing private labels

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
5. Establishing a more collaborative relationship with key stakeholders

Operators have started to build synergies with suppliers and brands through connecting with each other’s ERP, inventory and POS systems.

In an increasingly collaborative world, developing good relationships with key stakeholders can facilitate companies to achieve their objectives. Over 73% of the surveyed department store operators said they have strengthened relationships with suppliers and brands in the past year (Exhibit 20).

Joint POS system management and data sharing, followed by ERP and inventory system management and data sharing, and SKU management were the major types of collaboration between department store operators and key stakeholders (Exhibit 21).

Exhibit 20: Percentage of collaboration with suppliers and brands

Yes, have stronger collaboration with suppliers and brands

73.4%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Exhibit 21: Types of collaboration between surveyed department store operators and upstream suppliers or brand owners

<table>
<thead>
<tr>
<th>Collaboration Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint POS system management and data sharing</td>
<td>59.6%</td>
</tr>
<tr>
<td>ERP and inventory system management and data sharing</td>
<td>48.9%</td>
</tr>
<tr>
<td>SKU Management</td>
<td>46.8%</td>
</tr>
<tr>
<td>Product design, development, display and sale</td>
<td>27.7%</td>
</tr>
<tr>
<td>Others</td>
<td>21.3%</td>
</tr>
</tbody>
</table>

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
1. Embracing e-commerce

Faced with increasing competition from e-commerce players, more department store players have stepped into the e-commerce arena.

Almost half of the department store operators in our survey have started their e-commerce business either through setting up their own transaction website or launching online store on third-party e-commerce platforms (Exhibit 22).

Among the operators that have already launched their e-commerce business, 75.9% conducted e-commerce business only via their own transactional website, one-fifth sell on their own website as well as third-party e-commerce platforms (Exhibit 23). Tmall, JD.com and Tencent were the platforms that department store operators would go for.

Exhibit 22: Penetration of e-commerce business among surveyed department store operators

Yes, have e-commerce business

46.9%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
Among those who have started their e-commerce business...

When asked about the challenges they face when conducting e-commerce business, high cost of setting up e-commerce business was cited most, followed by lack of relevant expertise and knowledge, price difference between online and offline stores and unclear online strategy of the company (Exhibit 24).

Exhibit 23: Forms of e-commerce business among surveyed department store operators

Exhibit 24: Challenges facing surveyed department store operators when starting e-commerce business

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
2. Progressing from e-commerce to m-commerce

In today’s digital era, developing mobile strategies is crucial for department store operators. According to the survey, less than one-third of the surveyed department store operators have launched mobile apps; but the percentage was much higher among those with e-commerce business (46.7%) (Exhibit 25).

For those operators currently without mobile apps, around one-third said that they plan to launch mobile apps in the next two years.

Exhibit 25: Proportion of surveyed department store operators with and without mobile apps

<table>
<thead>
<tr>
<th></th>
<th>Operators with e-commerce business</th>
<th>Operators without e-commerce business</th>
<th>All operators</th>
</tr>
</thead>
<tbody>
<tr>
<td>With mobile apps</td>
<td>46.7%</td>
<td>9.1%</td>
<td>27.0%</td>
</tr>
<tr>
<td>Without mobile apps</td>
<td>53.3%</td>
<td>90.9%</td>
<td>73.0%</td>
</tr>
</tbody>
</table>

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
Currently, maintaining connection with customers is the key function of using mobile app.

As shown in Exhibit 26, the majority of the surveyed department store operators cited push marketing (94.1%) and product promotion (82.4%) as the two key functions of using mobile app.

Exhibit 26: Major functions of mobile app

- Push marketing and sales information: 94.1%
- Product promotion: 82.4%
- Membership scheme: 76.5%
- Product transaction: 70.6%
- Provide value-added services (in-store navigation, restaurant reservation, etc.): 41.2%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
3. Social media marketing is a hype, while social selling is gaining traction

Many department stores are using social media to market their products, interact with customers and provide various value-added services. Some operators have even started to sell their merchandise via social networks.

95.2% of the surveyed department store operators expressed that they use social media to promote their products (Exhibit 27). Two-third said that they use social media to sell their products, in addition to marketing their products (Exhibit 28).

**Exhibit 27: Use of social media as a marketing tool**

Yes, use of social media as a marketing tool

95.2%

**Source:** “Department store survey 2016”. CCAGM and Fung Business Intelligence.

**Exhibit 28: Use of social media as a sales tool**

Yes, use of social media as a sales tool

60.3%

**Source:** “Department store survey 2016”. CCAGM and Fung Business Intelligence.
WeChat is the most popular social network for sales and marketing

According to the survey, WeChat was the dominant social media platform for marketing, followed by Weibo and QQ (Exhibit 29). It was also the most popular social network to conduct sales. 76.3% of the surveyed department store operators cited WeChat as the social network they use to sell their products (Exhibit 30).

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
1. Growing adoption of O2O strategies

Many department stores in China have demonstrated growing sophistication with regard to O2O adoptions.

O2O strategies have become an industry consensus. Many department stores in China have demonstrated growing sophistication with regard to O2O adoptions. According to the survey, half of the surveyed department store operators have partnered with Internet companies to deploy O2O strategies in their business. 32.1% of the operators have yet to start deploying O2O strategies but are planning to do so (Exhibit 31).

For those operators that have kick-started their O2O businesses, 88% have deployed three or more types of O2O strategies (Exhibit 32).

Exhibit 31: Deployment of O2O strategies of surveyed department store operators

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
Exhibit 32: Number of O2O strategies deployed by surveyed department store operators

<table>
<thead>
<tr>
<th>No. of O2O strategies deployed by surveyed operators</th>
<th>Among operators already started O2O...</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 2</td>
<td>12.0%</td>
</tr>
<tr>
<td>3 - 4</td>
<td>40.0%</td>
</tr>
<tr>
<td>5 or more</td>
<td>48.0%</td>
</tr>
</tbody>
</table>

Source: Department store survey 2016

In terms of the types of O2O initiatives adopted, over 98% of the survey department store operators said that they offer free WiFi and 96% said they support in-store mobile payment such as Alipay and WeChat Pay. Interestingly, many department store operators (84%) cited that they use their online websites to drive traffic to their offline stores (Exhibit 33).

Exhibit 33: Types of O2O initiatives adopted by surveyed department store operators

- Free in-store WiFi: 98.4%
- Support in-store mobile payment: 96.0%
- Research online, experience and purchase at store: 84.0%
- Click and collect services: 76.0%
- Offline promotion, place order online: 52.0%
- Scan QR code at store, place order online: 52.0%

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
With the prevailing trend of mobile online payment, 96% of department store operators support mobile payment in their physical stores.

Exhibit 34: Types of online payment tools used by surveyed department store operators

<table>
<thead>
<tr>
<th>Type of Payment Tools</th>
<th>All operators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, currently using online payment tools</td>
<td>96%</td>
</tr>
<tr>
<td>Alipay only</td>
<td>3.2%</td>
</tr>
<tr>
<td>WeChat Pay only</td>
<td>11.3%</td>
</tr>
<tr>
<td>Alipay + WeChat Pay</td>
<td>67.7%</td>
</tr>
<tr>
<td>Alipay + WeChat Pay + Others</td>
<td>12.9%</td>
</tr>
<tr>
<td>Not using any online payment tools</td>
<td>4.8%</td>
</tr>
</tbody>
</table>

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
2. Leveraging technologies to enhance in-store experience

To facilitate better O2O integration, many department store operators are seeking to improve the in-store experience with digital technologies. Our survey shows that 98.4% of the department store operators have set up free WiFi; 73.4% set up QR code systems; and 31.3% have foot traffic analytics (Exhibit 35).

Exhibit 35: Adoption of technologies in physical stores of surveyed department store operators

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
3. Collecting customer data to better understand consumer shopping behavior

Many department store operators have leveraged data analytics to gather insights on customers and provide personalized services to them. 84.1% of the operators in the survey have collected customer data for big data analytics (Exhibit 36).

The means of collecting customer data and information include: membership scheme (76.6%), in-store WiFi (35.9%), shopping history from online shop (25.0%), and iBeacons (7.8%) (Exhibit 37).

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.

Source: “Department store survey 2016”. CCAGM and Fung Business Intelligence.
Contacts

Asia Distribution and Retail

Teresa Lam
Vice President
Email: teresalam@fung1937.com

Renne Chan
Research Manager
Email: rennechan@fung1937.com

Lucia Leung
Research Manager
Email: lucialeung@fung1937.com

Fung Business Intelligence
10/F, LiFung Tower, 888 Cheung Sha Wan Road, Kowloon, Hong Kong
Phone: (852) 2300 2470 | Fax: (852) 2635 1598
Email: fbicgroup@fung1937.com | https://www.fbicgroup.com

© Copyright 2017 The Fung Business Intelligence. All rights reserved. The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Though the Fung Business Intelligence endeavours to ensure the information provided in this publication is accurate and updated, no legal liability can be attached as to the contents hereof. Reproduction or redistribution of this material without prior written consent of the Fung Business Intelligence is prohibited.