

China Retail & E-commerce Quarterly

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Table of Contents

I. Market overview	3
1. Retail sales up by 10.4% yoy in 2016	3
2. Rural retail sales grow faster than urban retail sales, but the gap narrows in 2016	4
3. Online retail market scales up in 2016 amid slower growth	6
4. Mobile-based online shopping continues its growth momentum in 3Q16	8
5. China has 731 million Internet users and 467 million online shoppers in 2016	10
6. Chinese consumers remain confident in 2H16	12
7. Sluggish performance by large-scale retailers	13
8. Growth in sales and margin of retailers in China continues to inch downward	14
9. Top 100 retailers record a yoy sales decline of 0.3% during the National Day holiday	15
II. Latest developments	16
E-commerce	16
1. New technology breakthrough: Tencent launches WeChat "Mini program"	16
2. Singles' Day 2016 gears towards entertainment and interactive contents	16
3. Rural e-commerce becomes a major growth engine	17
4. Mobile payment becomes increasingly popular, but new restrictions may affect operation	18
5. More e-commerce players strive to gain offline presence	18
6. "New Retail" to take off, online and offline cooperation deepens	19
Supermarkets and hypermarkets	19
7. M&A activities and partnerships stay prevalent	19
8. Small format shops gain popularity	20
Department stores and shopping malls	20
9. Tough market for the department store sector with lackluster sales and persistent store closures	20
10. Pop-up stores prevail	20
Apparel market	21
11. IPO and M&A activities stay prominent in the apparel sector	21

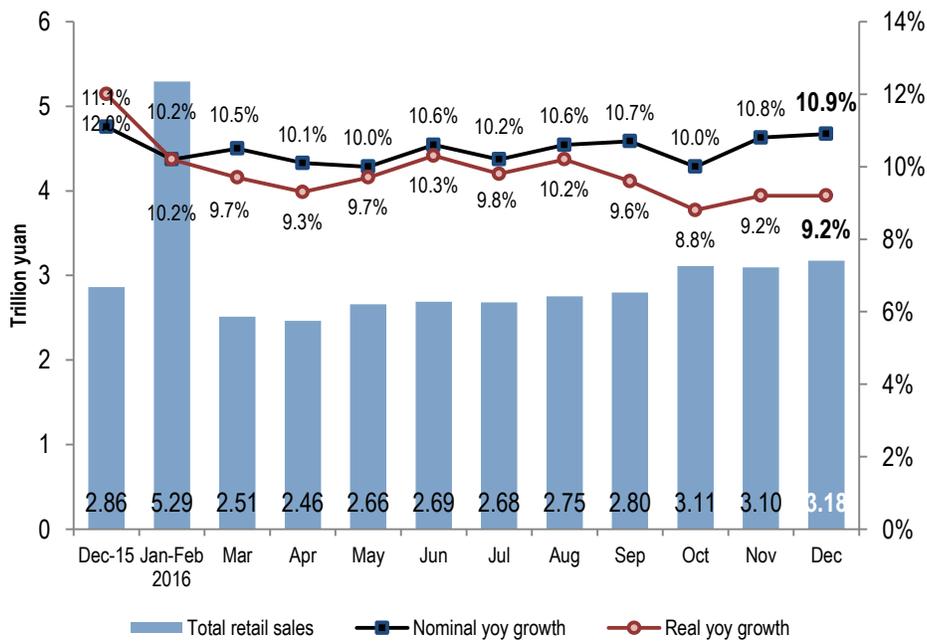
Cosmetics market.....	21
12. International cosmetics giants cut prices by 5% to 30% following the adjustment of consumption tax for imported cosmetics products	21
III. Competitive landscape	23
1. Department stores and grocery players	23
2. Internet and e-commerce companies.....	23
IV. Regulation updates	24
Domestic trade and distribution sector	24
1. China to speed up reforms in domestic trade and distribution sector.....	24
2. China to promote the transformation of physical retail and innovation in domestic trade	25
Internet and e-commerce	26
3. New requirements related to the “7-day Unconditional Return Policy” for retail e-commerce to be implemented on 15 March, 2017	26
4. New cross-border B2C e-commerce supervision rules further delayed in implementation until end of 2017	27
5. Cyber Security Law to be implemented on 1 June, 2017.....	28
6. Draft of first E-commerce Law under review.....	28
Taxation.....	29
7. Consumption tax adjustment for cosmetics effective from 1 October, 2016	29
V. Outlook.....	30
1. China’s economy is expected to face less pressure in 2017; total retail sales are estimated to grow at 10.2% in 2017.....	30
2. China’s retail and consumer market to grow steadily during CNY holiday	31

I. Market overview

1. Retail sales up by 10.4% yoy in 2016

Total retail sales of consumer goods increased nominally by 10.4% year-on year (yoy) to reach 33.23 trillion yuan in 2016. In real terms, retail sales of consumer goods increased by 9.6% yoy. By month, the nominal growth stayed stably at above 10% yoy throughout the year. Total retail sales of consumer goods reached 3.18 trillion yuan in December 2016, up nominally by 10.9% yoy.

Exhibit 1: Total retail sales of consumer goods, December 2015 – December 2016

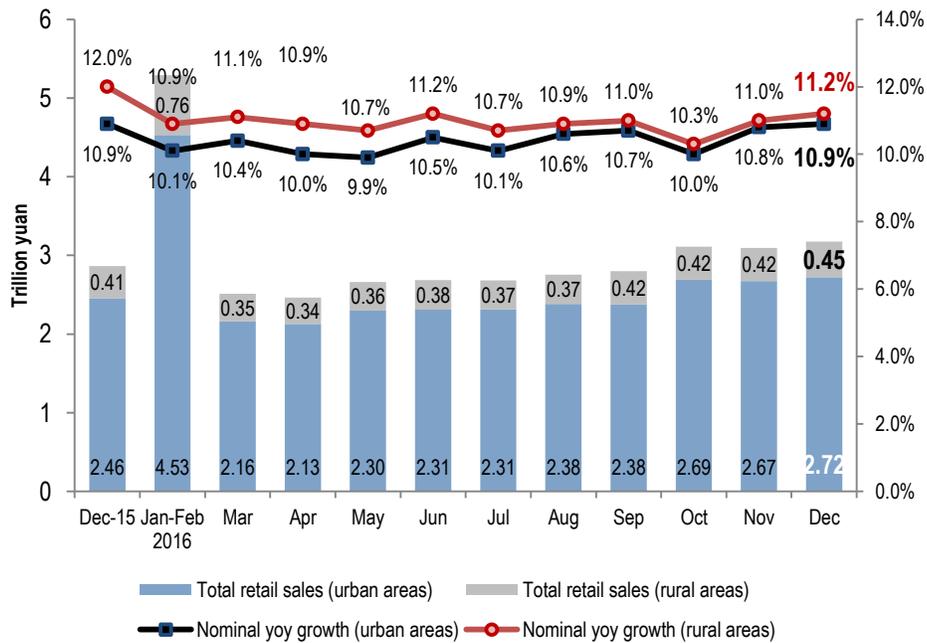


Source: National Bureau of Statistics

2. Rural retail sales grow faster than urban retail sales, but the gap narrows in 2016

Rural retail sales have been growing at a faster pace than urban retail sales, but the gap narrows in 2016. Rural retail sales increased nominally by 10.9% yoy to 4.65 trillion yuan in 2016, while urban retail sales rose 10.4% yoy to 28.58 trillion yuan. By month, rural retail sales amounted to 0.45 trillion yuan in December 2016, up by 11.2%, while urban retail sales amounted to 2.72 trillion yuan, up by 10.9% yoy.

Exhibit 2: Total retail sales of consumer goods, urban vs. rural areas, December 2015 – December 2016



Source: National Bureau of Statistics

The increase in rural household income contributed to the fast growth of rural retail sales. Per capita disposable income of urban and rural households reached 33,616 yuan and 12,363 yuan in 2016, up by 7.8% and 8.2% yoy respectively. Rural household income grew faster than that of urban households, but the per capita disposable income of urban households was still almost three times higher than that of their rural counterparts.

Exhibit 3: Per capita disposable income of urban and rural households, 2015 - 2016

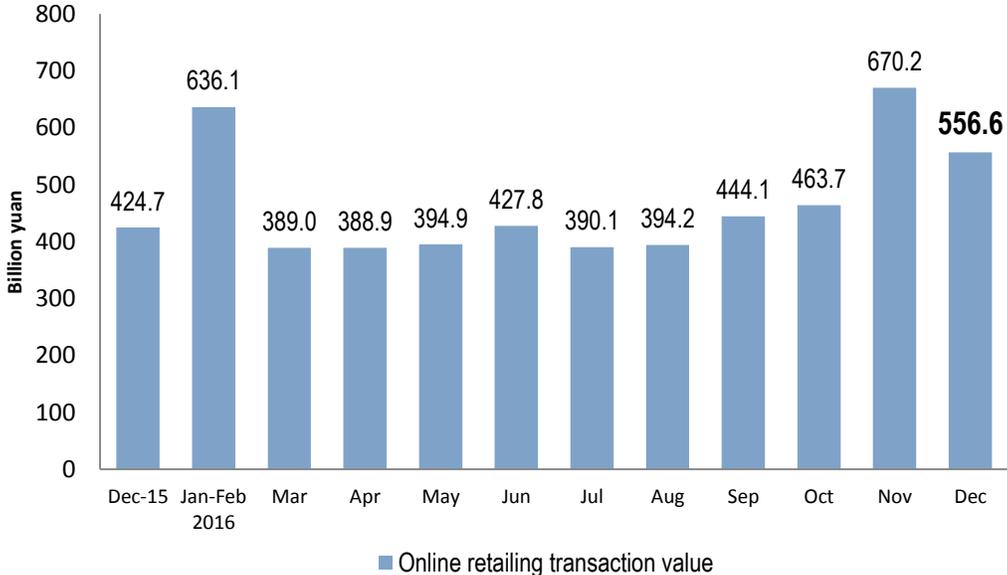
	Urban households		Rural households	
	Absolute value (yuan)	yoy growth	Absolute value (yuan)	yoy growth
1Q data				
1Q15	8,572	8.3%	3,279	10.0%
1Q16	9,255	8.0%	3,578	9.1%
Half-yearly data				
1H15	15,699	8.1%	5,554	9.5%
1H16	16,957	8.0%	6,050	8.9%
1-3Q data				
1-3Q15	23,512	8.4%	8,297	9.5%
1-3Q16	25,337	7.8%	8,998	8.4%
Yearly data				
FY15	31,195	8.2%	11,422	8.9%
FY16	33,616	7.8%	12,363	8.2%

Source: National Bureau of Statistics

3. Online retail market scales up in 2016 amid slower growth

Total transaction value of online retail sales of goods and services increased by 26.2% yoy to reach 5.16 trillion yuan in 2016. Of which, online sales of goods amounted to 4.19 trillion yuan, up by 25.6% yoy and accounted for 12.6% of the total retail sales of consumers goods.

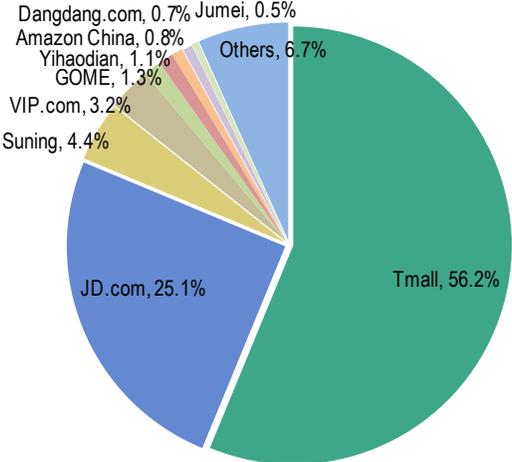
Exhibit 4: Transaction value of online retail sales of goods and services, December 2015 – December 2016



Source: National Bureau of Statistics

Within the B2C market, Tmall continued to be the distinct leader in 3Q16 with 56.2% of market share, followed by JD.com with 25.1% of market share.

Exhibit 5: Market share of top B2C players, 3Q16

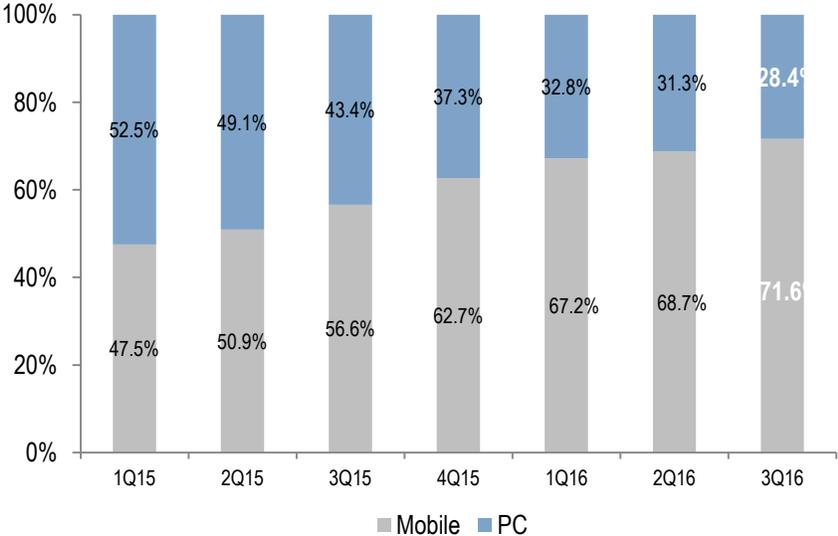


Source: iResearch Consulting Group

4. Mobile-based online shopping continues its growth momentum in 3Q16

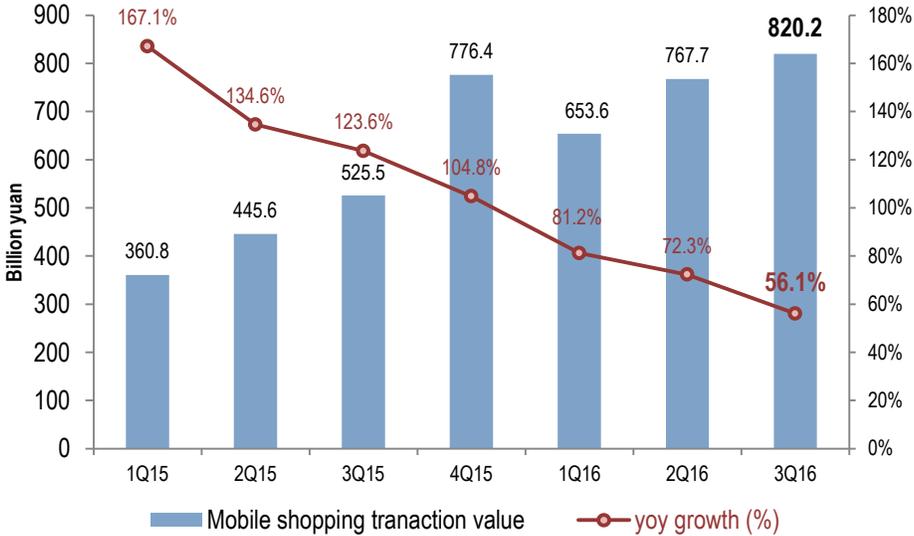
71.6% of the online shopping transactions were made on mobile devices in 3Q16 and total transaction value of mobile shopping reached 820.2 billion yuan, the highest quarterly figure since 1Q15.

Exhibit 6: Market structure of online retailing: mobile vs. PC, 1Q15 – 3Q16



Source: iResearch Consulting Group

Exhibit 7: Transaction value of mobile shopping, 1Q15 – 3Q16

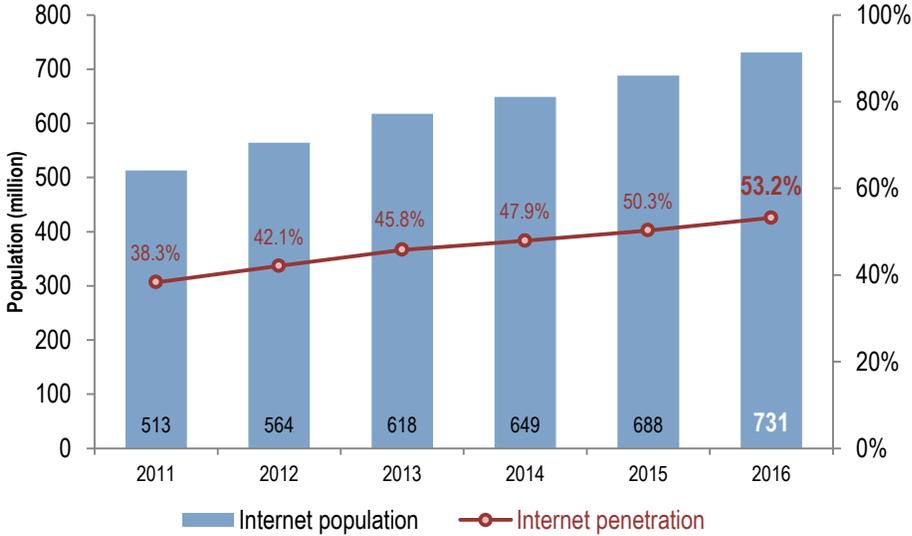


Source: iResearch Consulting Group

5. China has 731 million Internet users and 467 million online shoppers in 2016

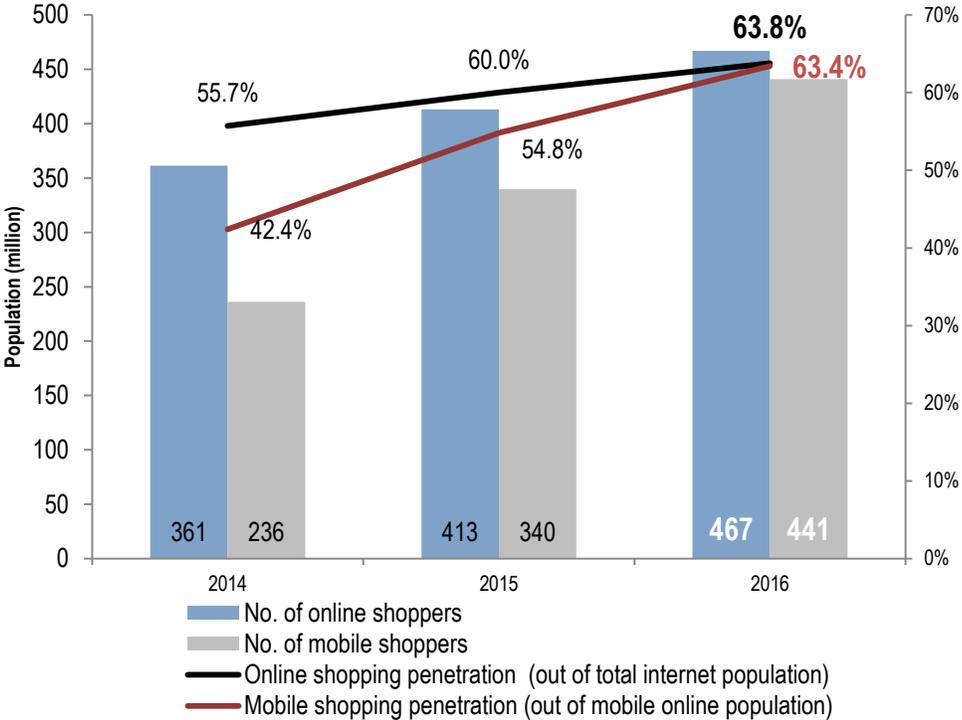
As of December 2016, there were 731 million Internet users in China, and the Internet penetration rate was 53.2%. Of which, 467 million were online shoppers. A total of 695 million people used mobile devices to access the Internet.

Exhibit 8: Internet population and penetration, 2016



Source: China National Commercial Information Center

Exhibit 9: Online shoppers population and penetration, 2016

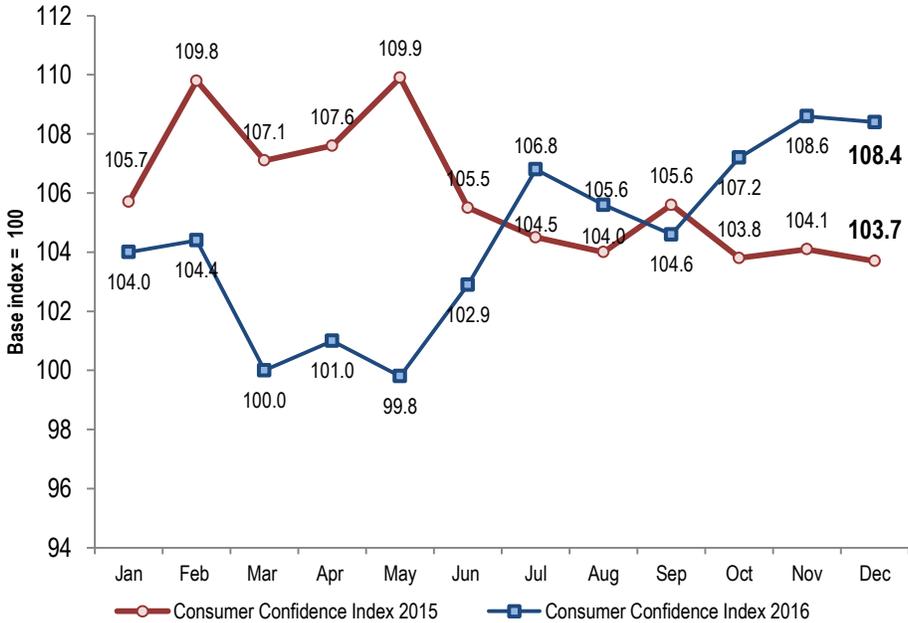


Source: China National Commercial Information Center

6. Chinese consumers remain confident in 2H16

Consumer confidence index gradually picked up towards the end of 2016, up from 99.8 in May to 108.4 in December, suggesting that the consumption atmosphere in China remained positive. Consumer confidence index in December 2016 is also the highest reading since May 2015¹.

Exhibit 10: Consumer Confidence Index, December 2015 – December 2016



Source: National Bureau of Statistics

7. Sluggish performance by large-scale retailers

Retail sales of 100 key large-scale retailers decreased by 0.5% yoy in 2016. Throughout 2016, the yoy growth of retail sales of 100 key retailers in China fluctuated from -6.1% in May to the peak of 2.1% in September.

Exhibit 11: Yoy growth of retail sales of 100 key retailers in China, December 2015 –December 2016

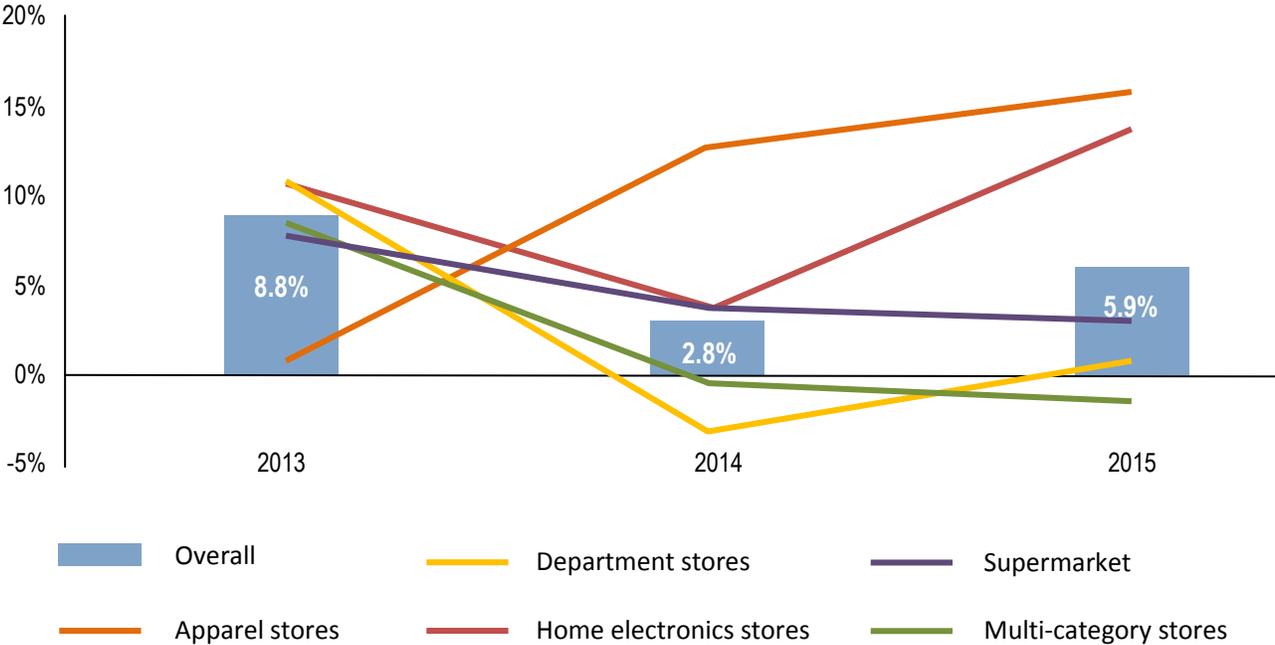


Source: China Chain Store and Franchise Association

8. Growth in sales and margin of retailers in China continues to inch downward

The growth of revenue and margin of retailers in China has decreased over recent years. According to a report by China Chain Store and Franchise Association (CCFA) and PricewaterhouseCoopers (PWC), the supermarket sector recorded mid-single digit sales growth in 2015, while certain large-scale department stores even recorded negative sales growth. Over 85% of the surveyed retailers identified inventory management as the biggest challenge².

Exhibit 12: Sales growth by retail formats, 2013-2015



Source: CCFA, PWC, compiled by Fung Business Intelligence

9. Top 100 retailers record a yoy sales decline of 0.3% during the National Day holiday

According to statistics of the China National Commercial Information Center (CNCIC), total sales of the top 100 retailers decreased by 0.3% yoy during the week-long National Day holiday in October 2016. The negative growth was lowered by 9.3 percentage points (ppt) comparing with that in 2015. Only 40 of the top 100 retailers surveyed recorded positive sales growth in the period. By product category, sales of fashion products recorded a growth of 0.9% yoy, 6.7 ppt higher than that in 2015; sales of cosmetics recorded a growth of 2.7%, 7.5 ppt higher than that in 2015³.

Exhibit 13: A summary of National Day Holiday sales data in selected provinces/ cities in China

Province/ City	Sales data
Beijing	120 key commercial and service companies recorded total sales of 1.03 billion yuan, increased by 7.7% yoy.
Chongqing	Key commercial companies within the six major commercial districts in the urban area recorded total sales of 3.559 billion yuan, increased by 12.9% yoy.
Tianjin	During the first four days of the holiday, ten shopping malls recorded total sales of over 120 million yuan, increased by 7.6% yoy, while 28 department stores and shopping malls recorded total sales of 260 million yuan and 82 chain supermarkets recorded total sales of 160 million yuan.
Chengdu	12 key retail companies recorded total sales of 163 million yuan on the first day of the holiday.
Anhui	During the first four days of the holiday, 54 key companies recorded total sales of 1.29 billion yuan, increased by 3.7% yoy.

Source: Linkshop

II. Latest developments

E-commerce

1. New technology breakthrough: Tencent launches WeChat "Mini program"

On 9 January, 2017, Tencent launched its new keynote function "Mini program" on its WeChat platform. The "Mini program" is seen as a lite version of apps on the WeChat platform, allowing users to use them without having to download and install additional program.

The "Mini program" has four major in-app features and functions: users do not need to download additional app; they can access information or services immediately without the need to subscribe or download them; the functions and applications of the "Mini program" are scenario-based and users can delete them any time; last but not least, users do not need to uninstall applications that they do not want as no installation is needed in the first place. It is expected that the new in-app function of the "Mini program" can take the current whitespace by offering better viewing experience than websites and better users' convenience than app.

There are several ways to locate a "Mini program" on WeChat, users can either scan the QR code, search from WeChat interface, access it through link from WeChat public account, shared by friends within 1-1 chat or chat groups or retrieve from users' previous usage of the "Mini programs".

Some of the examples include Meituan Waimai (O2O catering and delivery), Dianping (local lifestyle information and group buying), Didi Chuxing (taxi hailing), Ctrip (travel booking), Qunar (travel booking), KFC (fast food chain).

For more information, please refer to our publication [Tencent launches WeChat "Mini Program" – Key highlights and comments](#).

2. Singles' Day 2016 gears towards entertainment and interactive contents

Alibaba's 2016 11.11 Global Shopping Festival (aka the Singles' Day) was one of the major events for e-commerce market in China and around the world. Most players leveraged the event to explore new ways of doing e-commerce and enhance customers' experience. Omni-channel, augmented reality (AR) / virtual reality (VR) shopping, live streaming e-commerce, celebrity marketing, and new technologies such as delivery drones and warehouse robotics were some of the new breakthroughs for leading players such as Alibaba and JD.com.

Below is a summary of the performance of selected leading e-commerce players on the Singles' Day:

- Alibaba reported a total GMV of 120.7 billion yuan, up 32% yoy. Mobile GMV accounted for 82% of total GMV; with 235 countries and regions completed cross-border transactions. Alipay processed more than 1 billion payment transactions in total, and processed 120,000 transactions per second at peak hours. In logistics, Cainiao Network processed more than 657 million delivery orders placed on Alibaba's China and international retail marketplaces.
- For Tmall Global, at 9.5 hours into the sales event, total GMV surpassed the total for the 24-hour sale last year. Chemist Warehouse online flagship store topped the list with the highest GMV. The top 5 countries selling imported goods on Tmall Global were Japan, the U.S., South Korea, Australia and Germany. Among all the product categories, the best-selling product categories included paper diapers, baby milk powder, face masks, skin care products and watches.
- According to the statistics from JD.com, total GMV increased by 60% yoy during the Singles' Day period, i.e. from 1 – 11 November. The growth of GMV was 59% yoy on the Singles' Day (11 November), and 85% of the orders were generated from mobile devices. Among all the categories, apparel and home products were the top selling product categories and accounted for more than 40% of total orders in JD.com. Consumers from Guangdong, Beijing, Jiangsu, Shanghai and Sichuan made the most orders from JD.com. Meanwhile, total number of orders from tier three or below cities grew the fastest; and that from rural areas achieved JD.com's sales target of 30%.
- Gome reported a total GMV increase by 268% yoy on 11 November. 72% of total GMV were made via mobile devices. Guangdong, Beijing, Jiangsu, Shandong and Sichuan were the top buying provinces in terms of total number of orders. In logistics, Gome introduced on-demand goods delivery on a 24 hours/ 7 days basis this year, which is the first of its kind in China. Other than that, Gome also provided delivery from their shops, or customers can pick up the goods by themselves.
- Suning reported that its total number of orders increased by 193% yoy, with online orders up by 210% yoy. 83% of total number of orders online was made via mobile devices. Total number of orders from rural areas grew significantly by 300% yoy. In logistics, half day delivery and express delivery accounted for 80% of all the product deliveries.

3. Rural e-commerce becomes a major growth engine

China's rural e-commerce has become a new growth engine with the near saturation of urban e-commerce. In December 2016, the number of Internet users in the rural area rose to 201 million, accounting for 27.4% of the total Internet population, according to CNNIC.

According to the *Report on China Rural E-commerce Development (2015 – 2016)* by China International Electronic Commerce Center, rural online retail transactions reached 312 billion yuan in 1H16, accounting for 14.14% of total online retail sales in China. The market size of rural e-commerce is estimated to reach 647.5 billion yuan by the end of 2016.

The growth potential of the rural e-commerce market relies critically on the development of rural logistics and infrastructure – cold chain logistics development is still lagging behind and e-commerce infrastructure is not well-developed. That said, some leading e-commerce players and Internet companies have increased efforts to expand their distribution network in rural areas. For instance Alibaba has introduced a partnership program in rural areas and recruited 20,000 partners to teach and help rural residents buy and sell online. JD.com, on the other hand, has made substantial investment to expand “last mile” delivery capabilities in rural areas; for example, it has tested drone delivery services in some remote rural areas.

4. Mobile payment becomes increasingly popular, but new restrictions may affect operation

More retailers now accept third-party mobile payment in China. For example, Muji recently announced a partnership with Alipay. Close to 200 Muji stores in the Mainland China now accept Alipay payment. According to the announcement, the two companies will also integrate their membership systems. When consumers complete the payment process through Alipay, they will be awarded credit in their Muji passport membership cards.

However, People’s Bank of China earlier announced that effective from 1 December, 2016, each individual can only open one full-functioning payment account in each non-bank payment institution. Meanwhile, the announcement also requested non-bank payment institutions to set limits to both the amount and frequency of payment transfer allowed daily for each account. This may affect consumer’s incentive to use third-party mobile payment.

5. More e-commerce players strive to gain offline presence

An increasing number of e-commerce players now seek for new breakthroughs via offline channel. Setting up brick-and-mortar stores and deepening integration of online and offline (O2O) businesses become a key trend. Some recent examples include: e-commerce food brand Three Squirrels opens its first physical store in Wuhu City, Anhui province in September 2016. According to market news, the brand has reached partnership agreements with Golden Eagle Retail Group and Intime Department Store respectively to further expand its physical store network to Suzhou city and Nantong city in China; Alibaba’s Zetai and Zhejiang supermarket chain Sanjiang Shopping Club signed an agreement to establish a joint venture Ningbo Zetai Technology Service Co., Ltd. with 50 million yuan to run a fresh produce store; and Amazon China opened a showroom in Beijing’s Sanlitun to display overseas products.

6. “New Retail” to take off, online and offline cooperation deepens

In October 2016, Jack Ma pointed out that pure e-commerce players would soon face tremendous challenges. He proposed the “New Retail” initiatives, which is set to become a new model of O2O retailing in China. Selected key developments include:

Alibaba and Simple Style to open 100 “New Retail” experiential stores before 2017 year-end

Alibaba joined hands with retailer Simple Style to open 100 “New Retail” experiential stores before the end of 2017. Consumers can try on and purchase the products of various Taobao brands in the stores. Besides, the stores offer delivery services to designated locations and prices of goods are the same online and offline. The sourcing of goods in the stores is supported by the online sales data from Alibaba.

Alibaba to take Intime Retail Group private

Alibaba proposed to take Intime Retail Group private on 28 December, 2016, upon the successful privatization of Intime, Alibaba will take over Intime’s physical networks across the country, including 29 department stores and 17 shopping malls.

For more information, please refer to our publication [“New Retail” in Action: Alibaba proposes to privatize Intime Retail Group.](#)

Supermarkets and hypermarkets

7. M&A activities and partnerships stay prevalent

As a way out amid slowing growth, mergers and acquisitions (M&A) in the supermarket and hypermarket segment have been fairly active in the last few months. For example, Wal-mart announced in October 2016 a US\$50 million (around 336 million yuan) strategic investment in New Dada, a fresh produce O2O e-commerce platform. The investment is an extension of Wal-mart's broader partnership with JD.com. As part of the cooperation, New Dada will offer its customers two-hour delivery for groceries ordered from Wal-mart stores through the JD Daojia Dada application. The two-hour delivery service is available to customers within a three km radius of the 20 Wal-mart stores that are currently participating in the program. The number of Wal-mart stores offering two-hour delivery is expected to double by the end of 2017.

8. Small format shops gain popularity

Small format shops have gained popularity over the years as they can better address consumers' increasing demand for convenience, personalization, and fast services. For example, Carrefour has been very active in pursuing the small format strategy. It planned to open 40 Carrefour Easy convenience stores by end of 2016. With an average area of around 300 sqm, Carrefour Easy is a smaller scale retail format under Carrefour. Each Carrefour Easy store sells around 4,000 SKUs and serves around 300,000 customers per month. Currently, 17 Carrefour Easy has opened for business in Shanghai.

Department stores and shopping malls

9. Tough market for the department store sector with lackluster sales and persistent store closures

The department store sector faced a tough year in 2016 with lackluster sales and dropping profitability under the "new normal" of slower economic growth. More store closures happened in 2016. The complete withdrawal of UK-based Marks & Spencer from the China market was a big punch to China's department store sector; while Intime's sales in the first nine months of 2016 dropped 2.1% yoy and same store sales of Parkson Retail Group declined by 7.3% yoy in 3Q16 highlighted the slackening sales growth of traditional department store operators.

10. Pop-up stores prevail

Pop-up store is increasingly becoming a popular channel for brands and retailers to test the waters in the market. It is an easier option for retailers whom do not want to commit to an expensive, long-term lease. Pop-up store also allows brands to connect with customers in a more direct and dynamic way.

According to commercial property research agency RET CN, the number of pop-up stores in China has a compound annual growth rate of over 100% since 2015, and the total number of pop-up stores may reach over 3,000 by 2020. Pop-up store in China shows the below development trends:

- Pop-up stores can help local designer brands gain access to the mass market.
- By 2018, 54-72% of the pop-up stores will be in the tier 2 and tier 3 cities.
- Various types of pop-up stores will emerge in the future.
- "Celebrities pop-up stores" will have high growth potential.
- Pop-up stores can help turn shopping malls into more dynamic shopping venues⁴.

It is expected that more retailers will launch pop-up stores to reach out to customers. Intime Retail Group has earlier set up its first pop-up discount store in its Hangzhou branch selling luxury goods from various brands, with a hope to draw customer footfall and test the market.

Apparel market

11. IPO and M&A activities stay prominent in the apparel sector

To finance business expansion and scale up operations, a number of apparel companies went public in 2016. In 1-3Q16, there were a total of 28 listed apparel companies in China. Total revenue of the 28 listed apparel companies amounted to 69.251 billion yuan. Two companies, namely Heilan Home Co. (12.067 billion yuan) and Youngor Group (10.519 billion yuan) had revenues of more than 10 billion yuan. Average revenue was 2.473 billion yuan. Total net profit of the 28 companies was 89.71 billion yuan.

A recent IPO case is Chinese fashion company Ningbo Peacebird Fashion Co. The company officially listed on the Shanghai Stock Exchange on 9 January, 2017 and has issued about 55 million shares with each priced at 21.3 yuan, raising about 1.081 billion yuan. The company will use the capital for its investment in sales network expansion, logistics base project, as well as the construction of information system.

On the other hand, to ramp up international presence and grow their brands, an increasing number of competitive home-grown apparel companies have sought to acquire overseas brands. For example, in October 2016, Shenzhen Stock Exchange-listed Shandong Jining Ruyi Woolen Textile Co., Ltd. acquired SMCP, a French fashion company for 1.3 billion euro, making it the largest shareholder of SMCP. After the acquisition, SMCP's fashion brands, including Sandro, Maje and Claudie Pierlot, have become part of Shandong Ruyi's portfolio.

Cosmetics market

12. International cosmetics giants cut prices by 5% to 30% following the adjustment of consumption tax for imported cosmetics products

Following the Chinese government's move to slash the hefty imported tariffs on imported cosmetics products with effect from 1 October, 2016, a number of international cosmetics brands, including Estee Lauder, Dior and AmorePacific, have lowered the prices of color cosmetics starting January 2017. The price reductions, ranging from 5% to 30%, are mainly imposed on high-end brands.

Exhibit 14: Selected examples of cosmetic price reductions since January 2017

Brands	Products	Price cut range
Estee Lauder	Three liquid makeup foundation	7% - 10%
Clinique	Makeup foundation	16%
Bobbie Brown	SPF15 PA + foundation	8%
Bobbie Brown	Eyebrow pencil	12%
MAC	Makeup foundation	18%

Source: CBO, Deutsche Bank

Industry experts believe the price reductions will help international brands to gain a larger market share in China, while local high-end brands, facing market share dilution amid the wave of price cuts, are expected to follow suit and lower their prices. The lower-priced cosmetics, along with Chinese yuan devaluation against most of the major currencies, are expected to redirect some consumption back to China, underpinning domestic consumption growth.

For more information, please refer to our publication [China revises consumption tax on cosmetics items – Key highlights and implications](#).

III. Competitive landscape

Financial and operating performance of selected listed retailers, Internet and e-commerce companies:

1. Department stores and grocery players

Company	Parkson	Golden Eagle	Intime	Sun Art
Financial period	1H16*	1H16*	1H16*	1H16*
Total gross sales proceeds (million yuan)	8,495.2	8,015.3	8,351.7	NA
Operating revenue (million yuan)	2,324.6	2,152.2	2,725.5	52,943
SSS growth	-9.7%	-8.7%	-4.1%	-0.3%
Merchandise gross margin	16.7%	20.5%	15.3%	22.8%
Concessionaire sales	83%	83.6%	81.4%	NA
Concessionaire rate	16.9%	17.6%	17.2%	NA
Current operating stores	58	29	46	421

* For the six-month period ended 30 June 2016

Source: Company data, compiled by Fung Business Intelligence

2. Internet and e-commerce companies

Company	Alibaba	Tencent	JD.com
Financial period	3Q17*	3Q16**	3Q16**
Revenue (Billion yuan)	53.2, +54% yoy	40.4, +52% yoy	60.7, +38% yoy
GMV (Billion yuan)	NA	NA	158.8, +43% yoy
Annual active buyers	443 million (Dec 2016)	NA	198.7 million (Sep 2016)
MAU	Mobile MAU: 493 million (Dec 2016)	Combined MAU of Weixin and Wechat (Sep 2016): 846 million; MAU of QQ (Sep 2016): 877 million	NA
Notes	<ul style="list-style-type: none"> A record of 120.7 billion yuan GMV in the Singles' Day Shopping Festival For year 2017, Alibaba expects revenue to increase 53% yoy 		<ul style="list-style-type: none"> 7 fulfillment centers, 254 warehouses, 6,780 delivery stations and pickup stations

* For the quarter ended September 30, 2016.

** For the quarter ended December 31, 2016.

Source: Company data, compiled by Fung Business Intelligence

IV. Regulation updates

Domestic trade and distribution sector

1. China to speed up reforms in domestic trade and distribution sector

On 16 November, 2016, the Ministry of Commerce (MOFCOM) and nine other ministries jointly released the **13th Five-year Plan for the Development of Domestic Trade and Circulation** <国内贸易流通“十三五”发展规划>, which set out key tasks to guide the development of domestic trade and circulation in the next five years. The Plan is set to underscore supply-side reform, the *Internet Plus Circulation Action Plan* as well as strategies for upgrading and developing the circulation system.

Major tasks of the Plan include:

- Promoting the innovative development of “Internet Plus Circulation”.
- Optimizing the supply structure and resolving supply and demand mismatching.
- Promoting consumption upgrade.
- Enhancing informatization of the circulation system.
- Speeding up the standardization process for circulation.
- Encouraging intensive growth and development.
- Coordinating regional development.
- Encouraging opening up and collaboration.
- Establishing a better-regulated business environment⁵.

Besides, the MOFCOM and 12 other ministries jointly issued the **Opinions on Accelerating Innovation of Domestic Trade Circulation, Optimizing Supply-side Structural Reform and Improving Consumption** <关于开展加快内贸流通创新推动供给侧结构性改革扩大消费专项行动的意见> on 7 November, 2016. The Opinions set out 13 tasks in four areas, including enhancing innovation capabilities, deepening the reform of the circulation system, adjusting the supply-demand mechanism, and optimizing the consumption environment. These expect to address the underlying issues that restrict consumption and develop experience for reform and innovation that can be expanded and popularized.

Major tasks of the Opinions include:

- Intensifying efforts in information; pushing forward the “Internet Plus Circulation” Action Plan.
- Encouraging business model innovation.
- Supporting the integration of the circulation sector with various related industries.
- Reforming the operations of the commercial sector.
- Relaxing and abandoning various restrictions on operations.
- Reforming taxation policies.
- Optimizing regional planning.
- Coordinating urban and rural development.
- Strengthening and encouraging the use of advanced technologies.
- Regularizing the consumption environment.
- Improving consumption standards.
- Enhancing the credit system.
- Encouraging green consumption⁶.

2. China to promote the transformation of physical retail and innovation in domestic trade

On 11 November, 2016, the General Office of the State Council issued *the Opinions on Promoting the Innovation and Transformation of Physical Retail* <关于推动实体零售创新转型的意见>. The Opinions request relevant departments and local governments to launch policies to facilitate the innovation and transformation of physical retailers. The Opinions encourage retailers to move from saturated markets into other less-developed domestic markets, adopt new business models that can meet current market demands and improve operation efficiency, and use technology to achieve online/offline integration.

Major tasks of the Opinions include:

- Deepening the reform of state-owned enterprises including collaboration project with different types of investors.
- Improving the planning of commercial networks in cities and rural areas.
- Streamlining administrative measures and processes.

- Improving the market monitoring mechanism to facilitate fair market competition.
- Reducing fees and taxation rates such as import duties of certain consumer goods and electricity rate.
- Providing financial support to companies transforming their businesses through public and private funding and other financial tools.
- Setting up demonstration areas dedicated to retail transformation⁷.

Internet and e-commerce

3. New requirements related to the “7-day Unconditional Return Policy” for retail e-commerce to be implemented on 15 March, 2017

The State Administration for Industry & Commerce (SAIC) called for comments on the **Implementation Measures on 7-day Unconditional Return for Goods Purchased Online (Draft for Comments)** <网络购买商品七日无理由退货实施办法>. The Measures provide detail descriptions to how the “7-day Unconditional Return Policy” should be carried out on top of the previous requirements stated in the **Consumer’s Rights Protection Law** <消费者权益保护法>. The Measures become effective on 15 March, 2017.

Details of the Measures are as follows:

A. Unconditional return is not applicable to four categories of goods:

- Fresh products.
- Customized products.
- Newspaper and magazines.
- Digital products such as multimedia or software.

B. Unconditional return can be exempt for three categories of goods with consumers’ consent prior to the purchase:

- Goods that will depreciate or lose much of its value upon activation or trial use.
- Goods that have been clearly indicated as near-expiration or defected during sales display.
- Goods that are easily spoiled and will affect user’s health and safety after de-packaging.

C. Consumers' obligation in the goods-returning process:

- Consumers should make sure the goods returned are intact to the extent that it can retain its original quality and functions.
- Goods should be returned with their original labels.

D. Guidelines on the definition of intact returned goods:

- Cosmetics, food, health products and medical equipment: Sealed packaging is intact.
- Electronic devices: No unauthorized alteration, repair, tampering of the product labels and identification, unrecoverable damages to the product appearances etc.
- Home textiles, fashion, accessories, furniture and toys: No tampering of the product labels or damages to the product.

E. Goods-returning process:

- Return period: Consumers can return the goods according to the Measure within a 7-day period, which starts from the second day the consumer received the goods.
- Refund period: Sellers should make the refund within a 7-day period, which starts from the day the seller received the returned goods⁸.

4. New cross-border B2C e-commerce supervision rules further delayed in implementation until end of 2017

The MOFCOM announced on 15 November, 2016 that the transition period for new cross-border B2C e-commerce supervision rules has been further extended to the end of 2017 to allow for a stable transition towards the new supervision rules.

According to earlier decision made by the State Council, the implementation of new supervision rules on cross-border B2C e-commerce imports has been delayed in a one-year transition period starting from 11 May, 2016. Products entering the bonded zones in ten pilot cities of Tianjin, Shanghai, Hangzhou, Ningbo, Zhengzhou, Guangzhou, Shenzhen, Chongqing, Fuzhou and Pingtan will not be subject to CIQ clearance procedures. Products such as cosmetics, infant, formula milk powder, healthcare food etc. will not be subject to initial import licensing approval, registration and filing requirements as required by the new supervision rules. The above rules have also been suspended for goods imported through the direct purchase model in all regions⁹.

5. Cyber Security Law to be implemented on 1 June, 2017

The Standing Committee of the National People's Congress approved the **Cyber Security Law** <《中华人民共和国网络安全法》> on 7 November, 2016. The Law will come into force on 1 June, 2017.

The Law requires “operators of key information infrastructure”, i.e. companies in industries and fields such as public communications and information services, energy, transportation, water conservancy, finance, public services and e-government services to have higher standard of cyber security obligations. For example, they are required to conduct security risk assessment on their own or by entrusting professional agencies at least once a year. These operators are also required to store the personal information collected and generated during their operations within China. On the other hand, individual Internet users are required to follow the real-name registration protocol before they can use telecommunication services in China. The Law also requires network operators to obtain the consent of the person whose information is collected and to take technical measures and other necessary measures to ensure the security of collected personal information, etc¹⁰.

6. Draft of first E-commerce Law under review

The draft **China E-commerce Law** <《中华人民共和国电子商务法(草案)》> was submitted for review by legislators in the 25th session of the 12th National People's Congress (NPC) Standing Committee on 19 December, 2016. The draft, being the first comprehensive law addressing e-commerce, is expected to improve the regulatory regime, maintain market order and protect consumer's rights.

According to the Draft Law, e-commerce is defined as “commercial activities that use the Internet to carry out transactions and trade of products and services”. All such activities will be governed by the new law, with the exception of those that are subject to the regulation of other specific laws such as financial products and services, web broadcasting and web publishing activities.

Selected highlights of the Draft Law include:

- All e-commerce operators need to pay taxes and acquire the necessary business certificates; key operating information is to be clearly displayed online.
- E-commerce platforms are required to monitor and report any irregularities among the sellers on their platforms. Information regarding the transactions and the involved parties need to be safely stored.
- E-commerce contracts, electronic payment and logistics services are mentioned in the Draft and subject to the regulations of the new law.
- Enhancing consumer protection through means such as establishing dispute resolution mechanism that uses seller's deposit to compensate consumers upon valid complaint, prohibition of fake transaction and

fake credit ratings.

- Facilitating cross-border e-commerce through means such as electronic custom clearance, tax and inspection procedure¹¹.

Taxation

7. Consumption tax adjustment for cosmetics effective from 1 October, 2016

The Ministry of Finance and the State Administration of Taxation jointly announced the **Notice regarding the adjustment of consumption tax on cosmetics** <关于调整化妆品消费税政策的通知>, putting in effect a revision of the consumption tax scheme on cosmetics from 1 October, 2016. Consumption tax rate for cosmetics items is lowered to 15% from previous 30%. Major changes on the consumption tax for general cosmetics and upscale cosmetics items are set out as follows:

- Consumption tax on **upscale cosmetics** (with import/ex-factory price no less than 10 yuan/ml or 15 yuan/unit) will be cut **from 30% to 15%**. Upscale cosmetics include high-end color make-up, beauty products, premium skincare and packaged cosmetics products.
- Consumption tax on **general cosmetics** (with import/ex-factory price at less than 10 yuan/ml or 15 yuan/unit) will be **removed**¹².

Exhibit 15: Consumption tax change of cosmetics products

Category	Consumption tax before 1 October, 2016	Consumption tax after 1 October, 2016
Color make-up (high-end*)	30%	15%
Color make-up (low-end)	30%	0%
Skincare (high-end*)	n/a**	15%
Skincare (low-end)	0%	0%
Perfume	30%	15%

* "High-end" products refer to products over 10 yuan/ml, or 15 yuan/piece in terms of ex-factory or import price (ex-VAT).

** There is no clear definition of "high-end" skincare before 1 October, 2016.

Source: Ministry of Finance, compiled by Fung Business Intelligence

V. Outlook

1. China's economy is expected to face less pressure in 2017; total retail sales are estimated to grow at 10.2% in 2017

According to the report *Ten Highlights of China's Commercial Sector 2017* jointly published by Fung Business Intelligence and the Expert Committee of the China General Chamber of Commerce (CGCC), China's economy will face less pressure and see some improvements in 2017. The report stated that the 19th National Congress of the Communist Party of China will be held in 2H17, which will set out new directions for the future development of China. The economy is expected to grow at 6.7% yoy in 2017. Domestic consumption will continue to grow steadily and make up a higher proportion of GDP growth. The circulation (or distribution) sector will play a more important role in facilitating economic growth. CPI is expected to rise moderately by 2.5% yoy, which will contribute to the stability of the consumer market. Total retail sales of consumer goods are expected to grow at 10.2% yoy in 2017.

Growth of household income will be stable in 2017 as the government has rolled out several initiatives to raise incomes. For instance, it increased the basic pension by 6.5% in 2016. Also, the government adjusted salaries of public institution employees. Additionally, in October 2016, the State Council announced the **Implementing Opinions on Motivating Major Social Groups to Boost the Income of Rural and Urban Residents** <国务院关于激发重点群体活力带动城乡居民增收的实施意见> following the proposal at the Fifth Plenary Session of the 18th CPC Central Committee to double urban and rural residents' per capita income between 2010 and 2020. We expect income of both urban and rural households to increase gradually in the coming years.

As China's retail market has entered a "New Retail Regime", we expect more new retail formats and business innovations to emerge in 2017. In particular, community-based small-format stores dominated by convenience store chains, specialized stores, small-scale supermarkets and fresh produce grocery stores are expected to see explosive growth. Moreover, the deployment of O2O business strategies by retailers to enhance shopping experience will continue to transform the retail landscape. Meanwhile, innovative marketing tools will emerge to draw customer traffic. The adoption of virtual reality technology in business, the use of social media in the context of e-commerce and live streaming on social networks are examples.

For more information, please refer to our publication [*Ten Highlights of China's Commercial Sector 2017*](#).

2. China's retail and consumer market to grow steadily during CNY holiday

The first day of Chinese New Year (CNY), the year of the Rooster, begins on 28 January, 2017. The CGCC forecasted that China's retail and consumer goods market to demonstrate the following characteristics during the week-long CNY holiday:

- Market will remain steady; supply and demand of products will improve; and product quality will improve.
- Price level of goods will go up slightly.
- Higher demand for high quality, healthy and safe products.
- More discounts will be offered both online and offline.
- Mass catering will show stronger growth.
- Growth rate of online sales of physical goods will drop.

¹ “Consumer confidence index”, the National Bureau of Statistics of the PRC

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² “CCFA & PwC: Growth in sales and margin of retailers in China continue to show downward trend”, 15 December 2016, yicai.com

<http://www.yicai.com/news/5184342.html>

³ “Top 100 key major retailers record a yoy sales decline of 0.3% during the National Day Holiday”, 13 October 2016, CNCIC

http://www.cncic.org/index.php?option=com_content&task=view&id=42020&Itemid=124

⁴ “RET CN: Number of pop-up stores in China to reach over 3,000 by 2020”, 22 December 2016, ret.cn

<http://www.ret.cn/notepadType.asp?pkid=298>

⁵ “13th Five-year Plan for the Development of Domestic Trade and Circulation”, 16 November 2016, Ministry of Commerce of the People’s Republic of China

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<http://www.mofcom.gov.cn/article/b/d/201611/20161101775221.shtml>

⁷ “Opinions on Promoting the Innovation and Transformation of Physical Retail”, 11 November 2016, The State Council of the People’s Republic of China

http://www.gov.cn/zhengce/content/2016-11/11/content_5131161.htm

⁸ “Implementation Measures on 7-day Unconditional Return for Goods Purchased Online (Draft for Comments)”, 27 September 2016, State Administration for Industry and Commerce of the People’s Republic of China

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⁹ “New cross-border B2C e-commerce supervision rules further delayed in implementation until end of 2017”, 15 November 2016, Ministry of Commerce of the People’s Republic of China

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¹⁰ “Cyber Security Law”, 7 November 2016, National People’s Congress

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¹¹ “Draft of first E-commerce Law under review”, 27 December 2016, National People’s Congress

http://www.npc.gov.cn/npc/xinwen/2016-12/27/content_2005247.htm

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http://www.ec.com.cn/article/dszc/dslf/201612/13596_1.html

¹² “Notice regarding the adjustment of consumption tax on cosmetics”, 30 September 2016, The Ministry of Finance and the State Administration of Taxation, PRC

http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201609/t20160930_2430843.html

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