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I. Market overview

1. Retail sales up by 8.3% yoy in 1Q19

Total retail sales of consumer goods increased nominally by 8.3% year-on-year (yoy) to reach 9.8 trillion yuan in 1Q19, with real growth reaching 6.9% yoy. By month, the nominal growth in January–February and March were 8.2% yoy and 8.7% yoy respectively.

Exhibit 1: Total retail sales of consumer goods, March 2018 – March 2019

Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence
2. Rural retail sales growth continues to outpace urban retail sales growth in 1Q19; per capita income of rural residents also grows faster than urban income

Rural retail sales have been growing at a faster pace than urban retail sales. Rural retail sales increased nominally by 9.2% yoy to 1.4 trillion yuan in 1Q19, while urban retail sales rose 8.2% yoy to 8.3 trillion yuan. By month, rural retail sales amounted to 0.45 trillion yuan in March 2019, up by 9.4%, while urban retail sales amounted to 2.72 trillion yuan, up by 8.5% yoy.

Exhibit 2: Total retail sales of consumer goods, urban vs. rural areas, March 2018 – March 2019

Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence
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 11,633 yuan and 4,600 yuan in 1Q19, up by 7.9% and 8.8% yoy in nominal terms respectively. Rural household income grew faster than that of urban households, but the per capita disposable income of urban households was almost triple than that of their rural counterparts.

Exhibit 3: Per capita disposable income of urban and rural households, 1Q18 – 1Q19

<table>
<thead>
<tr>
<th></th>
<th>Urban households</th>
<th>Rural households</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Absolute value (yuan)</td>
<td>yoy growth</td>
</tr>
<tr>
<td>Quarterly data</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1Q18</td>
<td>10,781</td>
<td>8.0%</td>
</tr>
<tr>
<td>1Q19</td>
<td>11,633</td>
<td>7.9%</td>
</tr>
<tr>
<td>Half-yearly data</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1H18</td>
<td>19,770</td>
<td>7.9%</td>
</tr>
<tr>
<td>1-3Q data</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-3Q18</td>
<td>29,599</td>
<td>7.9%</td>
</tr>
<tr>
<td>Yearly data</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY18</td>
<td>39,251</td>
<td>7.8%</td>
</tr>
</tbody>
</table>

Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence
3. Online retail market continues to rise in 1Q19 amid slower growth

Total transaction value of online retail sales of goods and services increased by 15.3% yoy to reach 2,237.9 billion yuan in 1Q19. Of which, online sales of goods amounted to 1,777.2 billion yuan, up by 21.0% yoy and accounted for 18.2% of the total retail sales of consumers goods. By month, total online retail sales of goods and services in January – February and March totaled 1,398.3 billion yuan and 839.6 billion yuan, respectively.

Exhibit 4: Transaction value of online retail sales of goods and services, March 2018 – March 2019

Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence
4. Consumer confidence index remains stable in 1Q19

Consumer confidence index has remained fairly stable in 1Q19. Consumer confidence index came in at 123.7 in January, and 126.0 and 124.1 in February and March respectively.

Exhibit 5: Consumer Confidence Index, January 2018 – March 2019

Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence
5. Performance of large-scale retailers show signs of recovery

Retail sales growth of 100 key retailers increased slightly by 0.2% yoy in 1Q19. By month, retail sales growth rose from -3.6% in October 2018 to -0.5% in January-February 2019.

Exhibit 6: Yoy growth of retail sales of 100 key retailers in China, March 2018 – January-February 2019

Source: China National Commercial Information Center; compiled by Fung Business Intelligence
II. Latest developments

General retail

1. Growth pace of the Top 100s remains steady in 2018

In May 2019, the China Chain Store and Franchise Association (CCFA) released its annual list of “the Top 100 Retail Chain Operators in China” (the Top 100s). Total sales of the Top 100s in 2018 amounted to 2.4 trillion yuan, up 7.7% yoy. The growth rate was slightly slower than that of 8.0% yoy in 2017, and also slower than for the national total retail sales of consumer goods of 9.0% yoy. Total number of stores of the Top 100s reached around 138,000, up 16.0% yoy. The growth of number of stores was 9.1% yoy after taking out the effect of the rapid increase in the number of convenience stores (including Suning Xiaodian), similar to the growth rate in 2017. The Top 100s made up only 6.3% of the total retail sales of consumer goods, down from 11.1% in 2008, indicating the increasingly fragmented nature of China’s retail market (Exhibit 7).

Suning.com Group Co., Ltd., Gome Retail Holdings Ltd. and China Resources Vanguard Co., Ltd. remained the top three retail chain operators by retail sales, with no change in the rankings over the previous year (Exhibit 8).

Exhibit 7: The Top 100s’ share in national retail sales, 2008-2018

Source: China Chain Store and Franchise Association, compiled by Fung Business Intelligence
Exhibit 8: Top 10 chain retailers, 2018 (Ranked by retail sales)

<table>
<thead>
<tr>
<th>Rank in 2018</th>
<th>Rank in 2017</th>
<th>Enterprise</th>
<th>Sales, pre-tax (million yuan)</th>
<th>yoy growth (%)</th>
<th>Number of stores</th>
<th>yoy growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>Suning.com Group Co., Ltd.</td>
<td>336,757</td>
<td>38.4%</td>
<td>11,064</td>
<td>183.3%</td>
</tr>
<tr>
<td>2</td>
<td>2</td>
<td>Gome Retail Holdings Ltd.</td>
<td>138,184</td>
<td>-10.1%</td>
<td>2,122</td>
<td>32.3%</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
<td>China Resources Vanguard Co., Ltd.*</td>
<td>101,254</td>
<td>-2.3%</td>
<td>3,192</td>
<td>0.9%</td>
</tr>
<tr>
<td>4</td>
<td>4</td>
<td>Sun Art Retail Group Ltd.</td>
<td>95,900</td>
<td>0.5%</td>
<td>407</td>
<td>6.3%</td>
</tr>
<tr>
<td>5</td>
<td>5</td>
<td>Walmart (China) Investment Co., Ltd.</td>
<td>80,490*</td>
<td>0.3%</td>
<td>441</td>
<td>0.0%</td>
</tr>
<tr>
<td>6</td>
<td>6</td>
<td>Yonghui Superstores Co., Ltd.</td>
<td>76,768*</td>
<td>17.4%</td>
<td>1,275</td>
<td>58.2%</td>
</tr>
<tr>
<td>7</td>
<td>N/A</td>
<td>Beijing Easyhome New Retail Development Co., Ltd.</td>
<td>71,000</td>
<td>13.1%</td>
<td>303</td>
<td>35.9%</td>
</tr>
<tr>
<td>8</td>
<td>7</td>
<td>Chongqing General Trading (Group) Co., Ltd.</td>
<td>67,489</td>
<td>13.3%</td>
<td>413</td>
<td>-2.4%</td>
</tr>
<tr>
<td>9</td>
<td>9</td>
<td>Sinopec Group</td>
<td>62,000</td>
<td>19.0%</td>
<td>27,259</td>
<td>5.8%</td>
</tr>
<tr>
<td>10</td>
<td>8</td>
<td>Lianhua Supermarket Holdings Co., Ltd.</td>
<td>49,229</td>
<td>-2.9%</td>
<td>3,371</td>
<td>-1.5%</td>
</tr>
</tbody>
</table>

Source: China Chain Store and Franchise Association, compiled by Fung Business Intelligence

*Sales of China Resources Vanguard Co. Ltd. included sales of Suguo Supermarket. The pre-tax sales for Suguo Supermarket were 27,550 million yuan in 2018.

*Estimates

Convenience stores continued to gain traction. Among all retail formats, in 2018, convenience stores recorded the highest sales growth at 21.1% yoy, up from 16.9% yoy in 2017, while the growth rate for store numbers was 18.0% yoy, similar to 18.1% yoy in 2017. On the contrary, department stores recorded sales growth of 3.5% yoy, while hypermarkets and supermarket recorded sales growth of 2.5% yoy only (Exhibit 9), much lower than the average of the Top 100s.

Exhibit 9: Yoy growth of the Top 100s, by retail format, 2018

<table>
<thead>
<tr>
<th>Retail format</th>
<th>yoy growth of sales (%)</th>
<th>yoy growth of number of stores (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Convenience stores</td>
<td>21.1</td>
<td>18.0</td>
</tr>
<tr>
<td>Department stores</td>
<td>3.5</td>
<td>3.9</td>
</tr>
<tr>
<td>Hypermarkets and supermarkets</td>
<td>2.5</td>
<td>3.6</td>
</tr>
</tbody>
</table>

Source: China Chain Store and Franchise Association, compiled by Fung Business Intelligence
2. Retailers drop prices on VAT cut

In March, China announced to reduce its value-added tax (VAT) rates in a move to further ease the tax burden of businesses and consumers, while re-energizing the domestic economy. With effect from 1 April, the VAT rates for VAT taxable supplies and import of goods for general VAT payers will be reduced from 16% to 13% and 10% to 9%, respectively. The 6% VAT rate will remain unchanged. Various retailers have responded to the VAT tax reduction with price cuts. In the supermarket and hypermarket sector, several grocery players have cut prices on selected products sold in their stores. For example, Better Life has reduced prices for 10,000 SKUs in its supermarkets nationwide; while Walmart cut prices on dry goods, frozen food, FMCG products and home electronics from 8 April\(^1\).

The VAT cut has also driven price drops in selected products from premium/luxury brands. LVMH’s Louis Vuitton and Kering’s Gucci reportedly lowered the retail prices of selected products by around 3% following the tariff cut. Indeed, in June 2018, the two companies also marked down the prices of selected products by 3%-5% in China in response to the Chinese government’s policy to reduce import duties on consumer goods with effect from 1 July 2018\(^2\).

Prada has also announced to reduce the prices of its two core brands Prada and Miu Miu in China; these two brands reportedly have already trimmed the product prices for both their online and offline stores in China by an average 2%-3%\(^3\).

Estée Lauder has cut the retail prices of selected skincare products, color cosmetics and fragrance products for all its brands including La Mer, Estée Lauder, Clinique, Origins, Tom Ford, Jo Malone, M·A·C, Bobbi Brown, Darphin, and Lab Series starting 1 May. This is the fourth time that Estée Lauder lowered suggested retail prices for selected products in the past four years\(^4\).

Internet & E-commerce

3. E-commerce private labels expand offline

To extend customer reach and provide better shopping experience, various e-commerce operators have begun to sell their private labels offline in this quarter. In April, NetEase Kaola opened its first offline “Global Factory Store” at Raffles City Shopping Centre in Hangzhou. With a store size of 200 sqm, the store offers 1,500 SKU selected from its online “Global Factory Store”, ranging from cosmetics, personal care products, digital products, home electronics, food, home products and outdoor products. NetEase Kaola plans to open around 12 offline “Global Factory Store” in 2019 in Shenzhen, Hangzhou, Ningbo, Fuzhou, Wuhan, Chongqing and Chengdu; most of the stores will run under the franchise model except one or two stores will be self-operated\(^5\).
In May, Youpin by Xiaomi opened its first global flagship store in Hefei. With an area of over 500 sqm, the store sells around 2,000 SKUs from 17 categories including smart products, home products, kitchenware and baby and maternity products, selected from its online listings. Aside from displaying products, there is also an experiential zone in-store to create a home-like scenario to customers. The store is equipped with self-checkout systems and electronic tags to ensure the same price online and offline.

4. Social e-commerce platforms gain traction in the capital market

Social e-commerce platforms are getting popular in China. In this quarter, a number of social e-commerce players have successfully raised funds in the capital market. Yunji Inc., a membership-based social e-commerce platform, debuted on the Nasdaq Stock Exchange on 3 May, 2019, raising US$121 million. According to Yunji, the proceeds of the offering will be used to expand its business operations, enhance technological capabilities and infrastructure, improve fulfillment facilities, and for general corporate purposes.

In the same month, another social e-commerce platform Beidian completed a new financing round of 860 million yuan, with Hillhouse Capital, Xiang He Capital, Sequoia Capital, Sinovation Ventures, Gaorong Capital, IDG Capital, and Capital Today being the major investors. According to Beidian, the capital raised will be used to upgrade its supply chain infrastructure – deepening relationship with manufacturers/brands, creating a flexible supply chain, and enhancing shopping experience on social platforms.

5. Internet players proactively invest in other companies

In this quarter, some leading e-commerce players have continued their efforts to invest in companies in other industries to expand their ecosystem. For example, in May, Alibaba invested 4.36 billion yuan China’s major furniture retailer Red Star Macalline. The two companies also sealed a business cooperation framework agreement to carry out business cooperation on furniture building supplies, construction of furniture malls and shopping malls, and other business areas. Earlier in April, JD.com signed an agreement to invest in Jiangsu Five Star Appliances Co., Ltd. According to the agreement, JD.com will purchase a 46% stake in Five Star Electric from Jiayuan Group, its existing shareholder, for 1.27 billion yuan. The two companies first started cooperation in 2017 and have jointly opened more than 20 unbounded retail experience stores.

6. Amazon announces to shut down its China marketplace Amazon.cn

Amazon is partially retreating from the China market for online retailing. In mid-April, Amazon notified its Chinese sellers that it will no longer operate a marketplace nor provide seller services on its China marketplace Amazon.cn from 18 July; sellers interested in continuing to sell on Amazon outside of China are able to do so through Amazon Global Selling. According to Amazon China, it will continue to invest and grow in China through Amazon Overseas, Amazon Global Selling, Kindle e-readers and Amazon Web Services. Amazon first entered the Chinese market
years ago. Its decision to close down its online business in China comes on the back of stiff competition from local e-commerce players. In terms of sales, Alibaba holds more than half the e-commerce market in China. Other significant players include JD.com, VIP.com and Pinduoduo. Amazon reportedly has less than 1% market share in China.

Cross-border e-commerce

7. CBEC import business continues to grow fast; NetEase Kaola ranks first again among China’s CBEC players in 1Q19

China’s cross-border e-commerce (CBEC) import business continued to grow fast in 1Q19. According to the Ministry of Commerce (MOFCOM), the import value of CBEC increased by over 40% yoy. Imports from Japan, the U.S. and Korea were ranked the top three, accounting for 18%, 13.3% and 11.6% of the total import value respectively. By product category, cosmetics, grain, oil, food and daily necessities were the top three most popular categories, accounting for 36.2%, 24.3%, and 10.0% of the total import value respectively.

A report by iiMedia Research shows that, in 1Q19, NetEase Kaola ranked the top for the eighth times in terms of market share (27.5%), followed by Tmall Global and JD.hk with 25% and 13% market share, respectively.

Retail Technology

8. Adoption rate of digital transformation in retail to reach new heights

According to a report released by Alibaba Cloud Research in February on digitalization trends, the use of digital technologies has spread from the Internet sector to the government and other industries including the financial sector, retail sector, agricultural industry, industrial sector, transportation sector, logistics sector, medical and healthcare device industry. Among which, the retail sector is set to be impacted the most by advanced technologies such as cloud computing, artificial intelligence and the Internet of Things (IoTs). Retail enterprises have and will continue to leverage technologies to transform each and every aspect of the retail supply chain to enhance production efficiency and increase enterprise value. The adoption rate of digital transformation in the retail sector is expected to reach 70-80% in the coming three to five years.
Retail logistics

9. Logistics players partner with global counterparts to improve global delivery services

To accommodate the increasing demand of overseas delivery orders, domestic logistic players partner with global counterparts to enhance their global delivery services. In March 2019, Cainiao, AliExpress and Spain Post signed a strategic cooperation agreement to accelerate cross-border logistics between China and Europe, in the hope that SMEs in China and Europe can participate in global cross-border trade in an easier way. According to the agreement, Cainiao and Spain Post will jointly enhance the cross-border logistics service capabilities between China and Europe, and provide services such as warehousing, cargo sorting, trunk transportation and last-mile delivery for AliExpress to shorten the time for European consumers to buy/receive goods bought in China – parcels from China can be delivered to Spain in about 10 days\(^\text{15}\).

Later in April 2019, Cainiao, AliExpress and French delivery service provider Relais Colis sealed a partnership agreement. Under the deal, Relais Colis’ 5,200-plus offline delivery service stations will offer relay point delivery services for Cainiao, serving as pick-up points for Cainiao’s orders; such move enables French customers to pick up their orders from China at their nearest Relais Colis service station. It is the first time that Cainiao set up its self-pickup service network in Western Europe\(^\text{16}\).

10. Logistics companies adopt technologies in newly built infrastructures

In this quarter, some logistics companies have built new infrastructures that adopt various advanced technologies. For instance, in March, Cainao Network announced that its smart logistics park in Wuxi, Tianjin has completed IoT upgrading and already started operation. The smart logistics park uses various advanced technologies including IoT, artificial intelligence (AI), edge computing and robotics to achieve smart management and automated production. Covering Beijing, Tianjin, Hebei, Shandong, Liaoning and other areas, the park has further enhanced its efficiency and stability through technological upgrading, striving to provide same-day and next-day delivery services for customers\(^\text{17}\). Other than that, JD Logistics announced that it will set up China’s first 5G smart logistics demonstration zone in Jiading, Shanghai. It will utilize 5G network communication technology, and smart logistics technologies such as AI, IoT, automatic vehicles and robotics to create an integrated, intelligent demonstration zone with high degree of decision-making power\(^\text{18}\).

11. Logistics sector sees robust collaborations

Some logistics players have formed partnership with Internet players or domestic counterparts to expand their business. In March 2019, Alibaba announced that it would invest 4.66 billion yuan in STO Express. The two companies will collaborate in the fields of logistics technology, express delivery, and new retail logistics. Earlier,
Alibaba, Cainiao and ZTO Express announced a strategic investment agreement to invest US$1.38 billion in ZTO Express, holding about 10% of ZTO Express’s stake.

In April 2019, JD Logistics and China COSCO Shipping Corporation’s subsidiaries OOCL Logistics and COSCO Shipping Logistics announced to establish a joint venture company, aiming to build an online-to-offline integrated global supply chain service platform to further promote the transformation and upgrading of China’s logistics industry. Leveraging JD Logistics’ Global Smart Supply Chain network, the joint venture company will set up a global logistics network and a one-stop global supply chain service platform to offer cross-border air and maritime logistic, financial, and data services, etc.

Department stores and shopping malls

12. CCAGM and FBIC publish China’s Department Stores Report 2018-2019

In March, China Commerce Association for General Merchandise (CCAGM) and Fung Business Intelligence (FBIC) jointly released the "China’s Department Stores Report 2018-2019". The report provides a brief overview of the department store sector in China and highlighted the key innovation as well as transformation initiatives of major department store operators. It also points out some of the problems faced by department store operators during the transformation process.

According to the report, in 2018, the department store sector showed some signs of bottoming out after undergoing years of profound transformation. A survey with 90 key department store operators conducted by CCAGM and FBIC found that the total sales revenue and core operating profits increased by 4.2% yoy and 5.7% yoy respectively (Exhibit 10). Among the sampled companies, 57.8% registered positive yoy sales growth in 2018. This suggested that retail players started to see meaningful results with their efforts in adapting to evolving market trends. In addition, robust merger and acquisition activities has sped up market concentration in the sector, enabling department stores to expand upstream.
Exhibit 10: Operating results of 90 sampled department stores operators, 2018

<table>
<thead>
<tr>
<th></th>
<th>2018 vs. 2017 yoy changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sales revenue</td>
<td>4.2%</td>
</tr>
<tr>
<td>Core operating profits</td>
<td>5.7%</td>
</tr>
<tr>
<td>Total expenses</td>
<td>-3.7%</td>
</tr>
<tr>
<td>Net profits</td>
<td>6.4%</td>
</tr>
<tr>
<td>Year-end net asset value</td>
<td>7.5%</td>
</tr>
<tr>
<td>Average number of employees</td>
<td>-3.1%</td>
</tr>
<tr>
<td>Operating area</td>
<td>2.1%</td>
</tr>
</tbody>
</table>

The report summarizes four key innovation and transformation initiatives of department store operators. Firstly, online-to-offline (O2O) integration and digital transformation have become a high priority. 59.6% of the sampled department store operators have already started their e-commerce business. More and more companies have formed partnership with leading internet companies and e-commerce players and leveraged the latter’s huge traffic flows, big data as well as logistics capabilities. They not only deploy advanced technologies such as AI and IoT to enhance shopping experience, but also use big data analysis to formulate marketing strategies.

Another initiative by department store operators is the expansion of direct sales businesses. This is done through increasing the scale of direct product procurement, launching self-operated buyer/multi-brand stores and actively developing private labels. By strengthening direct sales businesses, companies hope to offer differentiated products and establish unique positioning. The third initiative is the diversification of retail formats and introduction of innovative business models. The report finds that over 75% of surveyed department store operators have ventured into other retail formats, including supermarket/ hypermarket (73.0%) and shopping mall (49.6%). Companies such as Rainbow Department Store and Bailian Group have rolled out concept shops and new services to upgrade consumption experience.

The last initiative is the introduction of experiential elements. To adapt to the changing lifestyle habits of consumers and greater demand for experiential shopping, many department store operators have endeavored to add experiential elements such as family and child-related services and shops, art and culture exhibitions, dining, entertainment, IP/content-driven ACG (animation, comic, games) subculture and technology elements.

The report also reviews some hurdles and challenges faced by the department store sector. These include bottlenecks to transformation, rising cost pressures, high product prices and the time taken to build core competencies. Nevertheless, the report forecasts that China’s department store sector will maintain stable growth in 2019 given the consumption upgrading trend as well as the government’s determined efforts to boost
consumption. The report concludes with a projection that the lines between large-scale department stores and urban shopping malls would blur further.

For more information, please refer to our publication *China’s Department Stores Report 2018-2019*.

13. New retail malls launch; department store operators explore digital solutions with tech giant

In this quarter, department stores operators have continued to reinvent and innovate with the launch of new retail formats and adoption of new digital solutions. In mid-May, Suning.com announced to rename the 37 department stores it acquired from Dalian Wanda as Suning.com Plaza. Those stores are being renovated into smart retail malls with the first one to be opened in late May 2019. Bailian Group also announced that it will develop a new series of concept shopping malls and accelerate the development of new stores in the next five years. Adopting the operating principles of “Social, Connect, Together”, those concept malls are aimed to bring together consumers, consumption scenes and products.

Meanwhile, Rainbow Department Store, together with WeChat Pay and Enterprise WeChat jointly announced digital solutions tailored for the department store sector. The solutions allow brands selling at Rainbow to connect with consumers via WeChat Pay and use the software provided by Enterprise WeChat. Rainbow in turn will share its 18-million-member database with the brands and provide operational support, such that they can enhance their services.

Supermarkets and hypermarkets

14. Supermarket and hypermarket operators explore new retail formats

Retailers in the supermarkets and hypermarkets sector have been active in engaging in new retail format expansion in this quarter. In late March, Freshippo announced the introduction of four new retail formats — Hema F2, Hema Market, Hema Mini, and Hema Xiaodian. Hema F2 stores are similar to convenience stores and are located in office areas in business districts. Hema Market stores are located in community areas of cities as well as suburban districts; there is no catering area in the store. Hema Mini stores are opened in suburban districts and lower-tier cities; the size of a Hema Mini store is around 500 sqm. Last but not least, Hema Xiaodian are opened in areas without Freshippo stores. It acts as “store-front warehouses” and offers delivery services only.

Another retailer YH Super Species has also opened a variation of its normal stores in Shenzhen Bao'an International Airport. This is the second YH Super Species store in an airport after the one opened in Fuzhou Changle International Airport. The store spans over 800 sqm and offers more than 1,000 SKUs. Besides the usual stalls and
the newly nurtured stalls, the store also offers special products such as souvenirs from Guangdong, Hong Kong and Macau targeting travelers at the airport. Meanwhile, Carrefour opened a small-scale concept store in WF Central in April. With a store size of approximately 720 sqm, the store offers more than 7,000 items including imported foods, organic foods and private label products. Carrefour said that the new concept store is a new retail format with integrated functions of supermarkets and convenience stores. In the initial set-up stage, Carrefour did a lot of research on customer segmentation; products are designed based on their customers’ needs. The concept store is highly digitized – equipped with scan and go facilities, mobile payment, etc. together with traditional checkout registers.

15. Other retailers leverage supermarkets/ hypermarkets to extend customer reach

In China, supermarkets and hypermarkets are major distribution channels to reach end consumers. More retailers in other sectors are trying to leverage the traffic flow of these channels to expand their customer base. A recent example is Gome Retail. In April, Carrefour China announced that it has formed a strategic partnership with Gome Retail. Under this partnership, by adopting the “shop-in-shop” model, Gome Retail will set up its stores in more than 200 Carrefour’s stores by the end of July. In each of these stores, Gome Retail will provide a range of best-selling items, including home appliances and 3C products. Gome Retail hopes to bring in more traffic flow by leveraging Carrefour’s vast network of physical stores. In fact, Gome Retail has reportedly rolled out its first batch of “shop-in-shop” in 11 Carrefour’s stores in Beijing, Shanghai, Wuxi and Hangzhou by end of 2018.

Convenience stores

16. CCFA: Easy Joy, uSmile and Meiyijia top the list of Top 100 Convenience Store Operators in 2018

In May, China Chain Store and Franchise Association (CCFA) announced the Top 100 Convenience Store Operators in 2018. Convenience stores saw the fastest sales growth among all retail formats. Easy Joy, uSmile and Meiyijia topped the list in 2018. CCFA also highlighted the following characteristics of the convenience store sector in 2018:

- Focused in regional markets – over 80% of the top 100 convenience store operators operated regionally.
- Scale of the top players varied – 20% of the operators had more than 1,000 branches, while 30% had only 100-200 branches.
- Markets in provincial capitals and tier 1 cities were more mature – only 30% of the operators were originated from prefecture-level cities and county-level cities.
- Most of the top enterprises operated single format – 80% of the top operators only operated convenience stores.
Apparel

17. Apparel sales slow down on higher unit prices; brands with greater upgrading efforts post stronger sales growth

In April, China National Commercial Information Center (CNCIC) published statistics on China’s retail sales of commodities. In 2018, retail sales of menswear, womenswear and childrenswear added 0.4% yoy, 0.9% yoy and 6.7% yoy respectively, with the growth rates moderating by 1.9 ppts, 4.7 ppts and 1.1 ppts from the same period in 2017. In 2018, the decline in apparel sales of key large-scale retail enterprises was mainly led by higher unit prices, which were up by 5.3% yoy, with the growth rate rising 4.1 ppts. Brands that have put greater efforts in store and product upgrading saw stellar performance and stronger sales growth in 2018. As a case in point, domestic player Peacebird posted record-breaking sales and net profit in 2018, with total sales amounting to 7.712 billion yuan, up 7.78% yoy and net profit attributable to shareholders of listed companies reaching 572 million yuan, an increase of 27.51% yoy. The company continued to deliver growth due to the company’s efforts in implementing supply chain optimization, opening stores in shopping centers, and shutting down underperforming stores.

Another local company JNBY also registered profit growth in 2H18. For the six months ended 31 December 2018, JNBY’s total revenue was 2.027 billion yoy, up 22.6% yoy, while gross profit went up 20.2% yoy to 1.24 billion yuan. The group’s core brand JNBY contributed to 57% of the total revenue during the period, while its three sub-brands – CROQUIS, jnby by JNBY and less contributed to 41.3% of the total revenue during the period. To reinforce its multi-brand strategy and achieve horizontal growth in more menswear categories, JNBY has recently rolled out a new menswear designer brand named “A Personal Note 73”. The new launch is expected to bring vitality and synergy to the group’s diversified brand portfolio and overall business, and enable the group to increase its market share in the designer clothing market and exert more influence in the industry.

Major foreign player Fast Retailing Group also experienced robust sales growth in China for the six months ended 28 February 2019. According to the company’s 1H19 financial results (September 2018 - February 2019), the company’s China business continued strong growth momentum – both revenue and profit growth rates remained at a high level of about 20% yoy. To bring in more customers and increase sales, the company has stepped up its efforts in creating better shopping experience for customers. Its flagship brand Uniqlo has recently launched an “express store delivery service” on its WeChat Mini Program. Currently, the new service supports Uniqlo’s app and WeChat Mini Program and available to designated Uniqlo stores with the express store delivery service sign. There are 17 Uniqlo stores in Beijing offering this new service. After selecting the express store delivery service option and placing orders via their smartphones, customers can have their orders sent to their home by SF Intra-city delivery service. Orders placed at the stores with the express store delivery service sign will be delivered by default through the intra-city delivery service, while customers can also choose other delivery options or pick up their orders at stores.
18. Some apparel retailers announce store closings amid intense competition

The trend of store closures in the apparel sector continued in the last quarter. Some apparel retailers announce store closings amid intense competition. For instance, Italy’s luxury multi-brand store 10 Corso Como has decided to shutter its Shanghai branch in June, due to the expiration of its lease and the end of its partnership with its Chinese partner Trendy Group, the parent company of womenswear brand Ochirly. Following its entry into China in 2013, 10 Corso Como opened two local stores respectively in Shanghai and Beijing’s SKP shopping mall; yet, the store in Beijing was closed in February 2017.36

In April, California-based fast fashion player Forever 21 also confirmed that it has decided to exit the China market entirely in the near future. According to Forever 21 China’s official website, its official online store has stopped its operation from 29 April; customers can return goods purchased on the store before 30 May. Meanwhile, the company will also close its online flagship stores on Tmall.com and JD.com. Currently, Forever 21 has four physical stores in China.37

Luxury market

19. Chinese shoppers make up a third of global luxury spend, splurging 770 billion yuan on luxury products in 2018

In April, McKinsey & Company China published the “China Luxury Report 2019”. According to the report, in 2018, Chinese consumers at home and abroad spent 770 billion yuan on luxury items—equivalent to a third of the global spend—with each luxury consuming household spending an average of 80,000 yuan per year. China delivered more than half the global growth in luxury spending between 2012 and 2018, and their outlay is set to almost double to 1.2 trillion yuan by 2025, when 40% of the world’s spending on luxury goods will be conducted by Chinese consumers. The post-80s and -90s generations, representing 43% and 28% of the total number of luxury consumers respectively, accounted for 56% and 23% of the total luxury spending by Chinese consumers in 2018.38

Bain & Company’s latest report on China’s luxury market released in March also points out that China’s luxury market grew 20% yoy in 2018, with Chinese spending representing 33% of the global luxury market, adding that millennials, repatriation of spending, increased digitalization and a rapidly expanding middle class are four major engines powering the luxury sales in China. Luxury brands that are more successful than others are adept in attracting millennials with younger and more casual collections and using WeChat to identify and target consumers for online and offline sales; they also strive to accelerate product launches and visual merchandising changes, aiming to address millennials’ need for newness. The global consulting firm states that millennials are more heavily
influenced by what they consider to be cool than by brand names or product pricing and they value newness more than discounts.

20. More international luxury houses join forces with local e-commerce players to further expand online reach in China; some strive to expand offerings through cross-sector collaborations

To satisfy online shopping expectations of Chinese consumers, especially the younger generation, more international luxury brands have paired up with local e-commerce giants – Tmall, JD.com and Secoo to further expand their online reach in the country. For example, in April, France’s SMCP Group announced a new partnership with JD.com to expand its online presence in China’s luxury market. The partnership will complement the growing digital presence of SMCP Group in China and serve as an important building block in the execution of the group’s omnichannel strategy, bringing together the best of online and offline shopping. Taken over by China’s Shandong Ruyi Group three years ago, SMCP Group currently operates 137 stores across 23 cities in China.

In addition, Italian fashion brand Moschino has also expanded its strategic partnership with JD.com with the official opening of its first Moschino Underwear and Swimwear online store flagship store on JD.com on 11 March. The launch marks a significant step of Moschino’s expansion into the China market and enables the brand to leverage on JD.com’s big data analysis capabilities to precisely market their products to local customers. Both parties will also work together to tap into new fashion needs in the market and offer Chinese customers fashionable pieces reflecting individual personality. Another major e-commerce player Tmall also announced in April that its invite-only luxury good platform Luxury Pavilion has listed Korean sunglasses brand Gentle Monster as its 100th brand. Originated from Korea in 2011, Gentle Monster is currently selling through its self-operated official website and providing delivery through direct mail services to its Chinese consumers. It has also opened flagship stores in Hong Kong, Beijing, Shanghai, Guangzhou, Xian and Chengdu.

China’s largest luxury e-tailer Secoo also sealed a strategic partnership with designer fashion brand Karl Lagerfeld in March. Both parties will work together on e-commerce sales, cross-sector co-brand products, fashion IP creation, social media marketing targeting young consumers, online and offline integration for new retail, etc. The partnership will focus on fashion brand Karl Lagerfeld and offer customers a wide range of Karl Lagerfeld-branded classic clothing and footwear products on Secoo’s online platform and offline stores, while at Karl Lagerfeld offline stores, members can also enjoy services provided by Secoo.

Apart from fostering collaborations with luxury players, Secoo has also forayed into other sectors including travel, high-end lifestyle service and duty-free retailing sectors, endeavoring to enrich its offerings. In March, Secoo announced that it has reached a strategic cooperation with domestic travel agency Utour Group. Both companies will integrate their platforms and memberships, jointly launch market campaigns, develop new businesses and products to create better shopping experience for customers, etc. Currently, the two companies have jointly...
launched various travel products for travelling in Japan, and will further cooperate in online and offline product integration and create better marketing and brand promotion strategies.

Besides, Secoo has also formed a strategic partnership with CÉ LA VI to expand into global high-end service industry. Both parties entered into a strategic partnership in May, aiming to integrate each other’s advantages in industry brand resources, customer base, supply chain resources, technical strength, as well as marketing channels and platforms. Bringing the cooperation between Secoo and CÉ LA VI to a strategic level, the tie-up will greatly promote the expansion of both companies’ respective businesses, setting a new industry benchmark for the premium lifestyle, food & beverage and entertainment industry.

To expand further into the travel retail industry, Secoo has invested 12 million yuan for a 20% stake in China National Service Corporation for Chinese Personnel Working Abroad (CNSC)’s subsidiary Jiangsu CNSC Duty Free, a move to expand into the dutyfree retailing market.
## III. Competitive landscape

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

### 1. Grocery players

<table>
<thead>
<tr>
<th>Company</th>
<th>Sun Art Retail Group</th>
<th>Yonghui Superstores</th>
<th>Lianhua Supermarket</th>
<th>Better Life</th>
<th>Zhongbai Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial period</td>
<td>FY18*</td>
<td>FY18*</td>
<td>FY18*</td>
<td>FY18*</td>
<td>FY18*</td>
</tr>
<tr>
<td>Total revenue (million yuan)</td>
<td>99,359</td>
<td>70,517</td>
<td>25,389</td>
<td>18,398</td>
<td>15,208</td>
</tr>
<tr>
<td>Yoy change</td>
<td>-2.90%</td>
<td>+20.35%</td>
<td>0.6%</td>
<td>+6.65%</td>
<td>+0.02%</td>
</tr>
<tr>
<td>Net profit attributable to shareholders of the company (million yuan)</td>
<td>2,588</td>
<td>1,480</td>
<td>-219</td>
<td>156</td>
<td>431</td>
</tr>
<tr>
<td>Yoy change</td>
<td>-7.30%</td>
<td>-18.52%</td>
<td>NA</td>
<td>3.45%</td>
<td>+537.06%</td>
</tr>
</tbody>
</table>

*For the year ended 31 December, 2018.

Source: Company data; compiled by Fung Business Intelligence

### 2. Department stores

<table>
<thead>
<tr>
<th>Company</th>
<th>Parkson</th>
<th>Wangfujing</th>
<th>Bailian Group</th>
<th>Dashang</th>
<th>Rainbow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial period</td>
<td>FY18*</td>
<td>FY18*</td>
<td>FY18*</td>
<td>FY18*</td>
<td>FY18*</td>
</tr>
<tr>
<td>Total revenue (million yuan)</td>
<td>4,848</td>
<td>26,711</td>
<td>48,427</td>
<td>23,867</td>
<td>19,138</td>
</tr>
<tr>
<td>Yoy change</td>
<td>+3.6%</td>
<td>+2.38%</td>
<td>2.64%</td>
<td>-10.75%</td>
<td>+3.25%</td>
</tr>
<tr>
<td>Net profit attributable to shareholders of the company (million yuan)</td>
<td>NA</td>
<td>1,201</td>
<td>872</td>
<td>988</td>
<td>904</td>
</tr>
<tr>
<td>Yoy change</td>
<td>NA</td>
<td>66.95%</td>
<td>2.96%</td>
<td>+12.69%</td>
<td>+25.92%</td>
</tr>
</tbody>
</table>

*For the year ended 31 December, 2018.

Source: Company data; compiled by Fung Business Intelligence
3. Internet and e-commerce companies

Alibaba Group Holding Ltd. – Financial results for the fiscal year ended 31 March, 2019:

- Revenue was 376,844 million yuan (US$56,152 million), an increase of 51% yoy.
  - Revenue from core commerce increased 51% yoy to 323,400 million yuan.
  - Revenue from cloud computing increased 84% yoy to 24,702 million yuan.
  - Revenue from digital media and entertainment increased 23% yoy to 24,077 million yuan.
  - Revenue from innovation initiatives and others increased 42% yoy to 4,665 million yuan.
- Annual active consumers reached 654 million, an increase of 102 million over 31 March, 2018.
- Mobile MAUs reached 721 million in March 2019, an increase of 104 million over March 2018.
- Tmall physical goods GMV increased 31% yoy; Taobao physical goods GMV increased 19% yoy.
- Income from operations was 57,084 million yuan (US$8,506 million) and adjusted EBITA increased 15% yoy to 121,943 million yuan (US$18,170 million); adjusted EBITA for core commerce was 161,589 million yuan (US$24,078 million), an increase of 31% yoy.

Tencent Holdings Ltd. – Financial results for the fiscal year ended 31 December, 2018

- Total revenues were 312,694 million yuan (US$45,561 million), an increase of 32% yoy.
- Operating profit was 97,648 million yuan (US$14,228 million), an increase of 8% yoy. Operating margin was 31%, down from 38% in FY17.
- Profit for the year was 79,984 million yuan (US$11,654 million), an increase of 10% yoy. Net margin decreased to 26% from 30% last year.
- Profit attributable to equity holders of the company for the year was 78,719 million yuan (US$11,470 million), an increase of 10% yoy.
- Combined MAU of Weixin and WeChat were 1,097.6 million, an increase of 11.0% yoy.
- Monthly active user accounts of QQ was 807.1 million, an increase of 3.0% yoy.

JD.com, Inc. – Financial results for the fiscal year ended 31 December, 2018

- Net revenues were 462.0 billion yuan (US$67.2 billion), an increase of 27.5% yoy.
- Operating loss from continuing operations for the year was 2.6 billion yuan (US$0.4 billion), compared to 0.8 billion yuan for FY17.
- Operating margin of JD Mall before unallocated items for FY18 was 1.6%, as compared to 1.4% for FY17.
- Annual active customer accounts increased to 305.3 million from 292.5 million over 31 December, 2017.

Source: Company data, compiled by Fung Business Intelligence
IV. Regulation updates

Market supervision

1. China reduces VAT rates starting 1 April

On 5 March, Premier Li Keqiang delivered the 2019 Government Work Report during the second session of the 13th National People’s Congress. Premier Li said that the government would deepen the value-added tax (VAT) reform and reduce VAT rates on certain goods and services to relief tax burden to businesses and consumers. This represents a significant step by the government to enhance economic activity in certain sectors. Following the Government Work Report, several authorities issued various tax circulars which set out ground breaking VAT rules to formalize the decision made by the State Council.

On 20 March, the Ministry of Finance (MOF), the State Taxation Administration (STA) and the General Administration of Customs (GAC) issued the Public Notice [2019] No. 39. With effect from 1 April, the VAT rates for VAT taxable supplies and import of goods for general VAT payers are reduced from 16% to 13% and 10% to 9%, respectively. The 6% VAT rate remains unchanged (Exhibit 11). Meanwhile, it also set out changes to the export VAT refund rates for regular export and tourists refund; introduced the 10% additional “super input VAT credit” regime to taxpayers engaging in postal and telecommunication services, modern services, and lifestyle services, etc.

Exhibit 11: New value-added tax (VAT) rates effective from 1 April, 2019

<table>
<thead>
<tr>
<th>Taxable activities</th>
<th>VAT rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Before</td>
</tr>
<tr>
<td>Sales and imports of general goods; provision of processing, repair and replacement services; and provision of leasing services of tangible and movable assets</td>
<td>16%</td>
</tr>
<tr>
<td>Sales and imports of specified goods; provision of transportation, postal, basic telecom services, construction services and leasing services of immovable property and sales of land use rights or immovable property</td>
<td>10%</td>
</tr>
<tr>
<td>Provision of value-added telecom services, financial services, modern services and lifestyle services; and sales of intangible assets other than land use rights</td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: Deloitte China
On 21 March, the STA further released Announcement No. 14 and No. 15 to state clearly the transitional measures during the VAT rates adjustment period, the administrative procedures for the new “super input VAT credit” regime, as well as the changes made towards the VAT return filing arrangements.


2. China lowers personal postal articles tax starting 9 April

Starting 9 April, China has lowered the tariff rates for baggage brought by individuals and articles mailed into the country (or so-called personal postal articles tax), in the hope of promoting imports and encouraging consumption. The tax rate on products including food and medicine is lowered from 15% to 13%, while the tax rates on commodities including textiles and electrical appliances are reduced from 25% to 20%.

Details can be accessed at http://www.gov.cn/premier/2019-04/03/content_5379418.htm (in Chinese only) (Source: 3 April 2019. The National People’s Congress of the PRC.)

E-commerce

3. Government to strengthen Intellectual Property Law enforcement

Six government authorities, including the State Administration for Market Regulation (SAMR), the General Administration of Customs (GAC) and the China National Intellectual Property Administration (CNIPA), jointly released the “Implementing Measures for Strengthening Intellectual Property Law Enforcement in the Fields of Online Shopping and Import and Export” in April 2019. The Measures call for improving regulatory measures and imposing stricter penalties for intellectual property infringement. The Measures also stress the need to enhance collaboration between government agencies and enterprises to protect intellectual property rights.

Logistics

4. NDRC and MOT to launch first batch of 15 national logistics hubs

The National Development and Reform Commission (NDRC) and the Ministry of Transport of the PRC (MOT) jointly issued the “National Logistics Network Construction Implementation Plan (2019-2020)” in April 2019. According to the Plan, the government will confirm and announce the first batch of around 15 national logistics hubs, considering the hubs’ importance in the development of the Belt and Road Initiative, the development of the Beijing-Tianjin-Hebei region (Jing-Jin-Ji), the Yangtze River Delta (YRD), and the Greater Bay Area.


5. Government urges high-quality development in logistics to create strong domestic market

In February 2019, 24 government departments, including the NDRC, jointly issued the “Opinions on Promoting the High-quality Development in Logistics to Facilitate the Formation of a Strong Domestic Market”. The Opinions call for pushing ahead the construction of a national logistics hubs network, boosting the capacity of the high-quality logistics to serve the real economy, reducing traffic costs of vehicles and costs of port logistics, etc.


Cosmetics

6. NMPA launches operation to crack down on websites selling substandard cosmetics products

On 30 April, China’s National Medical Products Administration (NMPA) officially issued a circular on launching an operation to crack down on websites selling substandard cosmetics products. Since May 2019, the NMPA has taken action nationwide against online vendors and e-commerce platforms selling substandard cosmetics products and illegally marketing their products online with fake product and manufacturing information.

7. NMPA develops mobile app for cosmetics regulation

On 20 May, the NMPA launched a mobile app to improve the regulation of local cosmetics market. The app has four major functions – 1) data enquiry service, which enables users to check product details, manufacturing information and regulatory approvals; 2) providing cosmetics regulatory guideline and popular science information; 3) conducting case studies and researches on cosmetics and explaining major policies and their development to facilitate understanding and compliance of the policies; 4) complaint reporting system – consumer can report product complaints and unlawful sales of cosmetics on the go with the app.

V. Outlook

1. CNCIC: Total sales of consumer goods predicted to grow at 8.5% yoy in 2019

According to China National Commercial Information Center (CNCIC), China’s domestic consumption market will continue to drive and support the steady development of the economy in 2019. It predicted the total sales of consumer goods to grow at 8.5% yoy. CNCIC also highlighted the following points on the future development of the retail market:

1. Stabilizing and expanding employment will further promote residents’ income and thus consumption power;
2. Improving social security system and policies such as education, medical care, and elderly care will continue to resolve the pressure of residents;
3. Enriching service consumption, improving rural distribution, promoting new retail formats and business models, expanding imports will stimulate consumption demand and drive the growth of new products;
4. Preferential policies for purchasing new energy vehicles, and smart home appliances subsidy programs will drive the steady growth of relevant industries;
5. Enhancing consumption environment, infrastructure and quality standards, as well as consumer protection policies will further improve consumer's confidence.
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Contacts

Asia Distribution and Retail
Fung Business Intelligence

Key authors
Teresa Lam, Christy Li

Contributors
Yvonne Mok, Renne Chan, Tracy Chan

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

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