



## GROUPINGS OF REGIONAL CITIES IN THE RETAIL SECTOR

**Category 1** – A large market with clear aims and objectives

**Category 2** – A large market with growing aims and objectives

**Category 3** – An emerging market with growing aims and objectives

Category 1			Category 2			Category 3		
Chengdu	Nanjing	Wenzhou	Changsha	Ningbo	Wuxi	Baotou	Nantong	Weifang
Dongguan	Shenyang	Xi'an	Dalian	Qingdao	Xiamen	Changchun	Ordos	Weihai
Foshan	Suzhou	Yantai	Harbin	Wuhan		Changzhou	Quanzhou	Zhengzhou
Hangzhou	Tianjin					Dongying	Shaoxing	Zibo
						Hefei	Shijiazhuang	
						Jinan	Tangshan	

## DOMESTIC CONSUMPTION DRIVES GROWTH

China's domestic consumption will be robust and grow rapidly in the next five to ten years. Key contributing factors include rapid urbanisation, continuous reform in the social welfare system and concerted government' efforts to promote domestic consumption. Since the global financial crisis, China is increasingly rebalancing its economy, reducing its dependency on exports and investment and increasing domestic consumption as a percentage of GDP. China's private consumption currently only accounts for 37 per cent of GDP, much lower than any of world's major economies. However, the average annual growth of consumption was 6.9 per cent between 1998 and 2006, the highest rate globally. There is clearly extensive room for China to boost its domestic consumption significantly.

Chinese household disposable income is set to rise with the country's continuous industrialisation and urbanisation, and a number of measures were set out in the 12th Five-Year Plan to increase household income and spending. A number of provinces recently raised minimum wages and it is widely anticipated that the threshold of personal income tax will soon be increased. The government's fiscal spending on social securities in the past three years has increased at an average rate of 13.5 per cent (RMB249.1 billion, 290.6 billion and 318.5 billion between 2008 and 2010) and there are continuous reforms to improve the provision of pensions, healthcare and education, which stabilises and further stimulates domestic consumption.



## DYNAMIC RETAIL SECTOR

In PwC's Annual Global CEO Survey (December 2010), China is viewed as the most important growth market among retail CEOs. Thirty three per cent of retail CEOs are looking to China for sales growth, while 44 per cent see it as important for their future sourcing needs.

The size of China's retail market was some RMB6.8 trillion by 2009. It expanded by 200 per cent between 2002 and 2009, equivalent to an average annual growth rate of over 17 per cent. The retail market is expected to grow by about 45 per cent between 2010 and 2014, to reach a total value of over RMB10.8 trillion.

Chinese consumers, particularly the growing middle class, are trading up and growing in sophistication. They are becoming more and more brand and quality-conscious, increasingly aspire to a Western lifestyle and are less price-sensitive than before, spending more on luxury goods.

UK brand owners and exporters have much to offer China's large, diverse and expanding retail market, although they should beware of regulatory challenges in this highly competitive sector.

## REGIONAL FOCUS

A significant characteristic of China's retail sector is that instead of being a national market, it is rather a highly fragmented and complex series of regional markets, providing opportunities for a variety of players to become local market leaders.

A number of key sectors in China have industry leaders enjoying concentrated market shares. For example, the top three players (G3) in the telecommunications sector have a 97 per cent share of the market; the 'G10' in automotive have a 66 per cent share; while the 'G5' in banking occupy almost half of the national market.

By contrast, the top 50 players in China's retail sector share only 5 per cent of the national market.

In the supermarket sub-sector, Shanghai Bailian, the largest player, has only 11 per cent of the market and has barely ventured outside its home region. None of the domestic and international players have a significant national market penetration, but rather have regional strongholds instead. Tesco, with over 30 per cent of the UK retail market (over 2,700 stores), only has some 2 per cent of the Chinese market with 105 stores, the majority of which are in the coastal provinces.

When devising strategies for market entry and development, companies must take into account China's regional complexities and set a clear regional focus.

## LUXURY MARKET

China's wealthy households have reached a critical mass. By the end of 2009, 875,000 individuals enjoyed personal wealth of more than RMB10 million (£1 million) while 55,000 had more than RMB100 million (£10 million). Forty eight per cent of these high-net-worth individuals live in the first-tier cities of Beijing, Shanghai and Guangdong Province, and they are typically male and in their late 30's.

There is also a flourishing middle class which is likely to see its income rise. Not only will such individuals continue to save heavily, but they are also increasingly willing to spend more. China's middle-class population reached 85.5 million in 2008 and is expected to reach 104 million by 2011. Although there are varying definitions of "middle class" they all tend to reflect households with an income of at least US\$10,000 per annum, and represent people who are home and car owners, take holidays, and are more aware of international brands and trends.

These increasingly affluent Chinese consumers have a very positive attitude towards luxury goods as symbols of good taste, success, wealth and social status.

The global luxury goods industry is forecast to grow at a rate of 8 per cent (value US\$267 billion). Much of that projection is a result of surging demand

in emerging markets, particularly the boom in China, whose luxury sector will grow at 25 per cent in 2011, making it the strongest market worldwide. The industry is expected to reach RMB180 billion (US\$27 billion) by 2015 and by then China will account for over one-fifth of global sales, overtaking Japan as the world's largest luxury goods market.

The world's super brands are taking the opportunity to expand in China's booming luxury goods market. Louis Vuitton now has 36 stores in 29 cities across mainland China, compared to stores in just 10 cities in 2005. Gucci has expanded even faster, growing from six stores in 2006 to 39 stores by 2010. Hermes quadrupled its stores from five in 2005 to 20 today. Vivienne Westwood, Alexander McQueen and Mulberry are amongst a number of UK fashion labels who have recently established a presence in Beijing.

Rolls-Royce reported an 800 per cent sales growth in China for 2010, surpassing many expectations. It is expanding its dealerships and showrooms from eight to 11 cities (there will be new showrooms in Chongqing, Tianjin and Wuhan) and Chinese sales are expected to grow by 33 per cent in 2011. This makes China Rolls-Royce's second-largest market after the US, which it is expected to overtake by 2014.

Retailers have to choose the optimum

moment to venture into regions and urban centres - not too early so that there is no market appetite for the products, but not too late so that you lose first-mover advantage. With an increasing number of players in the market, there is intensified competition over prime retail locations, such as larger units or those stores with street-facing facades.

The first-tier cities of Beijing and Shanghai stand out as the largest and most sophisticated market segment for luxury retail. In addition to Beijing and Shanghai, the cities of Tianjin, Chongqing, Shenzhen, Guangzhou, Dongguan, Foshan, Hangzhou, Nanjing and Wenzhou are all recognised centres for luxury brands based on sales volume and market presence. Emphasising the impact of regional effects both in market size and consumer trends it is interesting to note that Cartier's store in Chengdu was reportedly their number one in the world in terms of sales in 2007, ahead of even Paris, New York and Tokyo.

Opportunities also exist in smaller Chinese cities, Ordos, a city of 1.6 million inhabitants in resource-rich Inner-Mongolia, has China's highest GDP per capita at US\$10,451. Although the retail footprint is relatively small, it is fast growing, with huge interest from brand owners and retail developers.

## RETAIL SERVICES

Not only are there huge direct opportunities for UK brand owners and retailers in China, there is also great potential for UK companies to provide services to the country's retail sector.

To meet increased demand, there is growing investment in new logistic and storage facilities, modern management systems backed with relevant technologies and other aspects of a developed retail system. Urban regions away from China's coastline, lower-tier cities and townships will see higher rates of growth and higher

propensity of retail spending. Networks of chain stores, shopping malls and streets have emerged in and outside of China's regional cities, and new innovative forms of retail outlets are flourishing.

The UK has particular strengths in areas such as architectural consultancy, retail management, product design and development, marketing and the disciplines of branding and advertising. Chinese global companies and brands are also emerging rapidly. Many of these firms, such as Lenovo, Li-Ning and Media, already highly

successful in their home market, will venture out internationally, including to the UK and the rest of the EU. A number of sizeable UK advertising agencies are very well established in first-tier cities in China, initially following international clients but increasingly servicing Chinese companies. UK Trade & Investment and the China-Britain Business Council are working with partner trade associations such as TVCA and IPA to bring more UK service companies to the Chinese market.

## ONLINE RETAIL AND E-COMMERCE

China's online retail market is a relatively new phenomenon as a viable means of trading. With the number of internet users at least 500 million, the country's online retail market has, in recent years, been doubling in size on an annual basis, and continues to show a rapid pace of growth. In 2004-2010, the total online sales market, including Consumer-to-Consumer, grew by a compound annual growth rate of 95.9 per cent. This compares to 87.4 per cent for Business-to-Consumer (B2C) over the same period. However, B2C has now accelerated to become the

fastest-growing segment of total internet transactions volume.

Consumers are not only using the internet as one of the most important sources of retail information (particularly for luxury goods), but are also being driven to online retailers that have earned a reputation for customer service and trustworthiness. For traditional retail companies, online sales are creating new marketing channels, helping them to access regions of China they have not yet managed to cover without the need to invest in physical presence or distribution networks. Online-only retailers

are also emerging in China, creating strong competition for traditional retailers in accessing investment and negotiating with the supply chain where their established online retail expertise and technologies are hugely valuable.

A key issue for online retail is the availability of logistic and delivery infrastructure and services, as well as weaker financial services for transaction and settlement. China also lacks experience in policing the online market place against foul play, fraud and counterfeiting.

## GAINING MARKET ENTRY

Whist global retail companies can meet operation costs to strengthen brand awareness and market presence in China, independent brands and companies of smaller scale may find setting up a sales distribution network or formal presence in China challenging.

Though there might be a strong demand from Chinese customers, it often takes months to incorporate a Foreign Invested Commercial Enterprise (FICE) to enable foreign invested companies operating in wholesale, retail or franchising sectors. Registration, certification and testing for imported products can be a bureaucratic process. The costs of partnering with major retailers (such as in mid to high-end shopping malls) are high.

There may be additional tax burdens for consumer goods under certain categories, such as jewellery, cosmetics, luxury watches and tobacco. It is also difficult for a foreign brand owner with China based

manufacturing partner/facility to sell products in China directly unless they have also applied for the appropriate licenses and are not established as a processing company. Products manufactured for export markets still require to be "re-imported" even though the goods are physically in market.

The compounded tax and duties, combined with high operation costs for consumer brands in China results in the retail price for imported goods (particularly for luxury goods) becoming significantly higher than the same product purchased in other markets.

The issue of high transaction cost in retail trading has been noted by the Chinese authorities, and the Ministry of Commerce (MOFCOM) recently announced that they are investigating reducing tax and bureaucracies for locally manufactured foreign branded products to be retailed in China to encourage domestic consumption.

