Opportunities and Challenges of International Retailing in CHINA

BY LISA QIXUN SIEBERS

The performance of foreign retailers in China has shown a reversed U shape since their market entry in the 1990s. By the destruction of digitalisation, large retail giants continue to reduce both the number and the size of their stores, protecting bigger loss but worsening their sales too. They launched omnichannel retail after China's online sales had started to soar in 2010 and introduced the experience-based retail ecosystem mostly in collaboration with local companies. However, their long-term performance will largely rely on the local consumption demands and institutional environment.

China has become the world's largest e-commerce market, accounting for 40% of the value of worldwide e-commerce transaction by 2017, up from less than 1% ten years ago. China's online retail market has also become the world's largest, with a 38% annual growth rate of US$830 billion by 2017, compared to 14% in the U.S. In 2016, China's internet users reached to 731 million, overtaking the combined number of the European Union and the U.S.; 20% of the internet users rely on mobile only, compared with 5% in the U.S., and China's mobile payment has 11 times the transaction value of the U.S. The online competition has boosted customer-centred and experienced-based innovation in a physical shopping environment, represented by Life Mall (e.g., Parkson from Malaysia) and themed department store – Fashion Gallery (e.g., the New World from HK). Most of the foreign retailers have also started to emphasise private labels or owned brands, such as Carrefour's Quality Line and French Touch brands. For foreign retailers or brands to succeed, it is important to understand the key development stages of China's retail sector and what foreign retailers have experienced in the market in order to

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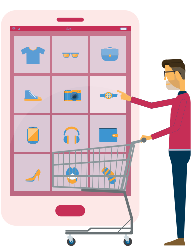
set up potential effective strategies they may implement in the future.

1995 – 2005 market development

China opened its retail market in the mid-1990s, when foreign retailers started to enter by introducing retail formats that were new to Chinese consumers, such as supermarkets and hypermarkets. They were obliged to adapt to the local environment such as laws and regulations after entry and used adaptation strategies to penetrate the market. China retail sector fully opened in 2004 following the World Trade Organisation agreement, when foreign retailers obtained all freedom to expand in the country. Until then, they have cultivated the shopping habits of Chinese consumers who switched their shopping from merely local open market to sometimes supermarkets, especially the middle class enjoyed more shopping in modern retail format. During this period, price was the key competitive factor.

2006 – 2010 market competition

After fully openning China's retail market, competition has increased. Domestic retailers started to benefit from foreign retail knowledge transfer and capable human resources who change their jobs between foreign and domestic retail organisations. The Chinese government also encouraged domestic retailers to compete with foreign rivals. For example, the merge of two large Chinese supermarkets Lianhua and Huanlian in 2010 formed the largest supermarket chain in China, managed by state-owned parent company Bailian Group.



2010 – date growth potential

Benefiting from the increase in the number of middle class and the improvement of technological infrastructure, China's internet sales started to soar in 2010, resulting in the declination of large-sized physical stores. Some foreign retailers exited from China, e.g. Best Buy; some sold majority of their shares to local companies such as Tesco and B&Q. Majority of foreign retailers closed stores that did not make a profit, including Wal-Mart and Carrefour.

Since 2015, the Chinese central government called for participation of provincial governments, the general public, and online retailers to encouraging digital players to experiment before enacting official regulations. Since 2016, the Chinese central government has encouraged high-level offerings of both products and services and collaborations between physical stores and online platforms, calling for retail stores to improve their uniqueness, core competencies, and differentiation. In 2017, the first cybersecurity law became effective, which includes measures to protect personal information, security requirements for network operators, and restrictions on personal and business data transfers. There are intensive activities undertaken by retailers both online and offline. On the one hand, the majority of retailers started to emphasise their online businesses; on the other, online retailers started to open physical stores. For example, Alibaba's Hemashengxian (盒马生鲜) sells fresh food in residential areas to provide convenience to customers.

To increase online sales, many foreign retailers have collaborated with Chinese online platforms such as Alibaba and JD.com or social media platforms such as WeChat (the Chinese twitter) owned by Tencent Group to increase sales through e-tailing (electronic retailing). For example, Wal-Mart formed a collaboration with both JD.com and Tencent in 2016 and mid-2018 respectively. By August 2018, some stores of Wal-Mart in Shenzhen (where its headquarter is located) have achieved 50% of its total monthly sales online; Carrefour is collaborating with Tencent too; RT-Mart is collaborating with Alibaba; and new entrants Macy's, Costco, Woolworths, and Sainsbury's chose to enter online first by collaborating with Alibaba's Tmall. Virtual platforms help to enhance customer experiences by offering fast information flow and providing convenience in purchasing and delivery.

Consequently, there is also a trend of continuously expanding physical stores, especially shopping malls, where experience-based shopping environment has been intensified. Many shopping malls have been upgraded to include entertaining and services centres such as floors for dining, children's playground, gym and so on. Some retailers use high-tech to provide the advanced virtual environment, such as B&T (the new name of B&Q in China) introduced online showroom in store in 2017, by which consumers can see how products look like when in a room by clicking on the screen while passing by these products. Others open flower shows or mini zoos in their shopping malls to attract customer flow. These possibilities attract more retail investors in physical stores. For example, the British department store House of Fraser opened its first store in Nanjing in 2016, named East Fulaide (东方福来德, meaning Eastern happiness and virtue), offering over 20 private labels.

Challenges forward

Aging population and reduction of birth rate

By 2014, China has had over 0.2 billion aging population, which is expected to increase to 0.4 billion by 2030. Because China had a high birth rate between 1962 and 1972, after 2020 this population is becoming aged consumers. The case of the aging population in China is different from that of the U.S.A., Europe, and Japan because of these people age before having become middle class. This situation worsens combined with the one-child policy that impacted the same population. There are an increasing number of households without young residents, which will impact on retailing.

The birth rate in China faces severe challenges. The second child policy implemented by the Chinese central government in 2017 has not seen effective results. Small-sized families will continue to dominate the retail market. The average birth rate against the number of women of childbearing age was 1.05 in 2017, meaning that by every other generation, the population will be cut in half. The dependency ratio will change from 5.8 laborers supporting one aged man in 1988 to 1.9 labours to one aged man in 2030. As a result of both an aging population and low birth rate, the retail consumption is expected to reduce.

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Residential retailing

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main consumption force, challenging existing ways of retailing. An increasing number of consumers in this group are becoming middle class or new entrepreneurs. They are not only hard working adopting traditional Chinese working culture but also adopt a lifestyle for enjoyment. Considering this group of consumers and the increase of small-sized household and aged population, in the coming decades, a retail transformation that provides life solution in residential areas is expected to be popular. In the current situation, residential grocery stores simply sell goods to community residents. Their competitive advantage focusses on prices. There is a need to transit from this price competition to value improvement, emphasising both communities and fresh supermarkets in the communities.

Competing with rural retailing

Rural consumers account for about 30% of Chinese online purchasers, about 186 million out of a total of 668 million online purchasers according to data in China Daily in 2015. Under the Chinese central government's support, the growth of e-commerce in rural areas overtook that of cities in 2016 and reached US$133 billion, about a five-fold increase from 2014, making up 17.4 percent of the whole e-commerce sales. The three Chinese e-tailing giants (Alibaba, JD.com, and Suning) have stepped up their efforts to develop rural e-commerce since 2015. This fast rise of rural e-tailing also put pressure on foreign retailers to enhance their online sales strategies. New alliances with local online platforms have become an important approach for foreign retailers to enhance customer experiences, transfer store information, and provide convenient services.

Expected slow retail growth

Although there is growth in online sales from both city and rural areas, the overall retail growth in China is expected to slow down in the next two decades, mainly due to the expected increase in costs as a combination of results from low birth rate, aged population, and changes in shopping behaviours. Currently, online shoppers are mainly younger consumers. For those retailers which target at the population who were born in or after the 1990s, it is important to offer a lifestyle that fit these generations. Moreover, such institutional issues as dealing with state-owned enterprises and local government as well as seeking local human resources remain as challenges faced by international retailers in China. Crucially, the strength of the capital determines long-term success. Most foreign retailers including the currently fast-growing convenience stores may make a profit between 8 and 20 years. This can be an advantage for large retail giants with strong capital, for example, Lawson has just started to make a profit after its market entry in 1996 from Japan. From the holistic picture discussed from foreign retailers' market entry stage to their processes of digitalisation, while there is potential growth in the market, it is apparent that market competition and institutional impacts may put some foreign operations at a disadvantageous position if without appropriate strategies.

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