

Alternative retail channels force malls to adjust

There has been growing excitement in China about retail sales which have grown at a double-digit pace for more than the past decade. One result is the construction of a large number of new shopping malls, so many in fact that we don't believe they will all survive. At the same time, the Chinese have been one of the most aggressive nations at embracing on-line shopping. If that wasn't enough competition, outlet malls have begun to emerge offering shoppers a discount on a number of well-known foreign brands in a single location. Finally, with approximately 100 million Chinese citizens traveling abroad annually, many are shopping abroad for themselves and others and they return not only with merchandise, but with increased expectations around what a retail experience should be. In the industry this new competition is summarized as the three "O's" referring the Online, Outlet and Overseas competition that domestic retail outlets now compete against. In this article we explore more detail around each of these competing categories and how Chinese malls are adjusting.

Online shopping

There are a broad range of players in online shopping. Giants like TMALL and JD.com sell a wide variety of products whereas others focus on specific submarkets. Two examples are VIPshop.com which focuses on discounted fashion products and Jumei.com which specializes in cosmetics.

Most consumers understand the convenience of shopping online, with a wide variety of products on offer, often at lower prices and with delivery included. But a comparison of online sales versus general retail sales shows just how serious this competition is in Tianjin. From 2013-2015, annual increases in retail sales have ranged from 6-14% year on year, while online retail sales have grown from 62-95% year on year. Admittedly, the base for online sales is much lower, but the adoption rate has been rapid.

Online retail sales vs. general retail sales

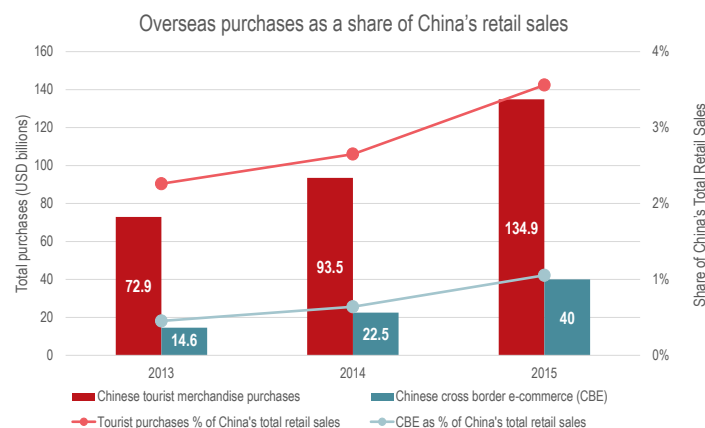
Tianjin	Online Retail Sales	Growth Rate	Retail Sales	Growth Rate
	(RMB/billion)	y-o-y	(RMB/billion)	y-o-y
2013	7.1	79.8%	447.0	14.0%
2014	12.5	62.1%	473.9	6.0%
2015	24.4	95.2%	524.6	10.7%

Source: Tianjin Statistics Bureau

Overseas shopping

Anecdotes abound regarding Chinese shoppers overrunning luxury outlets in key global cities as they snap up luxury goods that are comparatively cheaper than they are at home. But just how much do the Chinese spend abroad and what impact does that have on retailers at home?

The Ministry of Commerce and others estimated that Chinese consumers purchased nearly USD 135 million of goods as they travelled abroad in 2015, effectively double what they had spent in 2013. We believe purchases abroad are driven by the novelty of shopping while on holiday, the abundance of brands that are not available at home and lower prices, driven basically by China's own high taxes on imported luxury goods. For these reasons, not all shopping abroad can be considered a direct loss to shopping malls back in China, but there is an argument that making luxury taxes in China lower, would help generate more retail sales in malls within China.



Source: Ministry of Commerce, iChoice, Nomura Research

*Total retail sales figures exclude automobiles and gasoline

Outlet malls

Outlet malls have also quickly expanded in both Tier I and smaller cities. Certainly, not all outlet malls have been successful, but for those who have, they seem to have found a model they can replicate. Consumers have been attracted to outlet malls that offer a range of brands with a wide selection of stock and lower prices all in a compact location, generally in the suburbs of major urban areas.

In 2015, Tianjin Florentia Village, a 70,000 sqm high-end outlet mall located in a suburban area between Tianjin and Beijing achieved

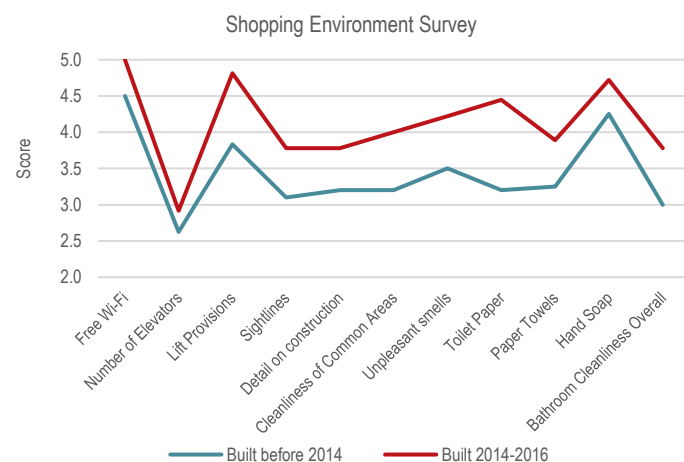
sales of RMB 26 billion. This was equal to the sales of the city's highest grossing shopping mall in Tianjin, Joy City which was located in the city center and was double its size at 164,000 sqm. Clearly outlet malls are an attractive retail option for Chinese consumers.

Mall Owners make adjustments

With more malls under development and with retail competition coming from these other avenues, what are mall owners doing to stay relevant and compete? They are largely focusing on tenant mix changes, delivering a better service standard and atmosphere and doing a better job in initial mall design.

Customer Service & Design

In 2016, we surveyed around 30 malls in Tianjin and we noticed a significant difference in malls opened in 2014 and earlier and those that opened in 2015 or later in factors related to customer service. Some factors such as the abundance of elevators and clear sightlines allowing shoppers to see what was on higher floors were clearly the result of better design and construction. But the newer malls also scored better in areas that were largely around the attitude and execution of customer service such as having clean bathrooms and common areas or providing wifi. It is important to note that as Chinese consumers continue to go abroad and spend a significant amount of time shopping on their trips, they will return with higher expectations for a retail experience and amenities in retail outlets.



Tenant mix

To maximize revenues, mall operators have always needed to keep a close eye on tenant performance and tenant mix, monitoring the sales of each shop carefully and being ready to replace non-performers quickly. They have also needed to ensure the right balance of tenant types such as fashion, entertainment and food and beverage outlets to encourage shoppers to spend more time and ultimately more money in the mall on each visit.

Many malls in Tianjin adopted traditional anchor tenants such as ice rinks, cinemas and KTVs to lease large areas and encourage longer visits. Now they are making other changes including:

- Focusing on kids' education such as Wall Street English and Sesame Street English. Xueersi, an education company for primary school students. Taekwondo clubs and instrument classes are often found in more community focused malls.
- Offer adult education including handicraft stores, painting classes, dancing and cooking clubs. Cheer Market and No. 5 Parking in Joy City are typical examples of this change.
- Increasing food and beverage outlets since restaurants suffer less competition from online sales. Bookstores with coffee shops, bakeries, snack stores and foreign food restaurants have expanded, reflecting change in consumers' taste. Examples include Paris Baguette, Baskin-Robbins, Meet Fresh, Japan's Matcha store (甘兔庵), Element Fresh and Withwheat.

Likely result

While the retail landscape is getting increasingly competitive due to new completions and 3 O's, shopping malls that are able to adapt to new retail trends by introducing attractive experiential brands, a broad range of food and beverage options and provide a convenient and comfortable shopping environment, still have a place in the market. Expect to see improvements in a retail mall near you soon.

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