



China E-Retail Market Report 2016

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Abstract

The era of consumer-led marketing is upcoming

In the Internet age, the era of consumer-led marketing has begun as China's retailing market is changing into buyer market from seller market. Current consumer behaviors and needs take on new trends and features: 1. channel digitalization and socialized online shopping; 2. quality-oriented purchase via channels and experience-oriented consumption; and 3. behavior personalization and mobile payment.

Large retailers are active in cross-industry activities to build a consumer ecosystem

Large retail giants are active in diversified development while consolidating their retailing businesses and improve consumer penetration rate through a multi-perspective coverage of consumers. Such cross-industry activities enable the competition for consumer resources to be expanded from retail industry to multiple scenarios including finance, entertainment, local services, socializing and logistics, making the diversified competition take shape.

Digitalization is the core of retailers' transformation into omni-channel

Omni-channel retailing connects all channels for strategic restructuring rather than incrementally adjusting the retail industry. Cooperation among strategy, operation and implementation is required for the revolutionary changes of shopping scenarios, category allocation, logistics warehousing, and service experience driven by digital transformation.

Supply chain management becomes the key to retailers' competitiveness

In order to serve consumers better and lower corporate cost in the current competition, industry giants have been investing substantial capital and human resources to improve their supply chain management capabilities and strengthen management systems of logistics, warehouse and sources of goods. For cross-border e-commerce, overseas logistics efficiency also becomes the key to increasing consumer satisfaction.

The market still sees interest in capital investment into e-commerce

The impetus of capital for e-retail development should not be underestimated. E-commerce financing maintains substantial growth and rural e-commerce, fresh products and cross-border e-commerce have developed into new investment hotspots. Meanwhile in the M&A market, e-commerce giants are actively leveraging M&As to complete their industrial chain layout due to limited profit and little growth potential while small and medium e-commerce can also increase their overall valuations through M&As, which improves the overall industry efficiency.

I. Overview of China's retail market

1. Development status of international and domestic online retail markets

In 2015, the global retail market showed strong resilience despite the uncertainty about the global economic development, and maintained a relatively solid growth driven by emerging markets including China and India. With years of rapid growth and a huge consumer market, China has taken up the largest share of the global online retail market. By contrast, online retail has developed slowly in two developed markets of North America and Western Europe. Therefore, China's e-retail is expected to take up more than 50 percent of global online retail market by 2019 to be the leading driving force for the growth of global online retail market.

1.1 Development status of international and domestic retail markets

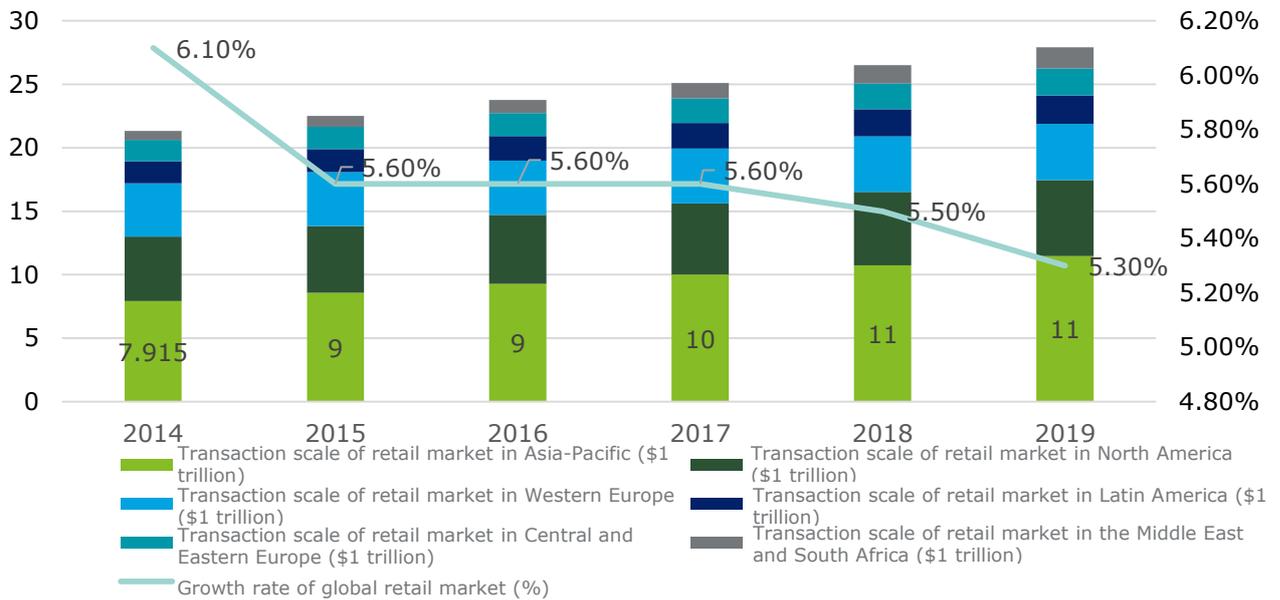
Emerging markets led by China are becoming the growth engine for the global retail market

According to eMarketer¹, the total sales of global retail market in 2015 was about \$22.5 trillion with a year-on-year growth of 5.6 percent. Despite the increasing uncertainty about the global economic development, the global retail market showed strong resilience under the trend of a relatively solid growth of retailing sales in developed markets and a rapid growth in emerging markets. The compound annual growth rate (CAGR) of the global retail market from 2014 to 2019 is expected to remain at about 5.5 percent, and the total sales will reach about \$28 trillion in 2019.

In 2015, the retailing sales of the Asia Pacific region represented by China and Japan was approximately \$8.57 trillion, accounting for the largest share of more than 38 percent in the global retail market. With the rise of emerging consumption powers like China and India and the increase of disposable income, the retail sales of the Asia Pacific region will still maintain a relatively rapid growth. In contrast with the comparatively low growth rate in two developed regions of North America and Europe, the retail sales of the Asia Pacific region is expected to account for more than 40 percent in the global retail market by 2019. In 2015, Asia Pacific contributed over 50 percent to the global retail sales growth, making itself a genuine growth engine for the global retail market.

¹ eMarketer (a world famous market research firm)

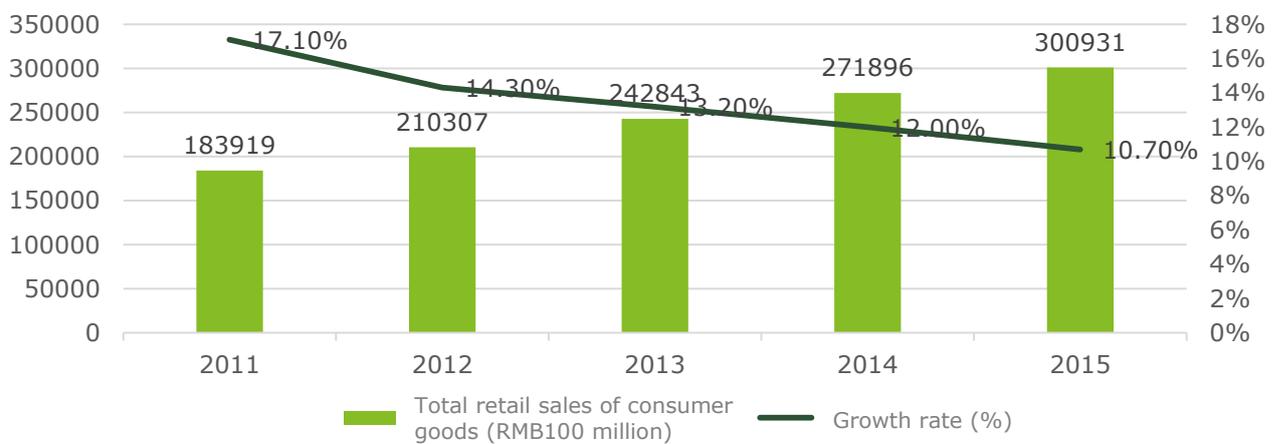
Figure 1: Transaction scale of global retail market



Source: eMarketer, Deloitte Research

In 2015, China's total retail sales of consumer goods amounted to RMB30.1 trillion (about \$4.61 trillion, converted at the average exchange rate of 6.5315 in May 2016). The growth rate further slowed down to 10.7 percent, but much higher than the overall growth rate of the global retail market. According to eMarketer, in 2015 Chinese retail market took up about 20 percent of the global retail market, and contributed 37 percent to the growth of the global retail market. Compared with the growth rate of less than 5 percent in two economically developed regions of North America and Western Europe, Chinese retail market shows stronger vitality and greater growth potential, and is expected to replace the U.S. as the world's largest consumer market in 2019.

Figure 2: Transaction scale of Chinese retail market



Source: China E-business Research Center (CECRC)², National Bureau of Statistics (NBS)

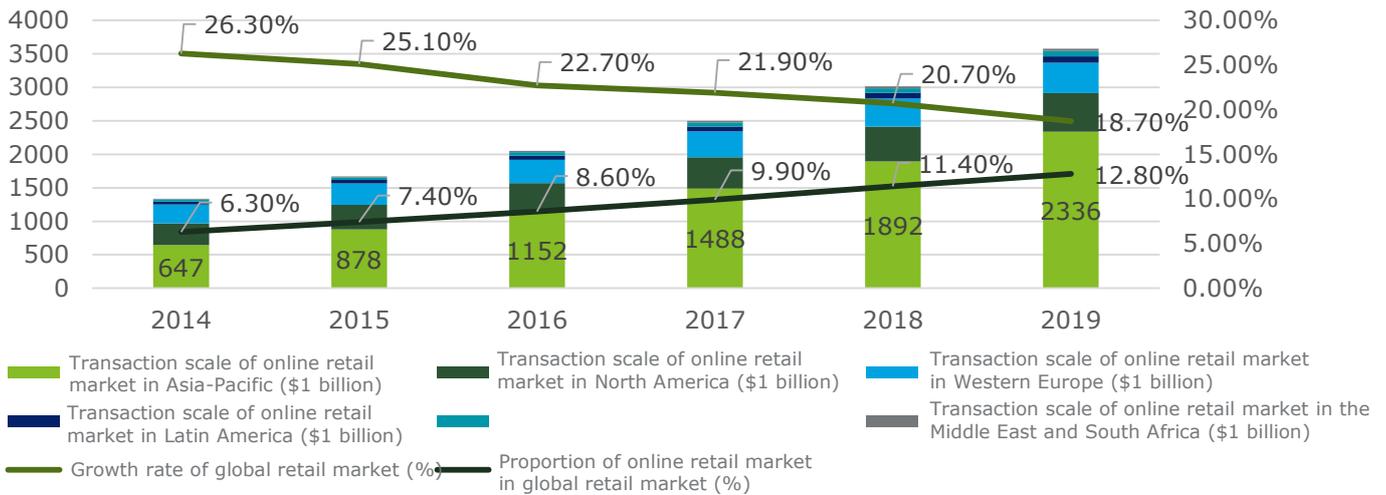
² China E-business Research Center (CECRC, an open network platform specialized in e-commerce)

China has remained the global e-retail leader with a rapid growth

According to eMarketer, the global online retail market was about \$1.67 trillion in 2015, up by 25.1 percent compared with that in 2014. The rapid growth showed that networked retail has become one of the major trends of the global retail market. However, the online retail still accounted for a relatively low proportion in the global retail, only 7.4 percent in 2015. Industry insiders predict that the global online retail market will maintain a rapid growth for some time to come and reach \$3.58 trillion in scale by 2019, with its proportion in the global retail market gradually rising to 12.8 percent.

The Asia Pacific region is not only the most dynamic market in the global retail, but also the fastest growing online retail market. According to statistics, in 2015 the growth of online retail sales in two developed markets of North America and Europe was significantly lower than other regions in the world, while the online retail sales of Asia-Pacific rose by nearly 30 percent year-on-year, accounting for over 50 percent in the global online retail market for the first time. The continuous increase in the number of online shoppers and the improvement of purchasing power have become the major driving force for continuous online retail sales growth in the Asia Pacific region.

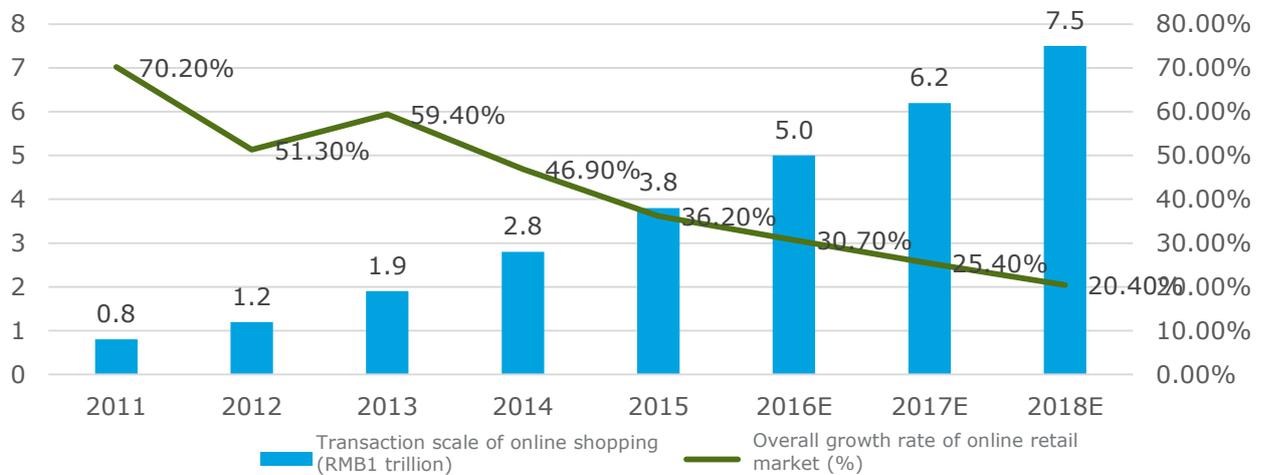
Figure 3: Development status and trends of global online retail market



Source: eMarketer, Deloitte research

In 2015, the transaction scale of Chinese online retail market reached RMB3.8 trillion (about \$581.8 billion, converted at the average exchange rate of 6.5315 in May 2016) with a year-on-year growth of 36.2 percent, significantly slower than that in the previous year. According to the data from eMarketer, in 2015 Chinese online retail market took up about 35 percent of the global online retail market, and contributed approximately 46 percent to the growth of the global online retail market, becoming the absolute driving force for the global growth. Based on current trends, Chinese online retail market is expected to account for over 50 percent of the global online retail market in 2019.

Figure 4: Transaction scale of China's online retail market



Source: iResearch³

According to the data from CECRC, the online retail market took up more than 12 percent in the total retail sales of consumer goods in 2015, and the proportion is expected to rise to 13.5 percent in 2016. And according to the data from eMarketer, the online retail markets of North America and Western Europe are expected to account for only 7.7 percent and 8.2 percent of the overall retail market respectively in 2016. By contrast, the penetration rate of Chinese online retail market is the highest among several large markets, and will rise at a faster speed.

Table 1: Expected proportion of regional online retail market in regional retail market in 2016

Region	China	Asia-Pacific ⁴	North America	Western Europe	Global
Proportion of online retail market	13.5 percent	12.4 percent	7.7 percent	8.2 percent	8.6 percent

Source: eMarketer, CECRC, Deloitte Research

It should be noted that Chinese online retail market has gradually stepped into a development stage with a relatively mature and stable growth from previous rampant growth. And with the continuously expanding scale, its overall growth rate will gradually slow down and get close to a reasonable range. According to NBS statistics, China's online retail sales from January to June of 2016 rose by 28.2 percent year-on-year, significantly slower than that in 2015, and it was also the first time in the last five years that the growth rate of online retail sales has fallen below 30 percent.

³ iResearch (a consulting service firm specialized in consumer behaviors in e-commerce, network media, etc.)

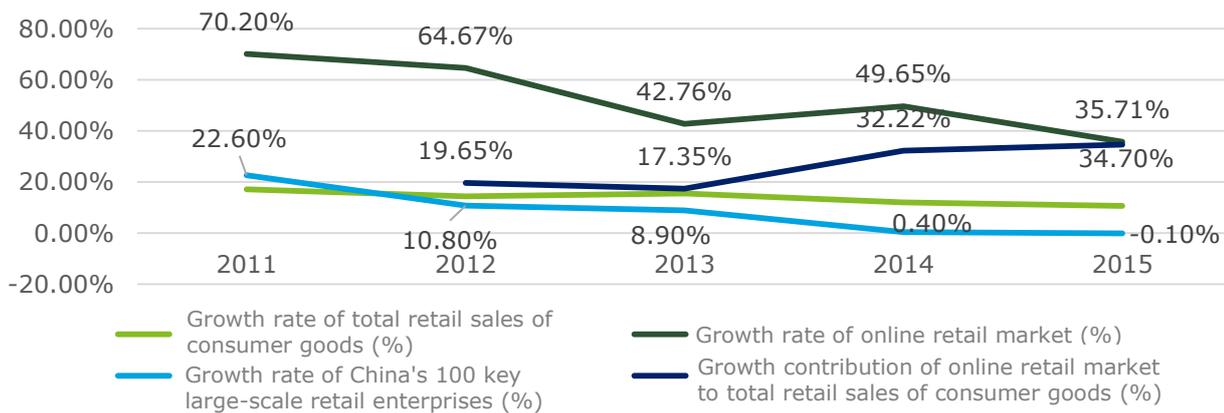
⁴ The Asia Pacific region includes China

1.2 Development characteristics of Chinese online retail market

The continuously growing e-retail is a major driver for the growth of Chinese retail market

Over the past five years, the sales volume of Chinese retail market has continued to slow down, and the growth rate of major physical retailers has declined significantly. According to the data from China General Chamber of Commerce (CGCC), the sales growth rate of China's 100 key large-scale retailing enterprises got close to zero in 2014, and the sales volume even showed a negative growth in 2015. By contrast, online retail has become a major driver and exerted an increasing impact on the growth of Chinese retail market. Deloitte Research estimated that the online retail market contributed 34.7 percent to the growth of Chinese retail market in 2015, nearly doubling the growth contribution of 19.65 percent in 2012. Although the overall growth rate gradually slowed down, the online retail market will still grow at a much higher rate than that of the overall retail market in the next few years. And the online retail market will have more significant impact on the overall retail sales growth.

Figure 5: Growth rate of Chinese retail market and growth contribution of online retail market



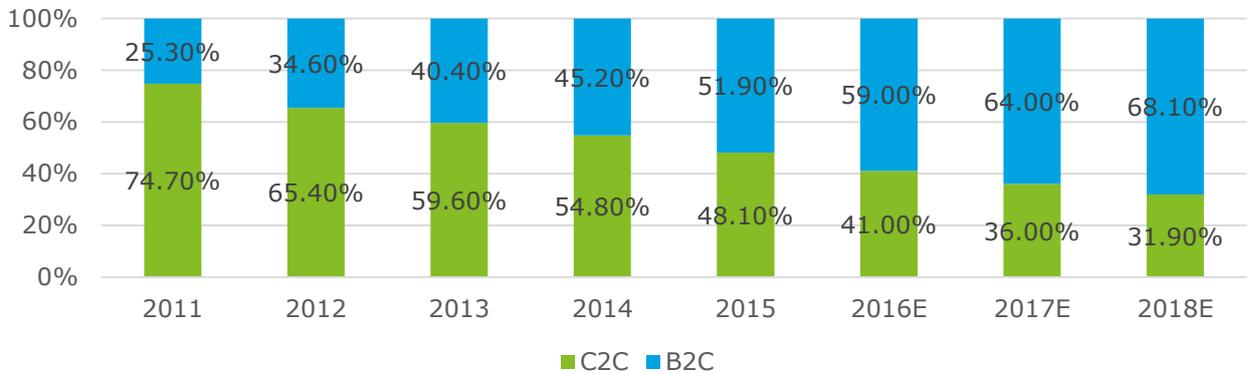
Source: NBS, CECRC, China National Commercial Information Center (CNCIC)

Note: China's 100 large-scale retailing enterprises are mainly traditional retailing enterprises

Online retail market becomes more standardized, market composition reverses and transactions at mobile terminals go mainstream

C2C model is the starting point of the rapid growth of Chinese online retail market, which has stepped into the maturity period to become more standardized, quality and diversified after years of development. Under this trend, the transaction scale of B2C market accounted for a growing proportion year by year, exceeding that of C2C market for the first time in 2015. According to the statistics from iResearch, in 2015 the transaction scale of B2C market rose by 56.6 percent year on year, while the C2C market only increased by 19.5 percent, far below the overall growth rate of online retail market. It is expected to maintain an obvious difference in growth rate, which will further improve the proportion of B2C.

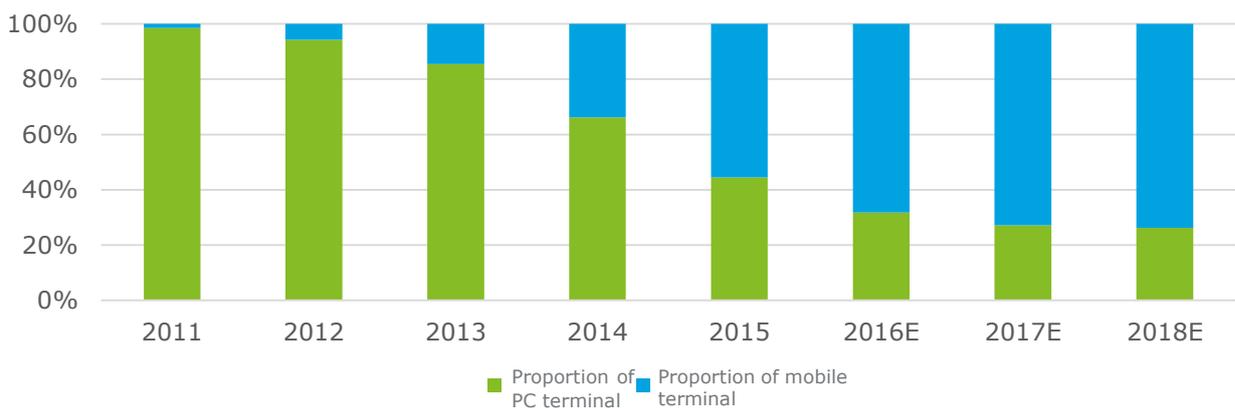
Figure 6: Growth rate of Chinese retail market and growth contribution of online retail market



Source: iResearch

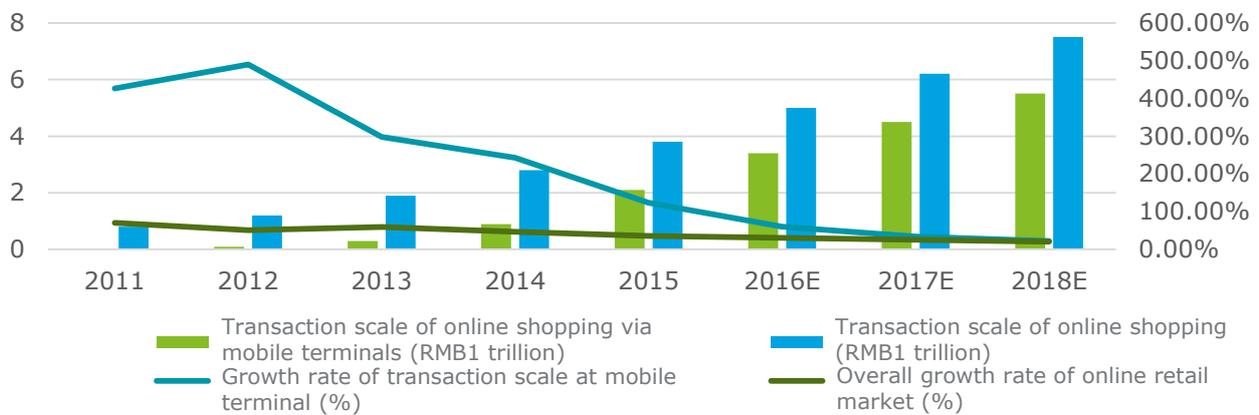
The popularity of smartphones and the maturity of relevant technologies lead to the explosive growth of shopping via mobile terminals. Deloitte research estimated that CAGR of the transaction scale at mobile terminals from 2012 to 2015 reached over 200 percent, much higher than the overall growth rate of the online retail market in the same period. According to the data from iResearch, the transaction scale at mobile terminals amounted to RMB2.1 trillion in 2015, accounting for 55.5 percent in the overall online retail market and surpassing PC terminals in proportion for the first time to become the mainstream online consumption pattern. Mobile terminal is incomparable to PC terminal due to its popularity, convenience, sociability and entertainment, with which smartphone has become an important part in consumers' daily life, and also a major tool for online retailing enterprises to communicate with consumers.

Figure 7: Growth of e-retail via PC terminal and mobile terminal



Source: iResearch

Figure 8: Changes in proportion of transactions via PC terminal and mobile terminal



Source: iResearch

Retail giants conduct in-depth cooperation to optimize industry models

In recent years, under the environment of physical retailing’s cooling down, Omni-channel construction has been considered by some physical retailers as a measure to get growth momentum, and also regarded by online retailers as a potential solution to development bottlenecks such as last-mile service. While establishing online channels, leading physical and online retailing enterprises began to conduct cooperation between online and offline activities to rapidly gain competitive advantages and seize market resources. In August 2015, two hallmark events successively took place in capital market, that is, JD.com announced to buy shares of Yonghui Superstores at RMB4.3 billion, and Alibaba and Suning Commerce announced the cross-holdings. At present, Yonghui Superstores has settled in Jingdong Daojia, and started to take advantage of the online channels of JD.com for business development, and in turn JD.com gained support in fresh food from Yonghui Superstores. Moreover, the cooperation between Alibaba and Suning was of greater strategic significance. On June 1, 2016, 10 months after the announcement of cross-holdings, Alibaba and Suning Commerce jointly released and determined their cooperation directions in the future in Beijing – from internal integration to external radiation to initiate new business models. During the 10-month cooperation, Alibaba and Suning connected activities in many aspects of channel, logistics and membership, and improved the passage for data and information consultation. Centered on incubating brand businesses, empowering retailers and serving consumers, both sides will provide integrated solutions for the retailing chain, set up the supply chain management model driven by C2B reversely, and intend to promote the expansion of the overall consumer market in an all-round way. Moreover, a transaction of profound significance also took place in June 2016: JD.com acquired Yihaodian from Walmart at 5 percent equity of JD.com, and took this opportunity to enter into strategic cooperation intention with Walmart. The cooperation between leading international and domestic retail enterprises not only could ensure more powerful offline support, but also is expected to facilitate the optimization and upgrading of the whole supply chain. More frequent cooperation between leading enterprises can achieve complementary advantages and resources sharing to a considerable extent, improve the influence of both sides within the industry, and gradually change the competition landscape of the industry.

Table 2: Representative M&As of retail giants in 2015

Transaction date	Purchaser	Object of transaction	Transaction amount (RMB100 million)
August 2015	JD.com	Yonghui Superstores	43
August 2015	Alibaba	Suning Commerce	282
August 2015	Suning Commerce	Alibaba	140
June 2016	JD.com	Yihaodian	5 percent equity of JD.com

Source: Compilation of public information, company announcements

Crossover is becoming the main tool for retailers to build consumer ecosystems

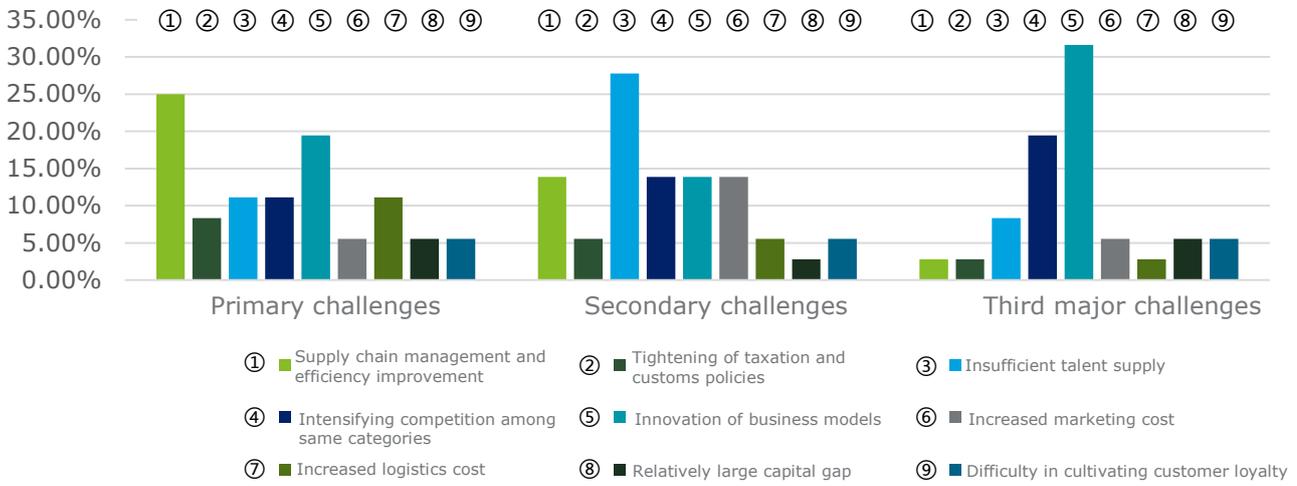
While consolidating retail business, e-retail giants are actively making an attempt on diversified development, and improving customer penetration rate through multilayer covering of consumers. For example, Alibaba's industrial layout reflects its philosophy of consumer ecosystems. Building a multi-industry layout closely related with consumers' daily life under the consumer-centered business model is also an epitome of crossover in retail market at present. Similar to Alibaba, JD.com is also actively building a similar industry layout to improve consumer stickiness. While providing characteristic financial services, JD.com made an attempt on new cooperation model of "social contact + e-commerce" through cooperation with Tencent. During the "Double 11" Festival 2015, users' shopping via WeChat JD.com and Mobile QQ accounted for 52 percent of all newly added JD.com users who placed orders, which marked an initial success of the crossover cooperation. Such cross-industry activities enable the competition for consumer resources to be expanded from retail industry to multiple scenarios including finance, entertainment, local services, socializing and logistics, making the diversified competition take shape.

The innovation of business model is pervasive in e-retailers' breaking the deadlock, with future development focusing on current hot spots

CCFA and Deloitte jointly carried out an ad hoc survey on the development strategies, operational status and development challenges of online retail enterprises. Base on the survey, 66.67 percent of the interviewed online retail enterprises thought innovation of business models as one of the major challenges against future development, and over 19 percent of the enterprises listed innovation of business models as the primary challenge, which is closely related to emerging models of cross-border e-commerce and rural e-commerce in recent years.

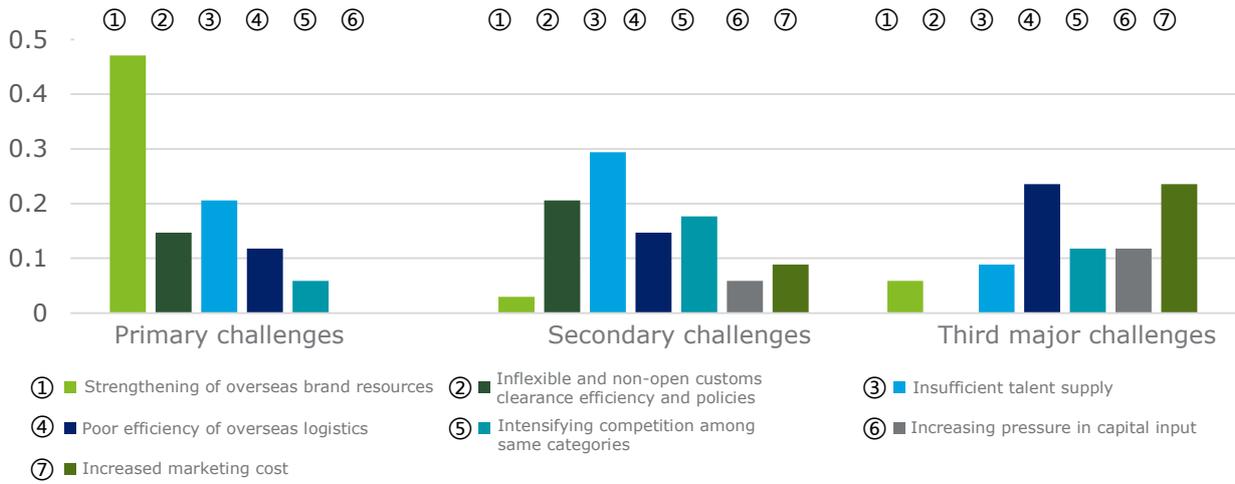
Online retail market has stepped into a relatively mature stage of development characterized by the decline of the overall growth rate and a comparatively stable competition landscape. High market centralization and the powerful position of giants have brought great competition pressure to online retailers now, but emerging models are expected to become new growth points for them. Tempted by fast-growing cross-border e-commerce, more than 80 percent of the enterprises plan to expand their existing business or engage in this business in the next two years. Under the impact of a series of new policies such as Notice on Taxation Policies for Cross-border E-commerce Retail Imports, enterprises need to reflect on how to develop cross-border business well. And the development uncertainty under innovative models make innovation of business models more challenging.

Figure 9: Findings of three major challenges faced by online retailers



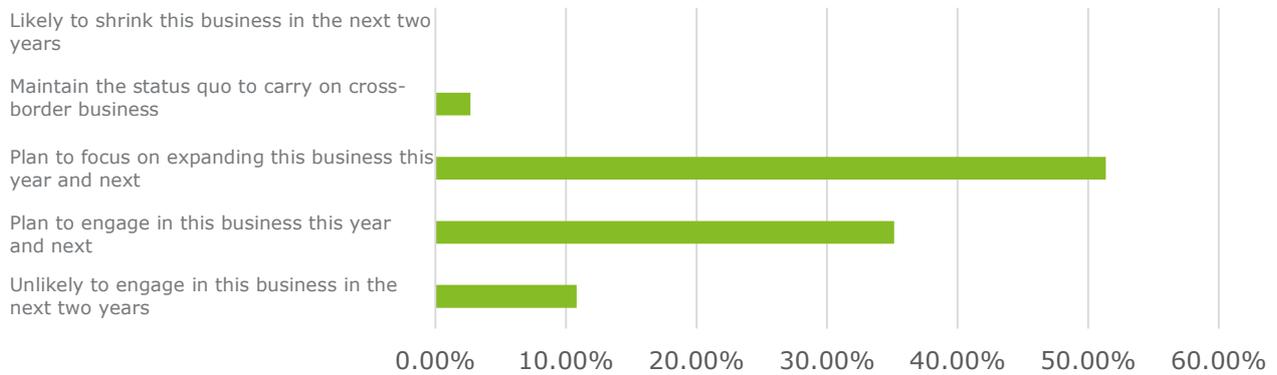
Source: Questionnaire Survey for Top 100 Chinese Online Retailers by China Chain Store & Franchise Association (CCFA)

Figure 10: Challenges faced by online retailers in the development of cross-border e-commerce



Source: Questionnaire Survey for Top 100 Chinese Online Retailers by CCFA

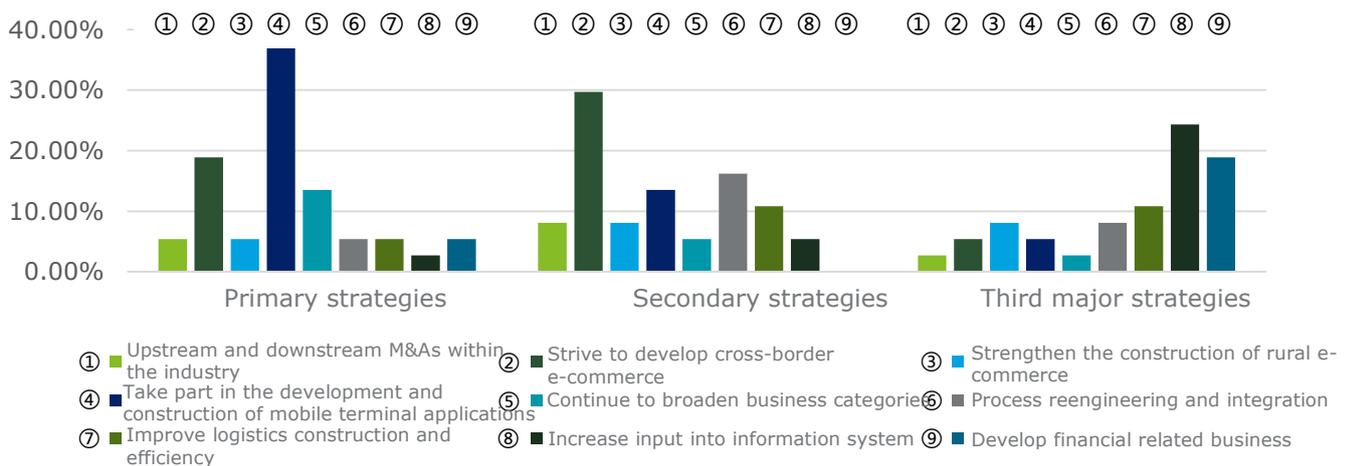
Figure 11: The attitudes of online retailers towards cross-border e-commerce



Source: Questionnaire Survey for Top 100 Chinese Online Retailers by CCFA

According to the survey, nearly half of the enterprises thought that the increasingly intensifying competition among same categories is the primary challenge for their future development, so they began to focus on emerging fields of cross-border e-commerce and rural e-commerce, and strive for new breakthroughs via innovation in products, channels, services and business models. In the next three years, over 50 percent of the interviewed enterprises will take the fast growing shopping via mobile terminals and cross-border e-commerce as their major development strategies. Moreover, input into information system, logistics construction, process integration, and financial business will also become development strategies of some enterprises, which to a certain extent reflects the differentiated strategies adopted by enterprises to avoid competition among same categories.

Figure 12: Development strategies of online retailers in the next three years



Source: Questionnaire Survey for Top 100 Chinese Online Retailers by CCFA

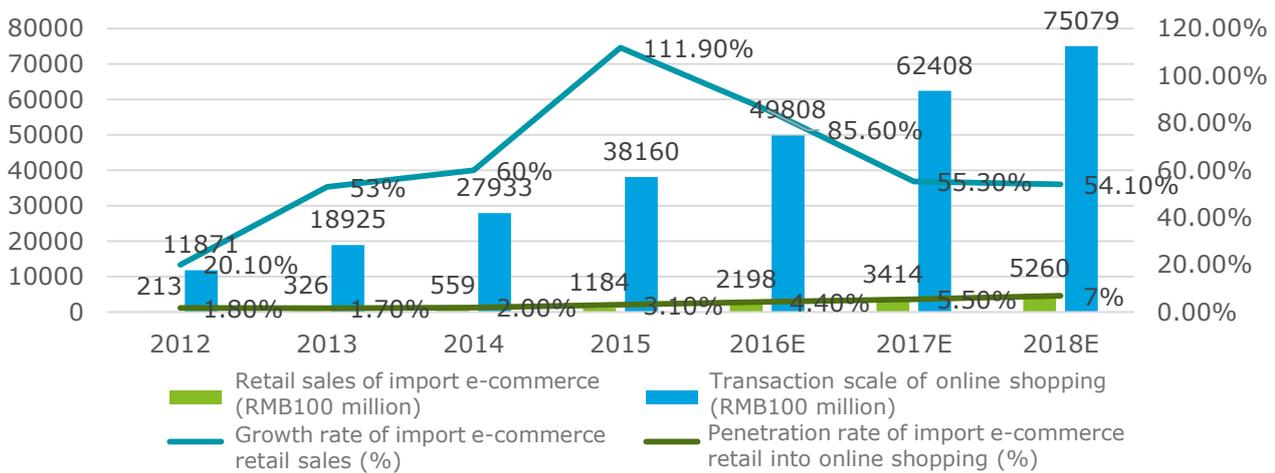
2. Opportunities in the online retail market

Under the influence of numerous factors including economic development, consumer demands, government policies and capital market, various fast-growing market segments have emerged in the online retail market. As the overall online retail market stepped into a relatively mature stage of development, cross-border e-commerce and rural e-commerce are becoming new growth points for the online retail market, and will maintain continuous growth for some time to come.

2.1 Cross-border e-commerce needs to break the deadlock

Driven by three favorable factors of policy support, consumer demands and promotion of capital market, cross-border e-commerce has experienced an explosive growth in the past two years. According to the statistics from iResearch, the retail sales of import e-commerce rose by 111.9 percent in 2015, much higher than the overall growth rate of online retail industry. But the retail sales of import e-commerce still accounted for a relatively small proportion in the online retail market, with the penetration rate of only 3.1 percent in 2015, so there is a huge space for the development of import e-commerce retail business given the trends.

Figure 13: Retail sales of import e-commerce



Source: iResearch

It should be noted that the new policies for cross-border e-commerce retail imports effective from April 2016 bring great uncertainty to the development of cross-border import.

The effect of new policies is mainly reflected in two aspects: First, tax rate changes lead to changes in final purchase price. Second, changes in customs clearance process and requirements. Compared with changes in tax rates, those in customs clearance process and requirements caused shock in the industry. Under new policies, the *List of Cross-border E-commerce Retail Imports* (i.e. positive list) replaced the negative list to define cross-border e-commerce imports as "goods". It stipulated that commodities purchased directly are free from the process of checking customs clearance certificate, while bonded commodities purchased online need to experience this process to enter into bonded areas under the regulation for general trade. Meanwhile, the positive list raised requirements on first-time import license and registration place of commodities like cosmetics, formula milk powder and healthcare products. Cross-border import got close to "circuit breaker" under new

policies, which has been gradually eased. Relevant departments published the second batch of the positive list, and issued Notice of the General Office of the General Administration of Customs on Matters Related to the Implementation of New Regulatory Requirements for Cross-border E-commerce Retail Imports. New policies determined to suspend the implementation of other provisions except changed taxation policies, and set the deadline for transition on May 11, 2017.

Based on industry development status, major problems and risk factors cross-border import enterprises faced are mainly reflected in two aspects:

First, policy risks. Transitional period gives cross-border import enterprises some time to make adjustments, but new policies reflect management's intention and attempt for standardized industry development, so there is still great uncertainty about industry development in the future. Cross-border retail imports are mainly centered in several major categories greatly restricted in the positive list, such as cosmetics, milk powder, healthcare products, etc. Based on current situation, it is quite difficult to meet all regulatory requirements during the transitional period.

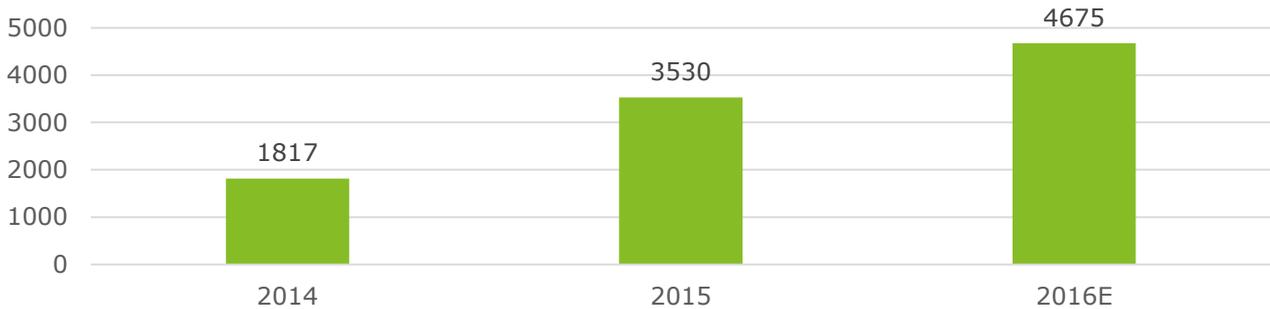
Second, problems about cross-border supply chain management and operation models. New policies invisibly increased the difficulty in supply chain management for cross-border e-commerce import enterprise, and gave rise to reflections on operation models of cross-border import. There generally exists B2B2C model in the process of cross-border import. Some cross-border retailing enterprises can neither control direct sources of goods, nor acquire contracts, certificates of origin, and brand licenses stipulated by customs clearance in new policies. And new policies have little impact on direct mail import, which has some disadvantages in time cycle, aftersales services, and customs clearance, and raise higher requirements for capital input and overall supply chain management. Cross-border import enterprises need various considerations for transformation to the model of direct mail.

Some business of bonded areas got close to fusing after the implementation of new policies. As the transitional period started, cross-border import business was gradually back on track. But enterprises will still focus on the impact of new policies on the industry and the uncertainty after the end of the transitional period, so observations and adjustments are likely to be the keynote during this period. Policy changes after the end of the transitional period will be a major factor to determine the industry development trend. Faced with robust customer demands and policy uncertainties, the cross-border import industry needs to break the deadlock.

2.2 The implementation of rural e-commerce is accelerated

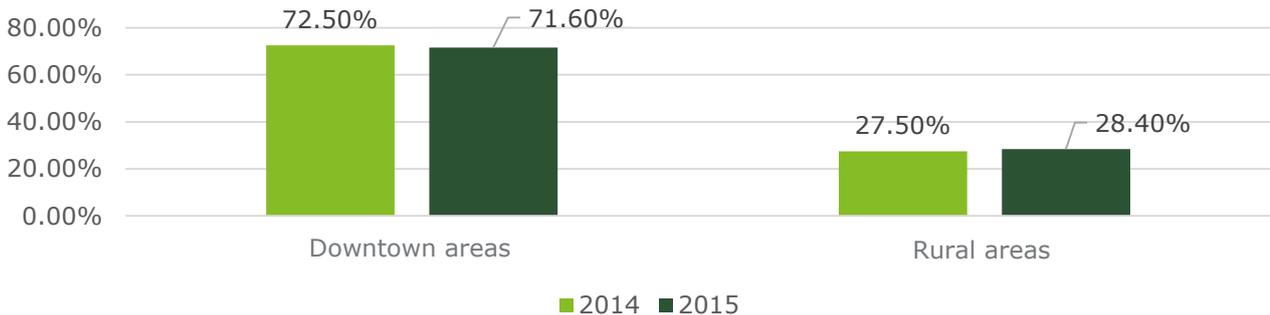
The year of 2015 has seen a rapid development of rural online shopping market with the guidance of government policies and active coordination of retail giants. Data from CECRC show that China’s rural online shopping market reached RMB353 billion in 2015, with a growth of 94.3 percent year on year, much higher than that of online retail market during the same period, becoming another important growth engine for online retail market.

Figure 14: Rural online shopping market (RMB100 million)



Source: CECRC

Figure 15: Structure of Chinese netizens in urban and rural areas



Source: China Internet Network Information Center (CNNIC)

The development of rural e-commerce is distinctive due to strong support from the government. Starting from 2015, the country has introduced a series of policies and documents to guide and support rural e-commerce, including guidelines for the overall development of e-commerce market and specific documents for rural e-commerce, which indicates an unprecedented attention for rural e-commerce. The strong governmental support pushes forward the active participation of local governments, general public and retailers, among which the three retailing giants, Alibaba, JD.com and Suning stepped up efforts to develop the rural e-commerce in 2015.

As the e-retail market is increasingly mature, retail giants are exploring new growth engines with various approaches, and the rural consumption market, a trillion frontier market, is inevitably a right choice. The rural market is both a consumption and output market. The layout of the three giants show that they focus on rural market consumption, agricultural product export, logistics and technology education, talent education and financial support. The development of the rural market in the future will be largely dependent on infrastructure construction, network popularity, the improvement of logistics systems and people allocation, therefore with governments’ supervision and active coordination of industry

giants, the purchasing power of the rural market is expected to be further released and develop into an integral part of e-retail.

Table 3: Three giants' development strategies and development status of rural e-commerce

Three retail giants	Development strategies	Development status
Alibaba	Rural Taobao partner strategy (村淘合伙人战略), rural logistics development strategy, rural financial support strategy, and rural e-commerce talent education strategy integrate superior resources including Taobao, Tmall, Ant Financial and Cainiao Network to address channels, technologies, logistics, financing, etc.	The number of counties with online shops' sales volume over RMB100 million on Alibaba retail platforms in 2015 is more than 350, of which the county-wide agricultural product e-commerce achieved a year-on-year growth of over 65 percent, with the sales revenue of online shops in 832 nationally designated poor counties reaching RMB21.556 billion, a YoY growth of 80.69 percent. The parcels sent out and to counties exceeded 7 billion pieces.
JD.com	Build a closed loop of buying and selling in rural areas focusing on three key strategies including industrial goods sold to rural areas, rural financing and fresh product e-commerce	200,000 village promoters serve 200,000 administrative villages, with 1,400 county service centers and nearly 4,000 JD.com service shops. There are more than 200 agricultural material e-commerce cooperative enterprises and 65 authorized service centers for agricultural materials.
Suning	Promote reversely the agricultural industrial development through channels including regular chains of Suning.com, Chinese specialty stores; drive the brand development of agricultural products by Internet special marketing platforms including Suning Dajuhui (苏宁大聚惠), Suning Crowdfunding (苏宁众筹); push forward the profession development of rural e-commerce talents by establishing Suning Rural E-commerce College	Suning direct sales network covers over 1,000 counties, 5,000 towns and 50,000 villages in China to create more than 30,000 jobs; 88 online Suning Chinese specialty stores have over 10,000 SKU of selected agricultural and special goods, achieving product sales volume of over RMB1 billion.

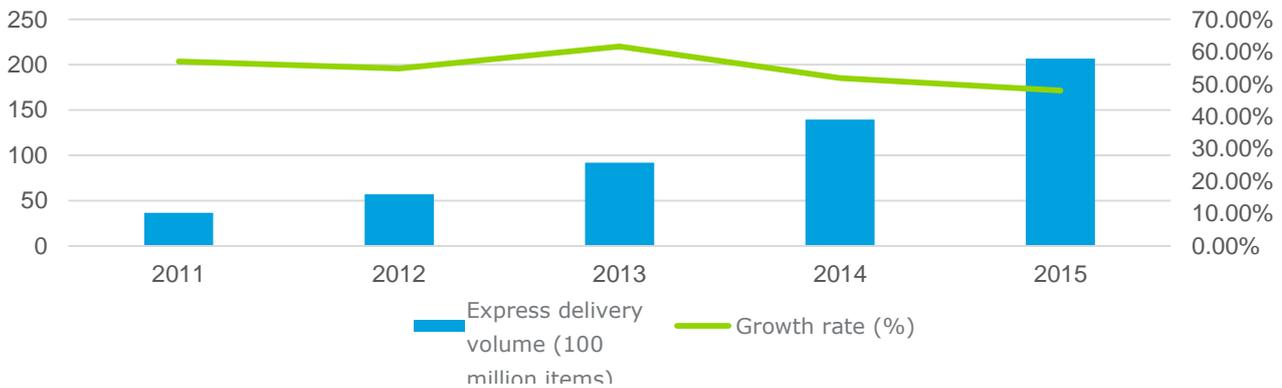
Source: Deloitte research, CNNIC and public information consolidation

2.3 Upgrading logistics warehousing

E-retail keeps growing together with logistics warehousing industry

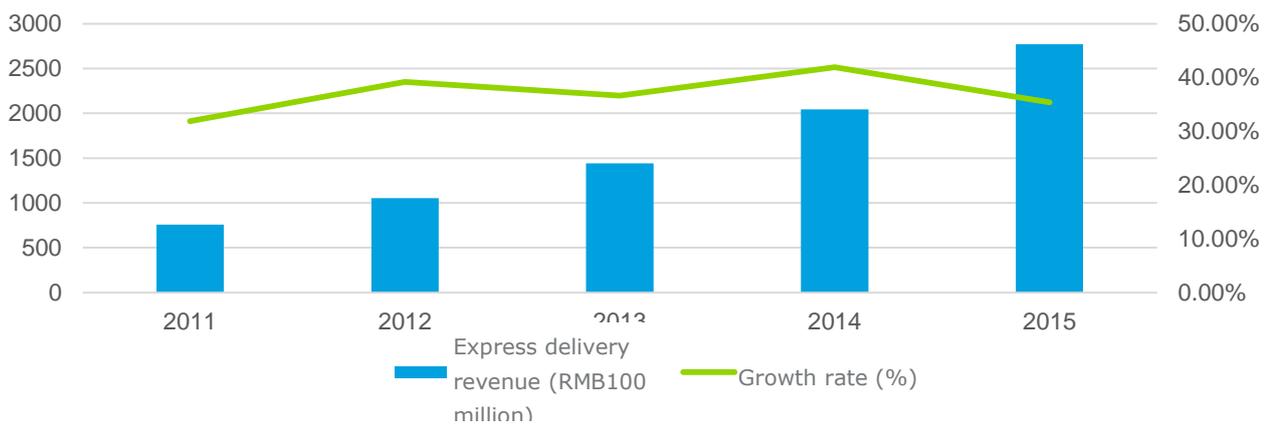
E-retail and logistics warehousing support each other interdependently, thus the e-retail keeps growing together with the logistics warehousing industry. Data from AliResearch suggest that e-commerce parcels account for over 50 percent of the parcels in 60 percent express delivery service stations, and e-commerce parcels take up 80 percent of the parcels in 17.74 percent express delivery service locations. According to the NBS, in 2015, driven by the growth of e-retail the business volume of the all express delivery enterprises in China accumulated to 20.67 billion, with a YoY growth of 48 percent and growth rate of over 45 percent for three consecutive years; the business revenue reached RMB276.96 billion, with a YoY growth of 35.4 percent and growth rate of over 35 percent for three consecutive years. With the immense volume and rapid growth of online shopping market and express delivery market, China has become the world’s largest online shopping and express delivery powerhouse.

Figure 16: China’s express delivery business volume and growth rate



Source: State Post Bureau - Statistical Communiqué of Postal Industry Development in 2015

Figure 17: China’s express delivery business revenue and its growth rate



Source: State Post Bureau - Statistical Communiqué of Postal Industry Development in 2015

E-retail logistics warehousing is upgrading in optimized effectiveness, regional expansion and intelligent efficiency

- a. Optimized effectiveness means collaborative improvement of transport network and delivery, equally shared risk through integration of warehousing required by regions and dividends brought by synergy. The average delivery time across the country was 2.6 days in 2015, increasing by 14 percent compared with that of 2014.
- b. Logistics network and warehouses are expanding into northwestern regions and remote rural areas, introducing more market flows by enabling more and more consumers to experience the efficiency and convenience of e-retail, and creating a virtuous cycle with the upgrade of logistics warehousing for spiral rise. According to Cainiao Network, the express parcel volume in rural areas accounted for one quarter of all the sent and received parcels in China in 2015. The express delivery in rural areas has long been a blank area of e-commerce logistics with village locations only penetrated by postal network, which represents challenge and opportunity for e-retail logistics warehousing.
- c. The collection of logistics real-time data, upgrade of storage facilities, introduction of advanced logistics technologies create a huge information flow to drive the optimization and iteration of logistics algorithm and ensure the best route and real-time tracking. The application of intelligent devices and technologies in all parts of the supply chain makes the whole process of logistics warehousing visual and improve its efficiency. Meanwhile the Internet of things and information flow established by collecting and integrating data from all parts of the supply chain can provide data support for the optimization.

2.4 Outlook for the future trends of retail market

1. Younger consumers lead the new retailing trend in the future

As the emerging consumption power including post-80s and 90s generations becomes increasingly mature, their influence on the retail industry will be more noticeable. How to use new technologies to lead the new development direction and meet new users' demands under this trend has become a key focus for industry leaders. Statistics from Taobao show that nearly 80 percent of its users are less than 35 years old and consumers aged under 24 account for 35 percent; and post-90s sellers are becoming a sizeable group. Driven by the younger consumer trend, innovative technologies and models are expected to lead the new retailing development trend in the future.

2. Virtual reality/augmented reality (VR/AR) enhance shopping experience, yet requires technical breakthrough

As a unique advantage of physical retailers for long, real shopping experience is also the key to enhancing customer experience. With constant emergence of innovative technologies, VR/AR technologies are expected to be another try for online retailers to improve customer experience. VR is a virtual human-interactive technology gradually used in several entertainment industries including games and film and television, providing users with immersive experience. It is expected to trigger another industrial revolution in the future; AR can integrate virtual information into the real world to generate more comprehensive experience through integration of virtual information and reality. At present, online retailers are exploring the application of VR/AR to shopping experience for purposes of integrating virtual online shopping environment into authentic shopping experience, or provide more creative shopping experience through combination of virtual information and reality, which will bring new opportunities for e-retail.

For now, hardware and technology are two bottlenecks for the development of virtual shopping. Hardware device required is the primary premise to realize the promotion of

virtual shopping, while the high price of VR device and immature technologies at this stage will be major issues to develop virtual shopping in a short term. IDC data suggest that the global shipment of virtual reality products is estimated to be 9.6 million with a low base in 2016, but in 2020 the shipment will reach 64.8 million and the compound annual growth rate (CAGR) of over 180 percent will offer ample space for the development of virtual shopping in the future. Technologies will limit the comprehensive improvement of customer experience as VR/AR technologies at this stage are still under exploration and development rather than being well mastered, and the envisagement of artificial intelligence and biometric identification in virtual shopping is not realized, all of which will be technical issues needed to be addressed in the future.

3. Socialized e-commerce is expected to be an important entry for future consumers

Mobile terminals have become an integral part in the life of Chinese people. Data in Deloitte's New Media Explosion Ignited reveal that the ownership rate of smartphones in China has reached 96 percent and that of tablets is 68 percent, marking the era of nationwide mobile Internet. The unique interconnectivity of mobile terminals and their expanding functions enable consumers to be addictive in smartphones. According to Deloitte's 2015 Global Mobile Consumer Survey, China Edition, almost all awakened mobile consumers across the world check their phones at least once in three hours, while in emerging markets 93 percent awakened consumers check their phones in one hour or less, and people in the Asia Pacific region are most addictive to smartphone. In addition to high dependency, 22 percent consumers in this region browse social media immediately when using mobile phones each time, which make mobile socializing become the second most important usage of mobile phone following instant messaging.

- a. Tremendous user groups and high liveness make user diversion possible. Statistics from EnfoDesk show that active users of WeChat reach 640 million in one month with daily average login times of 4.43 billion, while the figure of Taobao, a shopping APP used most frequently is only 190 million with daily average login times of 250 million. Judging from user base and frequency of use, mobile social software has the potential to achieve user diversion, which to some extent facilitates the cooperation between JD.com and Tencent.
- b. Social shopping model enables consumption scenarios to be better embedded into daily usage, making scenario-specific consumption transfer to immersive fragmented scenarios. The change of consumption scenarios is the most important feature to distinguish social shopping model from traditional models, and the sharing, comment and communications of users under such models may drive users' final purchase.
- c. User-centered socialized shopping is expected to help realize precision marketing. Domestic social software has integrated various functions including socializing, payment and shopping to expand functions from multiple perspectives in line with user preference and launch targeted services based on long-term accumulated customer data. The interactive promotion with thematic activities and flagship brands as its models has been developed in many ways including online and offline interaction/ broadcasting. Enterprises are exploring the model of interaction with stars and Internet celebrities.

II. Consumers have new forms of demands

Consumers' perception and consumption patterns have changed a lot in the mobile Internet age. As new purchase desires and demands are created, consumers have higher and new demands for the connotation and denotation of goods, consumption scenarios and experience along with consumption upgrade and update, thus consumption demands have various new business formats. Accurate understanding of consumers' demands is an important premise for enterprises to follow the trend and readjust strategic orientation. Consumer have new forms of demands in following aspects:

1. Digitalized channel and socialized online shopping

Changes in consumers' shopping behaviors are mainly reflected in digitalized channel and socialized online shopping. Firstly, the prevalence of Internet and electronic devices makes the information screening in early stage easier for consumers. According to CNNIC, by December 2015, the penetration rate of Internet in China had increased to 50.3 percent from 42.1 percent in 2012 with 688 million netizens. Over 60 percent of consumers think Internet is the main way for them to learn products, prices and brands. Consumers can know product information more quickly through various devices (e.g. cellphones, tablets, PCs) and Internet platforms (e.g. search engines, Taobao). Consumers continue to spend more time on obtaining product information in the multi-channel environment, and large numbers of customers spend 90 percent time to browse products for a comprehensive research before purchasing. Therefore, the new digital environment contributes to consumer behaviors centered on knowing information related to brands and products. Deloitte research results show that consumers' cost on "digital life" increases significantly. Globally, in 2015 millennials (groups born in 1984 to 1995) spent \$750 per capita on digital media platforms (including video games and stream media services) and the consumption on beach vacation, dinning out and concerts also rises.

Besides, VR technology has penetrated gradually into the retail industry and changed consumption experience, though it is still at the stages of early exploration and continuous improvement. Virtual technology makes virtual shopping possible in the future, which can provide more interactive and individualized experience for customers when they need to get to know raw materials and dressing effect. As technologies become mature, future users are able to try on clothes by virtual reality devices at home, considerably reducing the refund and return rate of online shopping and lifting efficiency and sales.

Virtual technology has an innate advantage on describing product performance and creating experience scenarios for users. Hospitality industry is such a model case. Hotels adopt virtual technology to display rooms for customers. Travel industry has similar applications for customers to make decisions easily by enabling them to see the scenic spots in a more intuitive way. In automobile industry, virtual technology can be used to replace test driving by stimulating driving experience. But equally important, consumers have relatively high requirements on the experience of virtual technology and technical disputes on virtual technology are still up in the air. Though with various uncertainties, Deloitte remains cautiously optimistic about the development of virtual technology. In 2016, the sales volume of virtual headsets are expected to be about 2.5 million, and 10 million kinds of virtual games are likely to be developed. Future product development will be more user-oriented.

Additionally, future online shopping will continue to expand on mobile terminals, promoting the socialization of shopping online. With increasing smartphone ownership, the penetration rate of online shopping on mobile terminals rises greatly as consumers are more willing to use mobile phones for online shopping. In 2015, the number of online shoppers via mobile phones reached 340 million with a growth rate of 43.9 percent, and the proportion of shopping online by such method increased to 54.8 percent from 42.4 percent in 2014. Post-80s and 90s generations, the new main consumption force, spending long time on social media platforms, are more likely to be affected by their friends in WeChat Moments and various “opinion leaders” on social networks. As consumers expect to take all chances to interact with brands, their purchase decisions are more likely to be influenced. Social media is increasingly influencing offline behaviors and it affects 33 percent of instore purchases as shown in Deloitte’s research results.

Accordingly, online shopping has huge potential in socialized media/ social networks and socialized online shopping will become a future trend. Socialized shopping behaviors at consumption end reflect to a certain extent the application form of emerging community economy in the retail industry. People joining in the same community for similar hobbies, identities and labels tend to have deep sense of identity and common languages in values and aesthetic, and similarities in consumption behaviors and purchase intention.

In a stable community established either in a consciously or unconsciously way, a warm interaction closed-loop is built among consumers for them to obtain information and spread it based on nodes. Reputation-based quality contents are widely spread for many times and thus creating unique sharing contents. Consumer behaviors and aggregation methods in communities have certain common features worthy of discussion, as shown in the figure below.

Figure 18: Features of community members



Source: Deloitte analysis

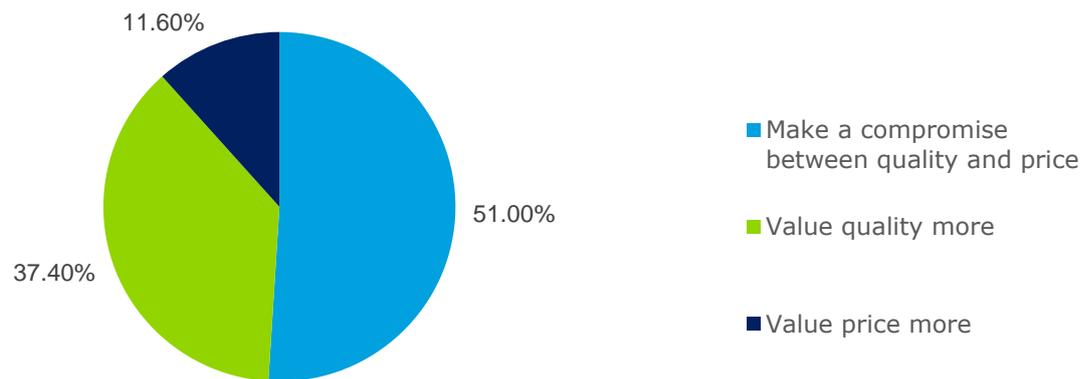
At present, some post-80s and 90s women who have become wives and mothers are willing to share parenting experience in communities and they are more likely to trust each other.

These groups can be targeted as customers of baby and maternal products. It is easy to achieve word-of-mouth effect when introducing products into such communities.

2. Quality-oriented purchase and experience-based consumption

Customers' consumption concept also changes dramatically. Firstly, changes in consumption concept arise from improved purchasing power and changes in major consumer groups. According to NBS, China's GDP in 2015 increased by 6.9 percent over the previous year, among which consumption expenditures contributed as high as 66.4 percent to GDP growth, 15.4 percent higher than last year. Increased income and consumption capacity allow customers to pay more attention to the quality of goods and consumption experience, other than price and cost performance when they make purchasing decisions. In addition, Chinese netizens are mainly at 10-39 years old, accounting for 75.1 percent of total netizen population; among them netizens aged 20-29 account for the largest proportion of 29.9 percent⁵. The new generation of customers grow up in a better economic environment with better economic conditions, therefore they know how to enjoy life better and value quality more. That's why consumption concept will gradually transform from price-driven to quality and consumption experience-oriented.

Figure 19: Customers' choices between the quality and price of goods



Source: CNNIC

In an era with widespread Internet, consumers are able to obtain information conveniently via the Internet. They can find the target goods with the most suitable prices at home, then go to physical stores to experience with obtained product information, and consult shop assistants pertinently. The figure below illustrates how customers' purchase behaviors are driven from searching information and considering where to buy and what to buy, to picking out goods, and purchasing offline or online.

Under this overall background, consumption experience has constantly been given new definitions and measuring standards. Rational experience such as cost performance, functions and product features, etc. is exerting diminishing impact on purchase behaviors, while the emotional experience on products and services is becoming increasingly important. Consumers are attaching more importance to that whether products and services are cool, fascinating, convenient, reliable, thoughtful, easy-to-learn, beautiful and comfortable. These factors determine whether customers will purchase repeatedly.

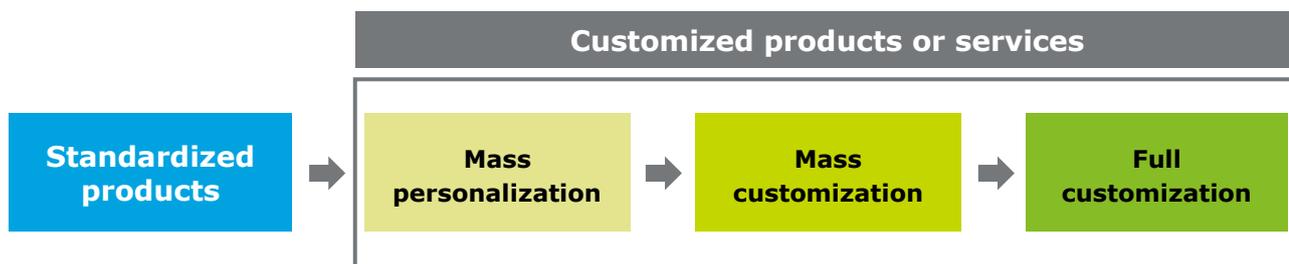
⁵Source: CNNIC

New challenges arising from consumer behaviors also intensify this trend along with the increase of retail volatility index and market fragmentation. Consumption tends to be centered on intangible experience from tangible goods, and consumption categories also switch from traditional categories to emerging categories gradually. Deloitte's research results show that air travel consumption hit a record in 2015, and catering sales were up 8 percentage points, much higher than 1 percent growth in retail industry. These phenomenon effectively show that consumers are turning their focus from individual product to the experience in the whole purchase process when evaluating retail operation.

3. Personalized consumption and mobile payment

Young generation has become the main force of online shopping with the most distinctive feature of personalized consumption behaviors. They like buying products that are different from their friends, and value both the quality of goods and the individuality expression. The emotional connotation and identities carried by goods are additional decisive factors when they selecting goods. Generally speaking, they prefer to buy personalized and niche goods, seek for the recognition of sub-cultural communities, and share shopping experience on social media.

Besides, consumers are becoming gradually mature in understanding and accepting personalized products. To satisfy personalized requirements, consumers are not averse to compromising on price to some extent. According to the survey results of Deloitte UK, one out of five consumers are interested in personalized products and willing

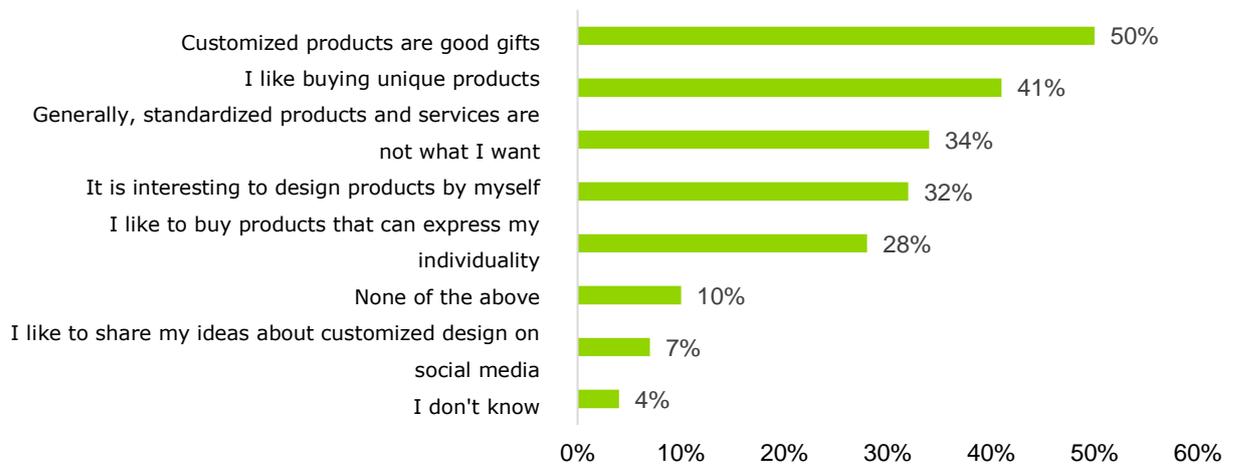


Source: Deloitte analysis

to pay 20 percent of premium; 42 percent of respondents who are interested in customized products or services are influenced by brand reputation and tend to make choices from a series of options; 22 percent of respondents said they are willing to share some personal data to obtain more distinctive products or services; respondents aged over 55 are more likely to pay for customized personal holidays than respondents aged 16-24.

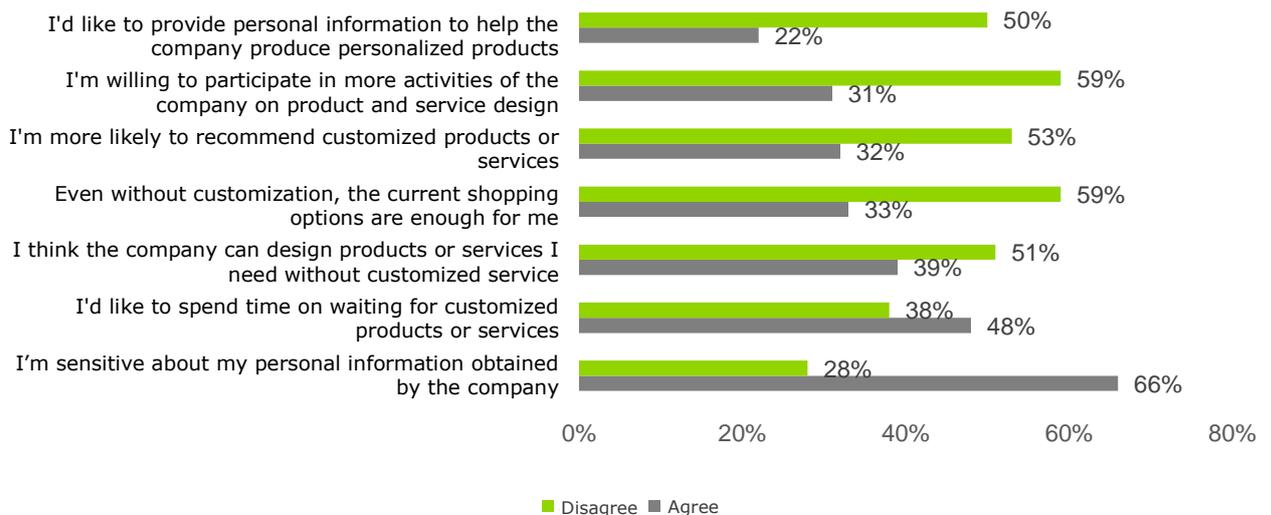
Undoubtedly, personalization and customization will be the main trends of consumption in the future. Customers' open views on personalization illustrated below will make customers participate in design and manufacturing process of products more actively.

Figure 20: Why customers like customization?



Source: The Deloitte Consumer Review

Figure 21: Consumers' attitudes toward customization



Source: The Deloitte Consumer Review

Based on Deloitte’s survey results, one third of consumers who are interested in customization think that customization has not yet met their expectation, and over half of them believe that enterprises can’t produce goods they want to buy without customized process.

In addition, mobile payment gradually becomes dominant in the payment part of shopping. Statistics from the People’s Bank of China (PBOC) show that in recent years the amount of digital payment transaction doubles every year. The amount of mobile payment transaction increased by over 200 percent year-on-year in 2015. As the Federal Reserve System (the Fed) estimates, the volume of global mobile payment transaction will reach \$616.9 billion in 2016, while this number was only \$60 billion in 2010. And a report recently released by Strategy Analytics estimates that the total number of mobile user will hit 5 billion globally in 2016, among which over 1 billion are mobile payment users, equivalent to 20 percent of the total.

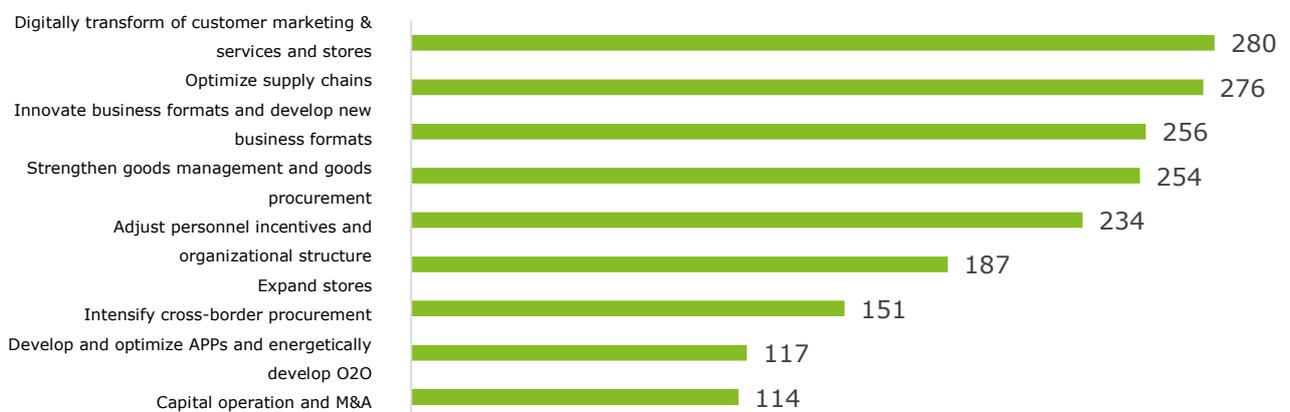
Driven by bank account-free payment and social payment, the turnover of mobile payment in 2022 will be over twice of 2016, increasing from \$200 billion in 2016 to \$571 billion by the end of 2022. About 75 percent of mobile users come from the Asia-Pacific, Middle East and Africa. Deloitte estimates that the number of users who make payments via mobile electronic devices is expected to increase by 150 percent to 50 million in 2016. Mobile phones break the boundary between traditional retailing and e-commerce. Consumers browse personalized information, enhance interactive consumption experience, and make payments via mobile devices by integrating mobile devices with physical stores. This trend is unprecedentedly strong in China, as China owns the largest population of mobile phone users worldwide, and Chinese users make more interactions with retailers in digital ways such as mobile payment, e-coupons and QR codes.

Young generation are no longer satisfied to place orders via mobile phones, they also hope to receive goods more quickly. Instant gratification has become a feature of this generation of users. Some research show that 63 percent of post-80s and 90s are very interested in same-day delivery, even half of them are willing to pay premiums for it. Therefore, enterprises can provide instant services such as same-day delivery, online purchase and offline pickup, etc., to keep pace with the consumption habits of the young generation and improve user experience. Finally, in terms of aftersales service, enterprises can simplify procedures and optimize service experience through a series of aftersales services provided directly on APP including goods exchanging and purchase feedbacks.

III. The Development Path of Retail Industry

Traditional retail industry has staked out its turf for long and achieved high-speed expansion by virtue of the macro-economic dividends over the past decade. Under the current background of Omni-channel, traditional retailers are undoubtedly facing the pressure of expanding online and offline sales channels as well as the challenges of enhancing service quality and customer loyalty. Compared with e-commerce enterprises, traditional retailing enterprises shall leverage their edges in building logistics distribution system and fostering vivid and intuitive customer experience, to make up their insufficient experience in Internet operation and achieve differentiated competition. By establishing Omni-channels, integrating online and offline marketing channels, and digging and guiding customer demands, retailing enterprises can not only enhance customers' brand awareness and loyalty, but also improve consumption experience for them. This chapter will focus on the way to develop Omni-channel retailing in marketing design, procurement and aftersales parts.

Figure 22: Retailers' next countermeasures



Source: CCFA Research on the Development of Retail Industry

Note: A survey on member enterprises of Leaders Summit conducted by CCFA, numbers in the table show the priorities of given enterprise strategies.

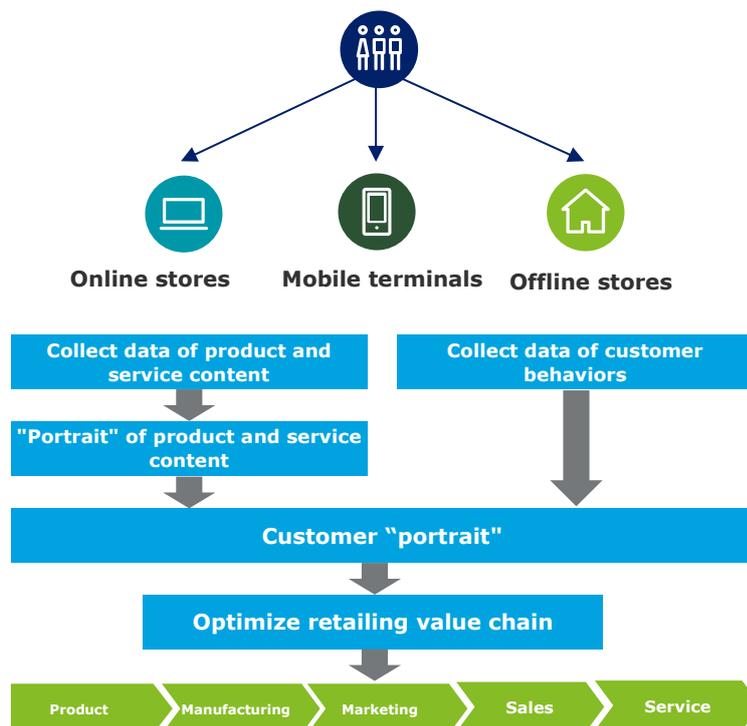
1. Interactive marketing design: online and offline integration

For the physical retailing with continuous cooling down, developing Omni-channel retailing may help it regain growth impetus; and online retailing enterprises also deem Omni-channel retailing as an effective solution to development bottlenecks such as the last-mile service limitation. Omni-channel retailing is not a progressive adjustment to retail industry, but a strategic restructuring of marketing channels, which initiates revolutionary transformations including data-driven shopping scenarios, category allocation, logistics warehousing and service experience, and requires close coordination in strategy, operation and specific implementation.

1.1 Precision marketing

Under the background of Omni-channel retailing, we shall begin with collecting data from different selling channels, including online stores, mobile terminals and offline stores; then label products purchased by consumers to form product portraits; and finally generate customer portraits by combining data of customer behaviors. Consequently enterprises can predict customer demand in real time and also know consumer preference for long-term monitoring, which making breakthrough contributions to sales, services and marketing for enterprises.

Figure 23: Consumer portrait collection and application



Precision marketing with customer portraits can avoid the blindness of traditional marketing models as which target all consumers. These data can be used to make more precise and accurate customer segmentation and develop differentiated marketing plans for different customer groups. Enterprises can implement cross-marketing based on customers' purchasing history, preferences, locations, etc. to promote cross-selling, e.g. to find various needs of customers, provide diversified products or services to cater to customers, and improve customer loyalty via client relationship management. Besides, enterprises can also facilitate the integration of marketing channels, apply big data to monitor Omni-channel operation in real time, innovate channel marketing models, connect online and offline data flows, offer online-and-offline seamless services, and improve integrated shopping experience for customers.

1.2 Deepen the layout of online channels

With the popularity of digital channels and mobile terminals, retail enterprises must deepen the layout of multiple touch points and channels, to realize interactive, personalized and socialized marketing.

Socialized: Socialized advertising is not simply another platform of promotion, but a progressive marketing process. Enterprises need to adopt new, interactive and personalized contents and forms when making promotion on these platforms.

Interactive: Online marketing shall transform from traditional one-way information transmission to new forms of dialogue. Retailing enterprises can use mobile applications, websites, and interaction devices placed in stores or public places to establish end-to-end interaction models with consumers, make communication with customers, better understand and dig customer demands and make adjustments in response to changes in their demands accordingly, so as to better serve customers.

Personalized: Enterprises shall optimize marketing platform design and give customers more discretion to customize information they are interested in and set personalized receiving mode, time and frequency, etc. In addition, they also shall grasp the initiative of marketing, dig into customers' personalized demands, and guide customers and persuade them to buy more.

1.3 Digitalized offline stores

Digitalized channels break up the boundary between time and space, so customers are able to get goods information more quickly via the Internet and mobile terminals. With goods information obtained online, consumers spend less time in offline stores. Increasing cost has brought offline outlet operators huge pressure. And information exchanges slows down because of information imbalance between the managing headquarters and stores and the influence of established process. To build digitalized stores, enterprises can classify customers with "labels" and build a customer database. Using their trust on brands originating from the experience in physical stores, enterprises can delve deeper into their needs, establish a customer-centered customer digital operation system, provide customers with precise services, and sell goods with the help of customers' publicity and recommendation. And meanwhile, the stores of traditional retail enterprises shall shift their role as "selling platform" to "experience transmission" and identify the breakthrough of transformation. Enterprises can also promote seamless experience by adopting cross-screen interaction, technology innovation and building up life experience stores to achieve sustainable development.

At information end, in terms of digital purchasing service, mobile points of sales (POS) are integrated with e-commerce, socialized customer relationship and inventory management system through instore sensors, wireless network and electronic price tags. For consumers, they can better learn inventory, price changes and sales promotion through real-time shopping information provided by store digitalization. For enterprises, frequent price changes required large quantities of human resources and frequent mistakes by human works at the time of promotion in the past, while the electronic price tags controlled by computer systems can not only save labor costs, and also guarantee accuracy. Moreover, instore sensors or wireless networks provided are able to record customers' intended targets, time and routes, customer volumes and final purchase to help enterprises understand customers' needs more precisely, so as to offer a basis for enterprises to adjust goods arrangement and locations of promotion ads regularly.

At experience end, retailers can integrate new technologies into shopping to provide new personalized consumption experience for customers. Not as main sales locations in the past, stores will be marketing oriented in the future and the places for customer to experience, rather than previous goods show rooms.

At shopping end, mobile payment is the main direction to expand diversified payment. Mobile payment by Apple pay, Alipay and WeChat payment provides post-80s and 90s generations, the main consumption groups, with convenience to make the younger consumers more willing to consume at stores. From the perspective of enterprises, mobile payment facilitates enterprises to achieve more scientific data-driven operation and helps them in customer management. Merchants can implement data-drive operation in accordance with behaviors and shopping preferences, geographical locations and credit ratings of different groups.

At service end, consumers are no longer satisfied to place orders via mobile phones, they also hope to receive goods more quickly. As instant gratification has become the feature of this generation of users, enterprises should provide quick and instant delivery accordingly. Customers need not to bring goods back by themselves, because goods will be delivered home after transactions complete. With such models enterprises leverage the predominance of shopping experience of physical stores while other channels lack, and offer convenience by online order and home delivery. Furthermore, physical stores can act as instant delivery centers, that is, enterprises' offline physical stores can serve as logistics delivery centers to fulfill online orders after customers purchase and pay goods on the Internet. This model has the following advantages: firstly, reduce the delivery time of all online orders; secondly, online and offline inventory sharing addresses the trust level of quality of online goods. For example, Walmart uses its widely distributed physical stores as delivery centers to fulfill online orders, and these stores have large amounts of inventories and delivery trunks for quick delivery to meet consumers' requirements for timely receiving of goods they purchase online.

In terms of **aftersales service**, enterprises can simplify procedures and optimize service experience through a series of aftersales services provided directly on APP including goods exchanging and purchase feedbacks. The feedbacks collected from activities in aftersales service can be proactively used for the design and development of future products. Therefore, understanding customers' needs and interpreting accurately how they connect and communicate, and how to find products and their preferences and expectations will become a component of new core competitiveness.

2. Procurement: Deep synergy between internal and external supply chains

Now the whole retail market has entered into a stage where the inventory market sees elimination and integration with fast growing segments, therefore enterprises must learn structural consumption changes and focus on new consumption habits and growing areas resulted from new business environments. Only retailers who can firmly control upstream resources and keep deepening the reform of supply chain management have the opportunity to win out.

2.1 Deep synergy between internal and external supply chains

Improving the efficiency of supply chain is an essential path for modern retailers to create competitive edges and explore new profit sources, which requires retailers' supply chain management centers to develop an overall planning of their main businesses, adopt information-based integrated management and achieve real-time sharing of order data to lower inventories of different units in the entire chain, accelerate inventory cycles and minimize overall costs.

Supply chain is classified as internal and external supply chains. Internal supply chain refers to enterprises' supply and demand network composed of departments of procurement, production, warehousing and sales involved during internal product manufacturing and distribution. External supply chain means a supply and demand network composed of suppliers of raw materials, manufacturers, storage and transportation parties, retailers and end consumers involved during external enterprise-related product manufacturing and distribution. Internal and external supply chains build up a supply chain from raw materials to product to consumers. Now many retailers establish their supply chain management centers specialized in optimizing supply chains.

"Bullwhip effect" is pervasive in the supply chain, i.e. when information in the supply chain is communicated to original suppliers from end consumers, the failure to share information effectively leads to information distortion and demand information magnification and fluctuation, and ultimately results in the imbalance of supply chain, suppliers' overstock and retailers' stockout. Thus, if distributors fail to coordinate with most suppliers or only focus on procurement instead of product manufacturing of suppliers, they are likely to encounter resulting issues including low procurement efficiency and stockout. Instead, if they can share information about planning and prediction with suppliers, the coordination in the supply chain will be further extended to the production stage for mutual benefits.

JD.com has explored actively the deep synergy of internal and external supply chains. In September 2015, JD.com and Midea announced one more achievement of their strategic cooperation – the deep synergy of Electronic Data Interchange (EDI) and completing deep connection of sales plans, order estimation and order replenishment. Now JD.com and Midea have initially realized production identification by sales and zero inventory sales. Suppliers share inventory data with JD.com, then the system drives automatically the procurement from suppliers at the time of customer's order placing. Later the order delivery is fulfilled after the warehousing of goods. Such business model of production identification by sales can shorten inventory turnover significantly and increase in-stock rate and sales revenue.

As the best practice of supply chain management in manufacturing and logistics, EDI has been widely adopted in European and American enterprises. RosettaNet standard, a globally leading e-commerce standard system in high-tech areas, has been applied in e-commerce

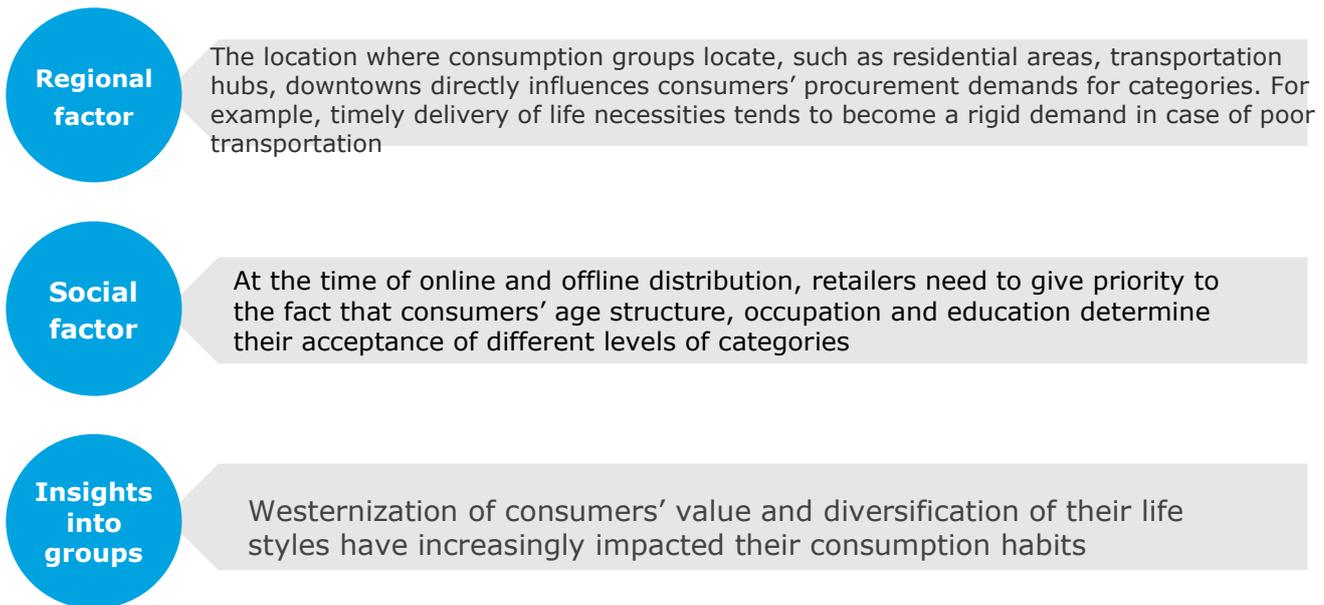
high-tech enterprises across the world. But in China, EDI is still in its infancy. The exploration of JD.com and Midea sets an example for domestic e-commerce and logistics, and is expected to establish Chinese standard and best practices from practices, and push forwards the internationalization and modern development of China’s e-commerce and logistics.

2.2 Strengthen category management for precision procurement⁶

Centered on shoppers with category as its business management unit, category management satisfies shoppers’ demands through effective cooperation between retailers and manufacturers based on data to create new customer value. With the alliance model widely used in the retail industry, traditional retailers have problems in overall operation and basic data analysis with limited abilities to control goods, whereas online channels take control of the follow-up of the whole sales process and customer behaviors clearly.

“Internet plus” at category management level enables retailers to realize that category management needs to be established on the basis of coordination activities on the top of thorough insights into the retail environment and consumers’ purchase habits, not just simple product management.

Figure 24: Three determinants of category allocation relationship



Source: Deloitte consolidation and analysis

These synthetic factors determine the allocation relationship of all categories, triggering consumers’ shopping desires at every key decision points. Bilateral integration of online and offline activities, a current feature of business format of the retail industry, raises expectations on category management. Enterprises can conduct a quantitative assessment in line with own characteristics from the following perspectives.

Develop relevant quantitative index: The long-standing category management index of the business format of traditional retail industry have been tried and tested, mainly including

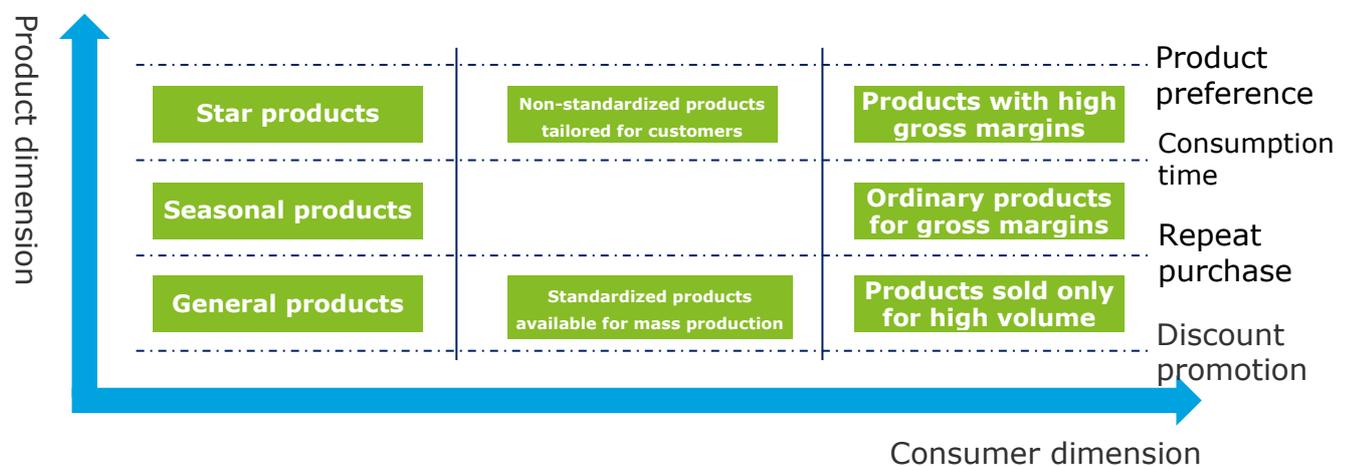
⁶Precision procurement: The quality of goods procured and procurement cost control are optimized.

per customer transaction, sales volume, sales revenue, sales structure proportion, integrated gross, gross profit contribution, etc.

The category index of e-retail, by contrast, is still expanding and improving, with commodity visitors and page view, visitor conversion rate, order payment rate, cart conversion rate, order amount interval, interval of commodity number of one order as its common index at the present development stage. The index effectiveness and the business judgement behind are adjusted in accordance with their industries and enterprises' own development stages.

Pinpoint the potential and roles of categories: It means a comprehensive appraisal of all categories based on specific metrics through scientific approaches.

Figure 25: Dimension segments of category considerations



Source: Deloitte consolidation and analysis

The potential assessment and role definition of categories depend on cross analysis at different levels. As shown in the figure above, classify categories based on demand frequency, standardization and profit contribution, observe and follow up the dynamic development of categories in a timely manner. Along with the tracking of consumers' consumption behaviors throughout their consumption journey, high potential commodity categories are distributed precisely into relevant customer bases.

The implementation of category strategies and their market effects are inevitably influenced by multiple factors.

- Firstly, the traditional industry experience will limit enterprises' open thinking for Omni-channel retailing, bringing pain for transformation of concept;
- Secondly, how to integrate and mutually complement online and offline channels and avoid vicious competition is still an unsolved issue for many traditional retailing enterprises;
- Thirdly, the implementation of category strategies requires effective coordination with all parties in the value chain, and enterprises need to know how to allocate profits reasonably on the premise of not losing control;
- Fourthly, as the implementation at an operational level involves various key points, its complexity and risk should not be overlooked.

2.3 Collaborate proactive in the supply chain to strengthen upstream resources

It is known that the advantage of physical retailers is in-depth cooperation with suppliers for years. Retailers can enhance the control of upstream commodity resources to achieve service offering, collaboration, merger and absorption of various channels in the future. Especially now that consumers of the new generation have growing demands for quality and brand, retailers will seize more opportunities in the competition if they can improve their capabilities to control overseas commodities by way of cooperation or M&As. For example, in recent years Yonghui Superstores has cooperated with Shanghai Vegetables Group, Shanghai Dongzhan International Trade Co., Ltd. who focuses on foreign (import and export) businesses and some other upstream companies through equity participation or shares holding. It is continue to seek opportunities to acquire commodity producers. Besides, its supply chain of global procurement has led the domestic superstore industry after introducing Dairy Farm, a strategic investor; and in 2015 Yonghui signed a strategic cooperation agreement with JD.com to establish a joint procurement mechanism, connecting online and offline activities. All these indicate that Yonghui has begun seeking new space for development backward from the integration of upstream supply chain.

Better Life, another retailer, has established 6 overseas companies respectively in Hong Kong, Japan, U.S., Australia, New Zealand and Germany to initiate business transactions with dozens of countries in North America, Europe, Oceania and Asia. It has also built logistics strategic partnership with Chongqing-Sinkiang-Europe International Railway and Hunan-Europe Railway and set up logistics warehousing in Guangzhou, Ningbo, Zhengzhou bonded warehouse, and Hong Kong and other countries including Japan. Finally its Omni-channel global procurement layout is established basically. In fact, these channels can not only provide more abundant commodity procurement resources for its Yuhou.com, also make a material difference for the commodity differentiation of its offline stores.

Such explorations in the supply chain by these enterprises will undoubtedly play an essential role in the innovation, category management and differentiated operation of future stores.

3. Aftersales service: Develop actively to improve the last-mile service

As the last step of delivery for customers, i.e. the process of delivery from delivery center to users, the "last-mile service" is more challenging to control cost.

3.1 Service model changing into being customer experience centered

In a meager profit era of the retail industry, take chain supermarkets as an example, their logistics costs account for about 20 percent of total costs. It is imperative to strengthen control of logistics and lower operational cost in such an increasingly competitive market. The logistics models of retailing enterprises are broadly divided into four categories: self-built logistics delivery center, direct delivery by suppliers, jointly-built delivery centers with suppliers and commissioning professional logistics service providers.

Local retailers prefer the first one among the four models, which is generally centered on proprietary logistics by many methods including outsourcing and supplier delivery. The complementary logistics service and point of sales are two sections composed of retailers' operation as the efficient logistics service needs a certain number of points of sales which in turn require quality logistics service to enhance their market competitiveness. At the time of home delivery business by retailers themselves, they need to build community warehousing and distribution locations in city terminals with each equipped with delivery and service teams. Besides, they should establish their own customer management platforms to provide supermarket and product promotional information. For example, Tianhong Shopping Mall in Shenzhen launched its "Tianhong home delivery" service in the

middle of August 2015, i.e., customers place orders via an APP named "Rainbow scarf" (彩虹领巾), a localized accommodation platform, and receive their ordered goods within 2 hours through home delivery from nearest stores provided there are Tianhong stores in the 5 kilometers around. In terms of delivery in the supply chain, every store is equipped with delivery staff responsible for daily delivery to complete delivery by acquiring goods from the store's inventory quickly upon receiving users' orders. While Yonghui Superstores in Shanghai opens stores for members targeting on medium and high end consumption groups and combines online marketing and order with offline shopping, self-pickup with delivery by electronic price tags to set up a consumption closed loop.

Moreover, many last-mile service platforms have emerged, intending to explore community business value. Various express delivery platforms, such as Jingdong Daojia, Jimaisong (即买送), Lifec, Shequ001, 19e and Medicinepower, integrate consumption groups in communities in a large scale, with an attempt to reshape the business ecosystem in communities. And in the future, the model of "self-operation + outsourcing" may be more suitable for most medium and small retailers. Outsourcing is a tendency for retailers to optimize supply chains in the long run. If third party logistics enterprises can gain shares from retailers and build strategic partnership, this tendency may be accelerated and more likely to help establish a relatively stable outsourcing relationship.

3.2 Proactive exploration of the last-mile service

Big data facilitate the last-mile service to achieve rapid delivery. Enterprises can perform data analysis of customers' delivery records by collecting and analyzing big data to acquire customers' next potential purchasing targets. Retailers can ask manufacturers to directly dispatch goods to their logistics warehouses and then deliver goods rapidly from sellers to buyers upon consumers' order placing. Now many online retailers have succeeded in direct delivery, such as Tmall, JD.com, Vip.com and Dangdang.com, but physical retailing is still needed to improve in this aspect.

Though the development stage and industry features of China's logistics industry vary a lot from logistics of other countries across the globe, various examples of international solutions to the last-mile service are available for us to draw lessons. Through cross-industry cooperation, enterprises can start with customer experience improvement, and develop delivery into an important point of the seamless connection of customer experience, enabling customers to pick up goods more conveniently and flexibly, such as the project jointly developed by GAP and Virgin Hotel for delivering goods users buy online directly to their rooms in the hotel. The following solutions can be a useful attempt but requires to take China's reality into account.

Table 4: Solutions to the last-mile service

Company name	Solution details
Gap & Virgin hotels	A project jointly developed by GAP and Virgin Hotel for delivering goods users buy online directly to their rooms in the hotel.
Amazon	Amazon has tested bicycle express service for Prime Now since December 2014, which promises to deliver goods to users from nearby merchants within one hour. Amazon has launched bicycle express service in Manhattan since February 2015.
Amazon	An APP named Amazon Student provides a 6-month free delivery service for undergraduates to make it easy for the transactions among them. This program enables students to pick up and return goods by themselves through intelligent cabinets.
Amazon	As reported by several American tech news sites including CNET, Amazon will launch "TreasureTruck" on streets in Seattle from 7 a.m. of this Saturday. Users can purchase popular goods for promotion on these trucks by mobile phones on the spot and pick up goods there. Most of such popular goods are daily necessities Amazon use for "group purchase promotion" on these trucks. Amazon users can check the catalogue of the day and goods' specific locations on the truck via mobile phones.
Peapod	As a successful company selling groceries (including fresh products) through e-commerce, Peapod keeps expanding the model of "online shopping with offline pickup" and adds 89 more pickup locations to 209 in total.

Source: News reports and companies' official websites

3.3 Attach importance to the construction of reverse logistics channels

Reverse logistics refers to logistics from customers to enterprises due to defect product recall and sales return. It can be triggered by many factors such as sales return for changing seasons and maintenance, inventory backlog, and manufacturing scrap, accounting for about 5 percent of the total sales of enterprises. According to the estimates based on researches of professional organizations, Chinese reverse logistics market values at over RMB1 trillion. Sales return during online shopping and from retailing stores to suppliers due to changing seasons or packing problems indicate huge market space of reverse logistics, the concept of which is still at the introduction phase in China so that many enterprises have not realized its monitoring value for product life cycle and its guiding role in the whole sales process.

Reverse logistics has the following characteristics: 1. great uncertainty due to the difficulty in predicting location, time, quality and quantity of logistics; 2. complex and diverse processing systems and modes; 3. technical particularities; 4. relatively high cost.

Reverse logistics management model means building reverse logistics systems within the supply chain network. Successful supply chain management can significantly enhance enterprises' core competitiveness in the intense market competition. At any time, enterprises must rely on each node in the supply chain for survival and development, including upstream suppliers and downstream consumers, listen to the consumers, and satisfy their needs for sales return. Reverse logistics focuses on solving the following problems: 1. enable regular movement of the location of goods or for pickup/returning; 2. car sharing and container loading of bulk cargo; 3. optimized truck-loading schemes and transportation routes precisely calculated rapidly through the information system available; 4. minimizing the logistics cost.

Furthermore, for sake of economic effectiveness, retailers can also choose to entrust third party logistics companies responsible for reverse logistics management. At present, S.F. Express has made use of its advantages in storage, express network layout, and terminal distribution to launch one-stop aftersales service platform of "warehousing + distribution + aftersales service" for electronic products, which can make consumers enjoy high-quality aftersales services for electronic products without leaving home through the model of "mail-in repair" of reverse logistics in a process of pick-up, maintenance and return. Take 3C products for example, their product lifetime is often different from product cycle (replacement cycle). Brand owners can seldom estimate accurately about the next round of sales opportunities, but product cycle can be tracked through aftersales services, callback, etc. After effectively tracking product cycle, S.F. Express can also assist brand owners to provide recycling and old for new services. This was indeed a good attempt that S.F. Express fully dug the value of warehousing logistics with its advantages.

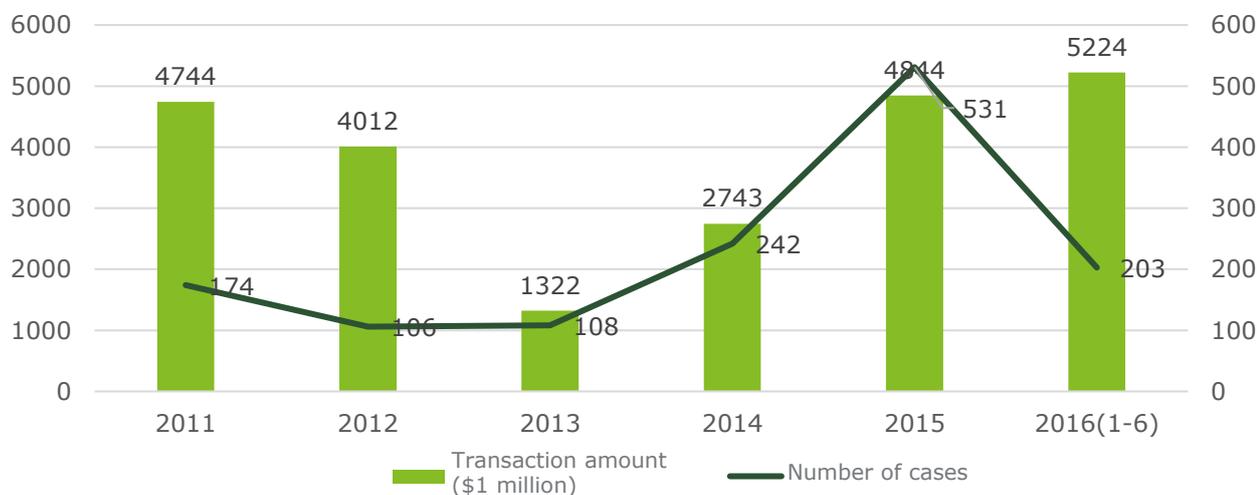
IV. Capital Integration to Boost Enterprise Development

1. VC/PE investment boosts the development of innovative business

1.1 Financing of e-commerce industry increases substantially with the influence of "Internet Plus"

"Internet Plus" initiative has greatly promoted the development of e-commerce industry, bringing a new round of investment boom, and made more institutions willing to invest more in this industry, which led the financing scale to a new height. According to the statistics from ChinaVenture, the financing amount of e-commerce industry reached \$4.84 billion in 2015, and \$5.22 billion in the first half of 2016, with a growth of 104 percent over the same period. In the next few years, the aggregate investment in e-commerce industry is expected to remain high under the conditions of Internet consumption growth and national favorable policies. However, in terms of the number of investment cases, only 203 cases took place in the first half of 2016, less than 232 cases in the same period of 2015, which indicated that capital holders and entrepreneurs tend to be more rational, and enterprises that have completed financing are more cautious about development strategies.

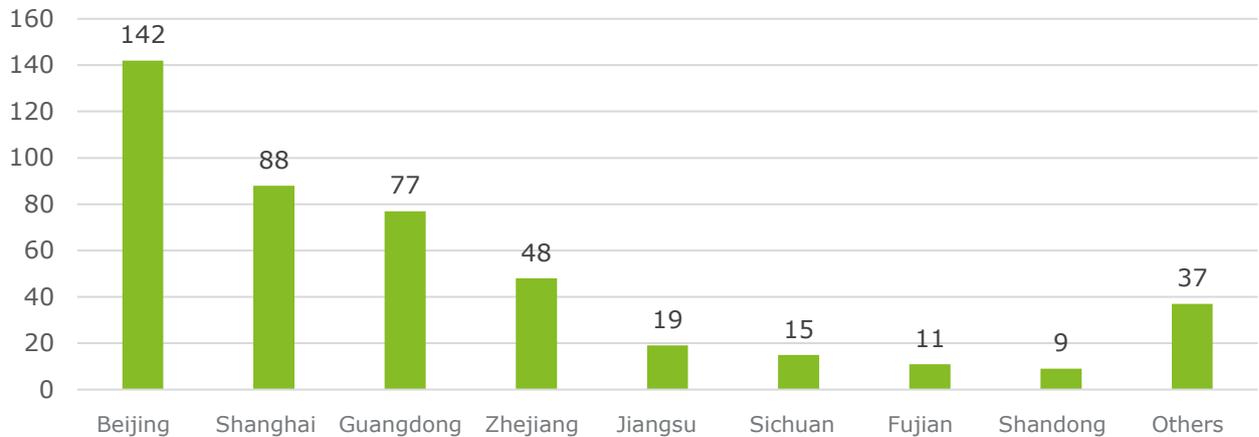
Figure 26: PE/VC investment in Chinese e-commerce industry from 2011 to 2016



Source: CVsource, Deloitte Research

In terms of geographical distribution, the investment in e-commerce industry highly concentrated in first-tier cities such as Beijing, Shanghai and Guangzhou, and costal developed regions like Jiangsu and Zhejiang provinces in 2015. The number of enterprises for e-commerce financing in Beijing, Shanghai and Guangzhou accounted for 31.8 percent, 19.7 percent and 17.3 percent of all e-commerce financing enterprises respectively in 2015. And meanwhile, quite a few central and western provinces have also attracted a certain amount of investment, which reflected that the e-commerce industry is experiencing rapid development in central and western regions.

Figure 27: Geographical distribution of enterprises financing via PE/VC in 2015



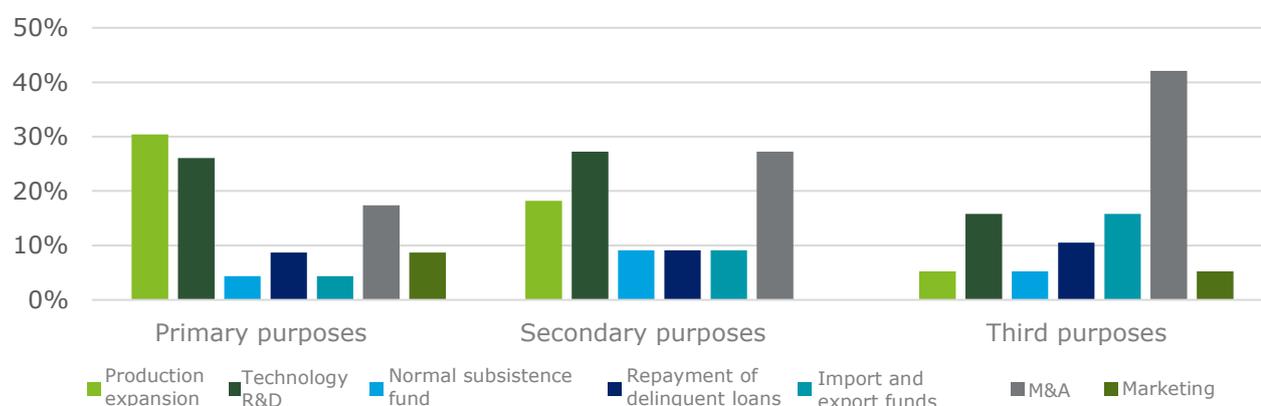
Source: CVsource, Deloitte Research

1.2 Retailing enterprises have increasing demands for financing

According to the statistics from CCFA⁷, 58.6 percent of traditional retailing enterprises have financing plans in the next 18 months, among which enterprises planning to raise over RMB100 million account for 44.8 percent, which means that Chinese traditional retailing enterprises need more capital input to extend their influence and gain competitive advantages due to the aggravation of competition. Chinese retailing enterprises mainly use raised capital for production expansion, technology R&D, and M&A. Retailing enterprises need a large amount of funds for a series of expansion activities including new locations, M&A and reorganization, thus generating a certain demand for financing. Vigorous development of e-commerce in recent years has made online retail take up a large market share. Traditional retailing enterprises have to compete with online retailers, and also develop online business actively and seek for transformation. Despite the advantages in offline channels and supply chains, traditional retailing enterprises still need to face some significant problems when carrying out online retail business, such as lagging behind in integration technologies for logistics and consumer information, and lacking marketing methods targeted at particular consumers, which requires traditional retailing enterprises to invest a large amount of funds in technology upgrading in the process of transformation. Accordingly, transformation will bring great financial pressure to enterprises, so financing has become an essential stage for the transformation of traditional retailing enterprises.

⁷Survey on Basic Situation of China Top 100 Online Retail Enterprises in 2016 carried out by Deloitte and CCFA in 2016

Figure 28: Purposes of financing by Chinese retail enterprises in 2016



Source: Deloitte Research

1.3 Fresh food e-commerce and cross-border e-commerce become new hot spots for investment

Fresh food e-commerce enterprises are heavily dependent on supply chains. The transaction scale of domestic fresh food e-commerce amounted to RMB54.2 billion in 2015 with an increase of 87 percent, 53.1 percent higher than the growth rate of online retail sales, and is expected to reach RMB91.4 billion in 2016 and RMB150 billion in 2017, representing a broad prospect. According to public data, 25 fresh food e-commerce enterprises have received capital investment in 2016, but meanwhile, dozens of fresh food e-commerce enterprises including FarmGirl, Yocai and Kakaxian (卡卡鲜) closed down, suggesting a highly competitive industry where only competitive enterprises can survive. Due to the disadvantages of high loss and low standardization, fresh food e-commerce has extremely high requirements for supply chains, and great demands for capital.

Investors preferred brands with relatively mature business models in 2016. For example, Yiguo (易果生鲜) and Fruit Day (天天果园) are building their own delivery teams, representing "deep" barriers; Zdongpin (找冻品网), Songxiaocai (宋小菜), and Urfresh (U掌柜) joined in this industry via fresh food supply chains, representing "deep" entry points; Andvip (俺的农场) and Okliang (良食网) have fresh food bases, representing "deep" industry chains. Benlai (本来生活) also indicated to the reform of O2O model this year, and its three service lines (Benlai (本来生活) with B2C model, Benlaijishi (本来集市) and Benlai Fruitmart (本来果坊) with P2B model, and Jufangbian (本来便利) with O2O model, renamed as JSD (极速达)) have been deeply integrated with offline channels. The year 2016 is of great importance for strategic layout of domestic fresh food market. Traditional shops and supermarkets begin to make efforts, and fresh food e-commerce enterprises with mature supply chain systems will be easily preferred by investors.

Table 5: Financing of fresh food e-commerce enterprises in the first half of 2016

Brand name	Round	Time	Financing amount	Investor
Andvip (俺的农场)	A	Jan.	Undisclosed	Beijing Huashan Capital
Variety Market (花样菜场)	Angel	Jan.	RMB3 million	Tisiwi

Brand name	Round	Time	Financing amount	Investor
Xiancailaile (鲜菜来了)	Angel	Jan.	RMB1 million	Undisclosed
Songxiaocai (宋小菜)	A	Mar.	RMB104 million	IDG Capital, Vision Capital
Zdongpin (找冻品网)	Seed	Jan.	RMB1 million	Undisclosed
Nongjiaxiongdi (农家兄弟)	A	Feb.	RMB10 million	Green Pine Capital
Huacaizhaoyu (华采找鱼)	Angel	Feb.	RMB4.5 million	Shangshi Fund, Dark Horse Ventures
Udongpin (全球优冻品)	Angel	Feb.	Millions of RMB	Mentors of Chuangke18 (金融创科营)
Hemaxiansheng (盒马鲜生)	A	Mar.	\$150 million	Alibaba
Laisanjin (来三斤)	Seed	Mar.	RMB3 million	Undisclosed
Fresh Life (鲜冻生活)	A+	Mar.	Tens of millions of RMB	He Zhi Capital, CRPE (长润资产)
FreshFresh (两鲜网)	A	Mar.	\$20 million	Tripod Capital, MXCF (民享财富)
Yiguo (易果生鲜)	C	Mar.	Undisclosed	KKR, Alibaba
Haishangxian (海上鲜)	Undisclosed	Mar.	Tens of millions of RMB	BDStar Navigation
Urfresh (U 掌柜)	B	Mar.	\$30 million	Fengshion Capital, Capital Today
Fruit Day (天天果园)	D	Mar.	Over \$100 million	Undisclosed
Okliang (良食网)	Strategic investment	Mar.	Tens of millions of RMB	Womai (中粮我买网)
FreshMarket (食行生鲜)	C	Apr.	RMB249 million	Addor Capital
Missfresh (每日优鲜)	B+	Apr.	RMB230 million	Grand Flight Investment, China Growth Capital
Songxiaocai (宋小菜)	A+	May	RMB85.15 million	Yintai Investment, Matrix Partners China, IDG China
Funxin (饭心)	A	May	Tens of millions of RMB	FireCapital
Benlai (本来生活)	C/C+	May	\$117 million	CURA Investment, Shanghai Nandu (上海南都), ChinaEquity, Joyoung Co., Ltd.
Xiababy (虾 baby)	Pre-A	May	Undisclosed	Tsinghua SEM X-elerator
Xianda365 (优食管家)	B	May	Tens of millions of RMB	Undisclosed
Meicai (美菜网)	D	Jun.	\$200 million	Undisclosed
Myzinong (滋农春天)	Seed	Jun.	RMB3 million	Tianfu Ventures (天府创投)

Source: ITjuzi (IT 桔子), Deloitte Research

Venture capitalists gradually tend to be cautious when investing in cross-border e-commerce. As favorable policies were issued and domestic consumers gradually deepened

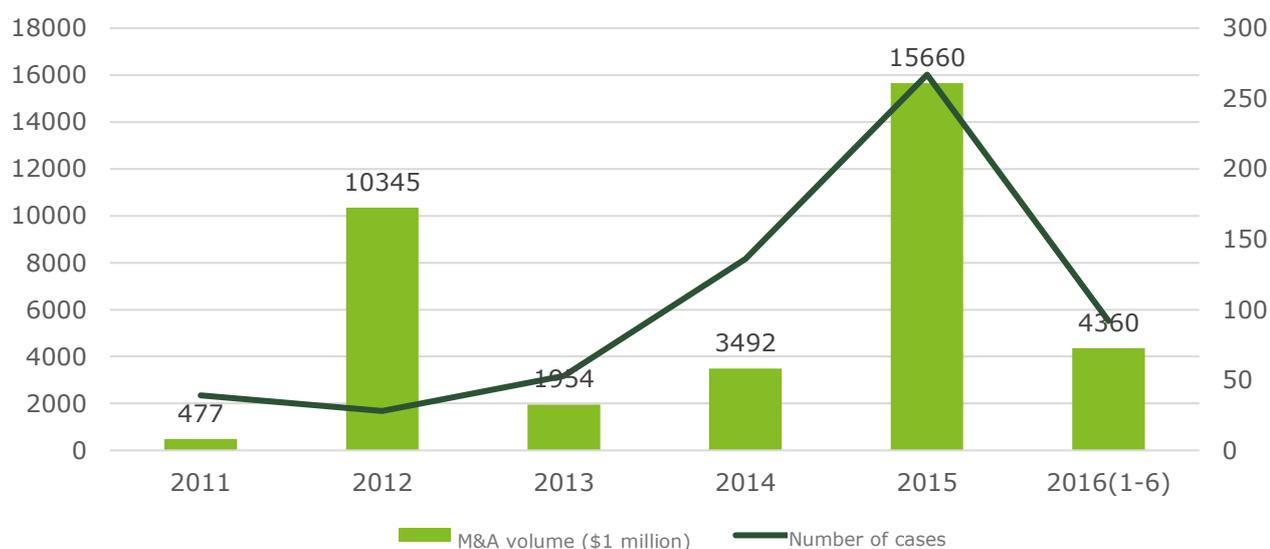
the understanding of cross-border online shopping in 2014 and 2015, cross-border e-commerce turned into a new highland for e-commerce financing due to its broad prospects. Dozens of financing events in the field of cross-border e-commerce took place from 2015 to March 2016. Mia (蜜芽) completed D-round financing of \$150 million, and Beibei (贝贝网) and Ymatou (洋码头) raised \$100 million respectively, which indicated that the industry continued to heat up. In 2015, three kinds of competition landscapes took shape in the field of cross-border e-commerce, including leading e-commerce enterprises like Alibaba and Amazon, cross-border platforms like Beibei (贝贝网), Ymatou (洋码头), and Xiaohongshu (小红书), and express enterprises that expand cross-border business like S.F. Express and YUNDA. Investors in the field of cross-border e-commerce were divided into two types – traditional leading e-commerce enterprises like Tmall and JD.com that took advantage of investment to expand cross-border business, and venture capitals like ZhenFund, Sequoia Capital and Morningside Venture Capital that focused on market profit margins. However, increased investment directly led to intensifying competition. Cross-border e-commerce is undoubtedly moving towards the Red Ocean stage, and the entry thresholds have been raised greatly, so small and medium entrepreneurs must rapidly build capabilities to compete with leading enterprises, and need to invest more and more human and material resources as well as trial-and-error costs so that investors will tend to be more cautious.

2. M&A facilitates the whole industry chain layout

2.1 M&A market experiences great changes, and e-commerce enterprises accelerate the pace of going out

615 M&A activities took place in Chinese e-commerce industry from 2011 to April 2016 with the disclosed M&A transaction value amounting to about \$36.3 billion. M&A volume reached peak in 2012 and 2015. Alibaba Group repurchased 21 percent share of Yahoo at \$7.1 billion, which led to the large transaction value in 2012. And M&A volume took a great leap forward in 2015 to reach \$14.74 billion, over 4.2 times more than that in 2014. Thus it can be seen that with the flourish of e-commerce, M&A number and volume have shown scale expansion.

Figure 29: M&A number and volume of Chinese e-commerce enterprises from 2011 to June 2016



Source: CVsource, Deloitte Research

Outbound M&A has developed rapidly in recent years. Chinese e-commerce enterprises carried out 13 outbound M&As in 2015, accounting for 6.91 percent of the total number of M&A cases that year to reach the highest in the last ten years, which showed that Chinese e-commerce enterprises are actively "going out" to expand overseas markets. As the "Belt and Road" turned into the national strategy, the construction of supporting infrastructure and favorable policies for cross-border e-commerce provide new opportunities for outbound M&As. Moreover, Chinese e-commerce enterprises can take advantage of outbound M&As to enter into overseas markets and speed up the process of internationalized layout. For example, Baidu rapidly took 55 percent of Brazilian market from 35 percent in half a year by acquiring Brazil's group-buying website Pexie Urbano. The number of mobile users and revenue at mobile terminal continued to increase, helping it beat the local group-buying tycoon Groupon to become Brazil's largest group-buying website. And Alibaba entered American market to build e-commerce empire and compete with international leading e-commerce enterprise Amazon through frequent M&As. Furthermore, Semir, one of traditional clothing retailing enterprises, completed its transformation and upgrading by acquiring Korean e-commerce enterprise ISE in 2015, exported products to other countries and opened up broader markets.

2.2 Rapid completion of industry chain layout through M&A

More and more crowded market led to intensifying competition among leading e-commerce enterprises represented by Alibaba and JD.com, and narrower space for profits and growth. Under this circumstance, leading e-commerce enterprises can make a layout in new markets and new business fields through mergers and acquisitions, such as the combination of Alibaba and Suning, JD.com and Tencent occurred in 2015, and the merger between Mogujie (蘑菇街) and Meilishuo (美丽说) at the beginning of 2016, to turn competitors into partners. Such integration is beneficial for eliminating competitors and achieving complementary advantages in order to be bigger and stronger rapidly, which conforms to the laws of market economy. E-commerce enterprises will compete on comprehensive capabilities of whole industry chain in the future.

After integration, e-commerce industry will cut down investment generated owing to vicious competition and improve efficiency due to its technical characteristics. The number of merger and acquisition cases in online retail market will experience rapid growth in 2016. With the disappearance of market dividends, the living space for small- and medium-sized e-commerce enterprises is squeezed by leading enterprises, so they will seek for powerful partners to ensure survival and development. Besides, with the pressure from capitalists, some small- and medium-sized e-commerce enterprises at low valuations will merge together to improve the overall valuation.

Online and offline enterprises carry out powerful combination. E-commerce enterprises without physical stores also ran into trouble. E-commerce enterprises and physical retail enterprises can conduct cooperation in the future and give full play to their advantages so as to promote the further development of domestic economy. JD.com invested RMB4.3 billion in Yonghui Superstores, and Alibaba invested RMB28.3 billion in Suning. Online and offline leading enterprises have transferred from competition to cooperation to uncover new landscape for industry development. Through cooperation, offline retailing enterprises can gain online customers and speed up the pace of transformation, and e-commerce enterprises can obtain offline resources to open up online and offline channels and gain a full range of market resources. With the acceleration of integration between online and offline enterprises, Omni-channel marketing has become a tendency.

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