

# Customer centric strategy on the rise economics essay

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According to China Economic Review (2007), foreign retailers have taken advantage of the lifting of territorial restrictions and have expanded their operations into second- and even third-tier cities to gain more market share. Why foreign retailers have low expansion in China? Political factors can act as obstacle to foreign retailers' expansion. Sieber (2012) pointed out an example, Heivado was failed to expand and its second store was forced to close due to political disagreement between national and local government leading to the failure in co-operation with local partner. Sieber (2012) noted that foreign retailers tend to deal with local government strategically. She emphasized that in most circumstances, local government policies are far more important than the central government policies for the retail operations in China. Positive local government help attract a foreign retailer to expand into a particular region. Conversely, obstructive or non-supportive local government policies can deny a foreign retailer to expand elsewhere. According to Sieber (2012), Wal-Mart was incapable to open its first store in Shanghai, in East China, because of the lack of the local government support, therefore the company opened its first store in Shenzhen, in South China, in 1996 (Chuang et al. 2012) , instead. Since Wal-Mart has had powerful support from Shenzhen local government, and hence it has expanded greatly in the surrounding areas. However, Chuang et al. (2012) argued that Wal-Mart chose, or was forced, to locate in Shenzhen because its joint venture partner was headquartered there. Come to the procurement function, Wal-Mart used the same centralized procurement concept in China that it does in United States (Chuang et al. 2012). Wal-Mart established a Wal-Mart Global Procurement Centre (WMGP) in Shenzhen in 2002, purchase

orders for all products manufactured in China moved from the headquarters in United States to the WMGP, which sources and negotiates for new products and sets prices with manufacturers. This centralized procurement system has been very effective and Wal-Mart's strength as a global buyer is unsurpassed especially for its success in globalizing procurement activities for the United States market. However, Chuang et al. (2012) pointed out that this centralized procurement system had given Wal-Mart very little flexibility to respond quickly and efficiently to fluctuations in the variable Chinese market. Wal-Mart has begun to modify its procurement system by establishing five regional centres (Chuang et al. 2012). Two of them, one located in the south and the another is located in the north, which are focus entirely on domestic procurement and report to the Shenzhen headquarters directly. The Purchasing Centres control all product selections, price negotiations, display, and promotion events in China. With no exclusion, each provincial capital that has outlets has a purchasing as well. Wal-Mart's new procurement structure is showed in Exhibit 1. Customer-centric Strategy on the Rise

With the increasingly competitive retailing environment, more and more retailers are adopting customer-centric strategy in the review period, aiming to facilitate consumers' shopping experience. In making efforts to enhance customers' shopping experience, retailers have strengthening the logistics system and enriching their product portfolios (Euromonitor Business 2013) Grocery retailers have endeavoured to improve their on-line stores by providing a range of consumer-friendly services, including home delivery and self-pick-up in nearby outlets. To cater to the local consumer preference for fresh produce, grocery retailers have

increased the proportion of such products in the total portfolio and have sourced products directly from producing areas to ensure freshness and quality. Many grocery retailers are constantly optimising the merchandise mix in their outlets to cater to consumers' changing needs. (copy from euromonitor 2013)

### **2. 3. 2 Responses to Psychic Distance**

According to Sieber (2012), at the early stage of foreign retailers' expansion in China, especially for those have less international experience have often neglected pshyctic distance factor. This is due to a lack of knowledge of the market. Sieber (2012) emphasized, psychic distance is gradually being recognised as a significant factor for expansion. In her study, Wal-Mart, Metro and Heivado, which have less experience in the Asian Market, compared to Carrefour and Tesco, which responded to psychic distance in China at the early stage of their expansion. According to a study (Evans, Treagold & Mavondo 2000), although ethnocentric oriented foreign retailers tend intent to retaining their own culture and management styles, but to succeed in the market, they must respond to psychic distance effectively and adapt to the host market management characteristics. Foreign retailers with more international experience tended to deal more effectively with psychic distance and expand more rapidly than their rivals, a real example is the success of Carrefour and Tesco compare with Wal-Mart and Metro. Sieber (2012) has mentioned that learning is important for retail internationalization. Through the learning process, foreign retailers can be more localized in China. They learned to collaborate with local partners and to employ local management teams in management decision-making to help

them understand the differences in cultural and business between China and their home countries (Sieber 2012). Significant business and cultural differences do exist between China and other more developed markets. Foreign retailers have had difficulties in understanding central and local government policies, business networking, and social and cultural issues in the local areas in which they are operating (Sieber 2012). Sieber (2012) claimed that in all the cases studied, foreign retailers made incremental efforts to train a local management team and empower local Chinese managers in decision-making about the expansion process.

### **2. 3. 3 Establishment of business networking**

Establish a business network is imperative for a foreign retailer to expand more rapidly. In China, local government policies are idiosyncratic among the different cities and regions (Siebers 2012). Business networking can help foreign retailers to have more in-depth understanding of local culture and to deal more effectively with local government. 'Guanxi' According to Chuang et al. (2012), 'guanxi', or an association facilitated by the exchange of mutual favours freely and often given, is an important part of doing business in China, and a better understanding of the social relationships between partners would greatly benefit Wal-Mart executives in developing long-term, mutually successful dealing with local governments and suppliers. 'Guanxi' networking is still a barricade between foreign retailers and Chinese governments. Foreign retail companies with more international experience in Asian markets tend to deal with 'guanxi' networks better, which contribute to their rapid expansion. Carrefour and Tesco are the examples that have proven to be more successful. However, foreign retailers that do not deal

with and do not involve themselves in 'guanxi' networking are seen as just maintaining fair competition by the local government, one fit example is Wal-Mart, because they are not officially supposed to use networking parties to promote their business (Sieber 2012). Whereas Chuang et al. (2012) noted that Wal-Mart has developed strong relationships with the central government, yet because of local protectionist practices, Wal-Mart's representatives still have a way to go to have in-depth and fully understand the Chinese market. In addition, Chuang et al. (2012) stated that Wal-Mart did not need to worry about social relationships with the local community beyond sponsoring events and avoiding scandal, and they able to achieved immediate oligopoly. Chuang et al. (2012) also point out that it is not surprising that Wal-Mart has continues to mishandle relationships in China as China not having embraced the Chinese version of 'guanxi'.

### **2. 3. 4 Localization**

From the findings of Sieber's (2012) research, the findings indicate that a higher level of localization reduces psychic distance and facilitates foreign retailers to better interpret institutional factors and market infrastructure, and accordingly, to further enhance their core competences. According to Sieber (2012), there are three main indicators of foreign retailers' localization, which include retaining a local customer orientation, strategic location choices and rapid adjustments to local culture and conditions.

Retaining customer orientation There are two ways the foreign retailers use to retain their customer orientation to expand in the Chinese market. First, they are selling the right products to retain their customer. Foreign retailers have move the " wet market" into their supermarkets to meet the Chinese

customers demand for products such as fresh and live fish (Sieber 2012). Because of cultural differences across the country, there is no doubt that customers in different parts of China have distinctive preferences in products and tastes. Foreign retailers are always intend to sell the same sorts of products in all their stores as what are sold in Western countries. However, successful foreign retailers adapted their policies with offering a combination of standard and regional products in different stores across China. Secondly, foreign retailers have recognized the importance of adapting to the Chinese ways of providing customer service (Sieber 2012). Different from Western countries, where do not have many staff can be found on shop floors, but in China, foreign retailers are expected to provide a large number of staffs on the shop floor to help customers, and also expected to provide more product tasting sampling activities. Wal-Mart has recognized the habit of Chinese consumers who prefer to shop more frequently and buy smaller quantities, so the Wal-Mart's first stop in Shanghai provides up to 50 small specially designed check-outs, therefore customers can be served efficiently. Strategic location choices When considering the different characteristics of the various regions in China, foreign retailers' location strategies are mainly influenced by investigation and research, local government support, economic conditions, potential growth rate and the location of local partners (Siebers 2012). Before foreign retailers' expansion, they spent a heap of time in researching the market in which research centred on local government, characteristics of specific locations, local market environment, customer preferences and purchasing power, and competitors' profile. Sieber (2012) had mentioned that gaining local government support is pivotal in location

strategy. According to Sternquist (1998), at the beginning of entry stage, economic conditions are significant considerations when making locations choices. Before 2004, in order to achieve good profitability under the location restriction rules, foreign retailers opened their first stores in well-developed regions, such as Metro and Tesco in East China, Wal-Mart in South China and Carrefour in the capital Beijing. Rapid adjustments in consideration of specific locations in a particular city, some foreign retailers have based on their international experience to make strategic decision, whereas others made strategic changes through learning. Sieber (2012) had stated a real case in her study. As car ownership is low in China, Carrefour located all its stores in the centre of cities on bus routes, with ample of parking lots and waiting areas for taxis, bicycles and also three wheel cycles. On the contrary, Wal-Mart did not choose good locations as they located Wal-Mart stores outside the city centre, and were not served by convenient transport systems. This is because Wal-Mart assumed the Chinese would follow Western shopping styles. Carrefour has been greatly benefited from their previous experiences in the Asian markets in market and operating stores in Taiwan. Wal-Mart eventually adjusted its location strategies by 2005 and started to located new stores in walking streets, such as in the shopping districts of Shenyang city in Northeast China and similar locations in other regions for example, Middle China. USDA (2012) found that most hypermarkets in China offer free shuttle bus service to nearby communities. According to Sieber (2012), free mini bus services from affluent suburban residential areas to their stores have been provided by both Wal-Mart and Carrefour. Sieber (2012) notes that these changes manifest the strong sense



of customer orientation of these foreign retailers. Recently, Wal-Mart has shown some sensitivity to local customer demographic differences (Chuang, Donegan & Ganon 2012). Wal-Mart sells a wide variety of take-out meals in its Beijing, Chaoyang store, in order to accommodate its young professional customers. Conversely, Wal-Mart focuses on fresh products in its Haidian district store as the customers are older and habituated to preparing home cooked meals. This literature review provides insights into what are the key factors influence foreign retailers' expansion in China market.

## **Chapter 3: Situation Analysis**

### **3. 1 Retail Industry in China-PEST Framework Analysis**

#### **3. 1. 1 Political and Legislation in China**

According to Business Monitor International (2012), authorities in major cities in China are now considering a number of new regulations aimed at restricting growth, protecting smaller independent retailers and maintaining the current make-up of urban centres, because of the pace of store openings in that major cities. Shanghai is one of the cities in which legislation to restrict store openings of a certain size. Business Monitor International (2012) mentioned, as with any other one-party state, China's political system is inherently capricious and incompetent in respond to the wider changes taking place in society. Provincial governments are often failing to enforce central government directives. Moreover, the Communist Party of China is facing increasing factional rifts based on ideology and regionalism.

Ineluctable, greater political debate would be welcomed by many and internal regime schisms could be politically destabilising (Business Monitor International, 2013). The Chinese government has long focused on <https://assignbuster.com/customer-centric-strategy-on-the-rise-economics-essay/>

encouraging traditionally prudent consumers, who save as much as 40% of their income (one of the highest individual savings rates in the world) to spend more (). In order to support the retail industry in maintaining a fast growth rate over the next five years, the government has established some supportive policies: As laid out in the 12th Five-Year Plan, targeting a 15% annual growth for social retail sales. Aiming to accelerate the pace of water and electricity price cuts for the retail industry down to industrial rates. The cost to retailers of water and electricity would be decreased by 30%-40%. Cutting the commission rate on bank card usage from 1% to 0.5%. Allowing VAT on air-conditioner and elevator equipment to be deducted from a company's VAT calculation. This is a direct tax preferential policy given by the government to the retail industry. (Source: Platinum Broking, 2012)

Government restrictions and protectionism

Lifting FDI restriction since 2001 in China has made the early adoption of modern retail best practices with organised retail for example, having Western-style chain outlets, department stores, supermarkets and other formats. All of these accounted for an estimated 22.5 per cent of the total retail market. In November 2010, China's parliament has passed a bill that is compounded in 2012 with the implementation of legislation to restrict the trading hours for large retailers (Business Monitor 2012). Upon China joined WTO, it committed to gradually eliminate market access barriers for foreign enterprises. Prior to 2004, foreign retailers could operate only in major cities and special economic zones. In 2004, the Chinese government issued the Administrative Measures for Foreign Investment in Commercial Sectors, which permitted foreign investors to establish retail enterprises in China without geographic

limitations, and foreign retailers also allowed holding 100 per cent equity in Chinese firms (Business Monitor, 2012). Foreign investors are now allowed to provide retail services through joint ventures (JVs) or wholly foreign-owned enterprises (WFOEs). Hence, China's retail sector experienced an accelerated growth. The 2009 Administrative Measures for Foreign Enterprises or Individuals Establishing Partnership Enterprises in China has also permitted foreign investors or individuals to establish partnership retail enterprises beginning in March 2010 (Business Monitor, 2012). According to Euromonitor International (2013), in order to improve incomes for rural residents, the Ministry of Commerce initiated the Nong Chao Dui Jie Programme, (Linking Farms to Supermarkets Programme) in 2008. This is to strengthen the links between farmers and retailers via direct procurement, and consequently cut out middlemen and benefit farmers and local consumers. Euromonitor International (2013) also stated that, by the end of 2011, the central government had spent a total of RMB00 million in supporting the Nong Chao Dui Jie Programme, with over 1, 000 on-going projects in 19 provinces and around 800 chained retailers involved in the programme. Many international and domestic retailers including Wal-Mart (China), Wumart, Tesco China, Shenzhen A-Best, Lianhua Supermarket, and China Resources, have been engaged in this programme. Through direct procurement from farmers, many grocery retailers are able to obtain and increasing the portion of fresh products (including vegetables and fruits) in their total product portfolio. The Nong Chao Dui Jie Programme has in line with the local consumer preference for fresh products that are cheaper. This had benefited not only farmers but also helped boost the value sales growth

of retailers (Euromonitor International, 2013). From the current situation, the domestic and foreign retail enterprises enjoy unequal treatment that has affected the fair competition in market. Foreign retail enterprises enjoy the Super-National Treatment that express mainly in the following few aspects. The first is tax incentives. In foreign investment enterprises, central and local of income tax rate combine as 33%. Although the nominal rate is equal with the domestic enterprises, most of the regions generally do not levy local income tax in order to attract foreign investment. Therefore, domestic and foreign retail enterprises have unequal effective tax rates. In the five special economic zones and foreign retail enterprises in Pudong, Shanghai, enjoy the "two exemptions and three reductions" of low tax incentives. Secondly, some local governments also competing each other and provide preferential policies to foreign retailers in order to meet attracting businesses and investments, and engage in the performance requirements of image projects. Some local governments examine and approve illegally foreign-funded to build stores, and implement "Super-National Treatment" to foreign-funded retail enterprises in the land, taxation, region of expansion, commercial outlets and other respects (Wang, 2006). Especially, in the site, it does not spare to sell the prime location in city and gives the most favourable policy. Foreign-funded retail enterprises and domestic enterprises do not have the same starting line. If foreign retail enterprises still enjoy the "Super-National Treatment", they will take the more absolute advantage in competition with domestic enterprises. This is one of the important reasons that the foreign retail enterprises can expand rapidly in China. Although China central government has more severe checks for opening of retail

stores, some local governments and officials do not spare to go against the wishes of the central government, blind attract investment, and even does not consider the country's industrial security in order to pursuit performance. All levels of government work each for them, and lack of coordinated system, so that create chaotic situation in opening of the retail. Given differences in regional tastes, logistical difficulties, and the size of China, many retailers choose to focus in a particular region of China first rather than try to develop the entire market at once. The Chinese Central Government is promoting aggressive policies to develop these interior regions and many foreign retailers are racing to establish an early presence in many of these major urban centers. Opportunities are waiting to be found, but require resources and patience (USDA, 2012).

### **3. 1. 2 Economic Environment in China**

Economic According to National Bureau of Statistics of China (2013), China's GDP in year 2012 was 51, 932. 2 billion yuan, increased by 7. 8 percent over the previous year. The GDP in year 2011 was reported at 47, 310. 4 billion yuan. Although the GDP is increasing from year-to-year, but the real GDP growth rate was slow down start from year 2010, which was accounted for 10. 4 per cent growth rate, and 9. 3 per cent in year 2011. Employment The number of people being employed in China was accounted for 767. 04 million at the end of year 2012. Of this total, employed people in urban areas reported at 371. 02 million. In contrast, the urban unemployment rate at the year end of 2012 was maintaining the same level as year 2011, which recorded at 4. 1 per cent. A total of 262. 61 million migrant workers in 2012, was rose by 3. 9 per cent over the past year. Of which, 163. 36 million

workers are migrate from hometown and worked in other provinces, this had went up by 3. 0 per cent, the migrant workers worked in local provinces reached 99. 25 million, up by 5. 4 per cent. Annual per capita net income of rural householdsAccording to National Bureau of Statistics of China (2013), the annual per capita net income of rural households was increased by 13. 5 percent, reached 7, 917 yuan in year 2012. However, after deducted the factors of price increase, the real increase over the year 2011 was 10. 7 per cent. The median of per capita net income of rural households was 7, 019 yuan, up by 13. 3 percent. On the other hand, the annual per capita disposable income of urban households reported at 24, 565 yuan, rose by 12. 6 percent, but the real increase is 9. 6 percent. The median of per capita disposable income of urban households was 21, 986 yuan, up by 15. 0 percent. The proportion of expenditure on food to the total expenditure of households for rural households and for urban households were 39. 3 percent and 36. 2 percent, respectively. Wage levelsPolicy makers have set a clear target that per capita disposable income should rise at least as fast as GDP in the 12th five-year plan. The main steps are focused on increasing minimum wages and the reference wage. Four-fifths of China's administrative districts took action in the first half of 2012, 16 provinces raised the minimum wage by an average of 19. 7 per cent, and 12 others raised the government reference wage by an average of 14 per cent. Supply and demand dynamics are pushing in the same direction as government policy. China's labour pool is shrinking due to demographics and a reduced flow of migrant labour from rural areas, and this is exerting upward pressure on wages (McKinsey China, 2012). China is a very large country and different

parts of China are at different levels of development. However, there are large variations of income and pockets of wealth in all large urban areas, and Chinese cities are no exception. According to USDA (2012), the wealthiest areas in China are Beijing and Tianjin in the north, Guangdong and Fujian in the south, and the Shanghai, Jiangsu, Zhejiang area in eastern China.

Increasing Consumer Power  
Increasing income is another major driving force behind the retail sector's future growth. In particular, we see rural households and low-income urban households as one of the main drivers of retail sales growth during the 12th Five-Year Plan period, with a higher than average income growth rate. During the period of 2001-2005, the per capita disposable income of urban households increased at a higher CAGR of 10.8% compared to rural households' net income growth of 7.6%. However, thanks to the government's policy of improving living standards in rural households, both urban and rural households' incomes increased at a CAGR of 12.7% during 2006-2010. We anticipate that rural households' income will increase at a higher pace than that of urban areas, further contributing to overall retail sales growth. Approaching this from another angle, it is not difficult to understand that there is huge potential for rural households' income growth. In 2010, urban households' disposable income per capita of RMB19,109 was over three times the rural level of RMB5,919. This is even lower than the urban household disposable income per capita in 2000 of RMB6,280. In other words, we foresee that a similar growth pattern might be observed in rural areas over the next 10 years, and that the level of consumption will also gain enormously. Low-income urban households are another of the groups rapidly gaining consumer power. During 2011, the

minimum wage level rose by 22%, much higher than the real GDP growth and CPI growth rates of 9.2% and 5.4% respectively. Furthermore, they will also be amongst the beneficiaries of the 12th Five-Year Plan, since the government has set a target of raising the minimum wage level by more than 13% per year during the period. Several regions have already increased the minimum wage from the beginning of 2012, such as Sichuan and Jiangxi raised minimum wage levels by 23% and 21% respectively. Moreover, we foresee that their contribution to the whole retail sector would be larger than the extent of their income growth level. The marginal propensity to consume of those in rural and low-income urban households is higher than the average, because most of them work in manufacturing industry at a low wage and a grand portion of their salary is spent on covering their daily expenses. Therefore, in aggregate, the effects of this group on the retail sector and the economy as a whole should be more apparent, driving the consumption level in China. Rural households and low-income urban households have higher marginal propensity to consume, bringing more apparent benefit to the retail sector (Platinum Asia, 2012). Consumer Price Index 2012, a rise of 2.6 per cent in consumer price over that of 2011 was reported. Among this total, the prices for food went up by 4.8 per cent, but the producer prices were down by 1.7 per cent and the purchasing prices for manufactured goods were also decreased by 1.8 per cent (China Briefing News, 2011). Consumer Price Index (CPI) According to a most recent statistic provided by National Bureau of Statistics of China (2013), in January 2013, the consumer price index (CPI) increased by 2.0 per cent year-on-year. In details, the prices grew by 2.0 per cent in cities and 2.2 per cent in rural



areas. 2.9 per cent was increased in food prices, whereas the non-food prices was increased by 1.6 per cent. Also, there was an increase of 2.0 per cent in the prices of consumer goods and 2.2 per cent in the prices of services. See Appendix 1. According to U. S. Commercial Service, there are approximately 655 cities in China. Of this total, 160 cities are having populations of 1 million or more, and 12 metro areas with populations greater than 5 million. The plan for 8 mega cities is targeted at more than 10 million populations by 2025, which include Beijing, Shanghai, Chengdu, Chongqing, Guangzhou, Shenzhen, Tianjin and Wuhan. According to CNBC (2012) and U. S. Commercial Service (2012) stated that cities in China can be unofficially divided into different tiers, including Tier 1, Tier 2 or Tier 3. However, it is commonly agreed that the Tier 1 cities incorporate Shanghai, Beijing, Guangzhou and Shenzhen. Tier 1 cities are regarded as large size city and have the highest income in the country. However, Tier 1 cities accounted for only 9 per cent of China's population. Compared with Tier 1 cities, there are more people living in the Tier 2 cities, and Tier 2 cities often defined as the provincial capitals and special administrative cities, with 23 in total (CNBC 2012). According to CNBC (2012), capitals with prefecture level or county-level are classed as Tier 3 cities. However, there is no precise breakdown between Tier 2 and Tier 3. CNBC (2012) also mentioned that it is important to break them down, as the significance of Tier 2 and Tier 3 cities is growing. Many companies are moving from the expensive coast to tap the interior regions because of people are migrating from the countryside to these cities. Economic in Tier 2 and Tier 3 Cities According to EDC (2012), 14 of China's Tier 2 cities reported at 54 % of the total imports from the United

States. This shows a growing importance of the Tier 2 and Tier 3 cities.

Wages Comparisons Between Tiers in China (Source: China Briefing News, 2011). Tier 2 sample is 62% the salary of the Tier 1 city sample. Historically, Tier 2 cities wages are 30% that of the Tier 1. Whereas the average salary of the Tier 3 city sample is 91% the average salary of a Tier 2 city (China Briefing News, 2011). The inequality in income and living standards in China are corresponds to geographic differences. The major coastal cities such as Shanghai, Beijing, Guangzhou, and especially Shenzhen were the first to experience market oriented reforms. As such, these areas grew faster over the past 20 years than most other parts of China and have emerged relatively affluent. There are also big geographic differences in the way that Chinese spend their money. Finally, regional differences are not simply about money. China is a highly diverse nation, with many languages, lifestyles, types of food, and business styles. Companies doing business in China must take account of these differences when choosing product and service mixes as well as when managing local enterprises. In addition, China is not a single entity when it comes to doing business - especially consumer business.

Domestic Trade The retail sales of consumer goods raised by 14.3 per cent over the past of 2011, therefore reached 21,030.7 billion yuan. After deducting the price factors, the real growth was 12.1 per cent. Both the retail sales of consumer goods in urban areas and in rural areas, have reached 1,824.4 billion yuan (rose by 14.3 per cent) and 2,789.3 billion yuan (rose by 14.5 per cent) respectively.

### 3. 1. 3 Social Factors

Population From National Bureau of Statistics of China (2013), Chinese population at the mainland reached a total number of 1, 354. 04 million at the end of 2012, went up by 6. 69 million over that at the end of the previous year. Of which, there were 711. 82 urban population, accounting for 52. 6 per cent, and it is 1. 3 percentage points higher than that at the end of 2011. The year 2012 saw 16. 35 million births, a crude birth rate of 12. 10 per thousand, and 9. 66 million deaths, or a crude death rate of 7. 15 per thousand. The natural growth rate was 4. 95 per thousand. The sex ratio at birth was 117. 70. The number of population aged 0-14 (under the age of 15) increased 0. 01 per cent from the end of 2011, reached 222. 87 million, accounting for 16. 5 per cent of the total population; however, working-age population aged 15-59 (under the age of 60) accounting for 937. 27 million, 69. 2 per cent of the total it showed a 0. 60 percentage point lower , which was a fall of 3. 45 million compared with that at the end of 2011; and the number of population aged 60 and over was 193. 90 million, accounting for 14. 3 per cent of the total, which was 0. 59 percentage point higher compared with that at the end of 2011. There are many urban centers in China that westerners have not heard of. Even a " small" city by Chinese standards may have millions of people. These are becoming much more prosperous, and their growth rates are starting to exceed those of the three large urban areas. It would be a mistake to overlook these markets and the potential to develop strong market positions in them. (USDA 2012)DemographicsChina's population growth is relatively slow. Over the next 20 years the population is only expected to increase by 11% to about 1.

45 billion. Yet, given China's large population, this represents an increase of 147 million people, or more than the population of Japan. More interesting, however, is the way in which the age distribution is expected to change. Because of declining fertility rates and delayed marriage and childbirth, the number of children and young adults will decline considerably. The under 20 population will drop by 49 million over the next 20 years. In addition, the number of young adults (ages 20 to 34) will decline by 42 million. On the other hand, the number of middle aged adults (ages 50 to 64) will increase by 134 million or 73%. The number of elderly (over 65) will double from 99 million to 199 million. Finally, among children and young adults there is a large disparity between the numbers of males and females. For example, today there are 50 million males aged 5 to 9 while there are only 44 million females in that age group. Similar differences exist for many other young cohorts. This unusually large gap is due to the one-child policy followed over the past generation. The desire for sons led many Chinese families to undertake measures aimed at assuring male births. This gender disparity could have significant implications for lifestyles of adults in the future. Moreover, it could have an adverse impact on social stability and crime as a large number of men fail to find permanent mates. Finally, a relative dearth of young females will exacerbate the low rate of fertility. What do these demographic trends augur for consumer business in China? First, the absolute decline in the number of dependent children means that there will be far fewer households in which children are present. This implies less spending on child and teen related products (clothing, toys, and games). It also implies that there will be more money available for adults without

children to spend on themselves. Those adults who don't have children or delay having children will likely spend more on eating out, decorating homes, travel, and entertainment. Second, the increase in the older working age population (50 to 64) has important implications. This age group tends to save more and spend less. It tends to spend more on services and less on goods. It also tends to spend considerably on grandchildren. The huge increase in the number of elderly Chinese will have vast implications for many industries including healthcare, pharmaceuticals, recreation, fashion, home furnishing, and food service to name a few. Aging population China is an aging society as life expectancy rises and birth rates fall—the latter the result of the one-child policy that was introduced in the 1970s and remains partly in effect today. Only ethnic minorities are allowed more than one child, although the policy was recently relaxed to allow families in which both parents are single children to have a second baby. Assuming this policy holds, the population's median age will rise from 34 to 37 over the coming decade, similar to the median age of 36.6 in the United States in 2010. At the same time, the proportion of the population over 65 will rise from 10 to 15 per cent. This remains low compared with developed countries such as Germany (31 per cent) and Japan (34 per cent) but it still imposes a heavy economic burden on younger working people. As is always the case in China, there will be marked regional differences. In six of China's 22 city clusters—Shanghai, Jingjinji, Nanjing, Changchun-Haerbin, Liao Central South, and Chongqing—20 percent of the population will be over 65 by 2020. In five other clusters, however—Guangzhou, Shenzhen, Nanning, Kunming, and Fuzhou-Xiamen—the majority will be under 34. Several reasons account for

this: some clusters have attracted large numbers of young migrants looking for what is mainly labor-intensive work; others are poorer and so life expectancy is lower; and in some places the one-child policy is not strictly enforced. Ongoing urbanisation in China

The 12th Five-Year plan stated that the urbanisation level is forecasted to rise to 65% within the next 10 years. According to the latest statistics, China's urbanisation level in 2011 was 51.3%, implying that China has a greater population residing in urban areas than in rural areas for the first time in history. Ongoing urbanisation in China is mainly driven by population migration from rural to urban areas. During the last 10 years, the urban population grew at a CAGR of 3.7% while the rural population declined at a CAGR of 1.9%. Due to unevenly distributed economic opportunities, people migrate to urban cities where the wage level is higher and there is a greater variety of goods and services available. Assuming that the level of urbanisation will grow by 1 ppt per annum, at least 10 million rural inhabitants could become urban residents every year, and receive a higher salary than before. There is no doubt that the migrants would spend at least part of their increased incomes on consumer products in urban areas. Therefore the consumption driven by enhanced urbanisation would act as a strong stimulant to the overall retail sector. Peaking of urban labor growth

First, while China will see continuing urbanization over the next two decades, the urban labor pool will stop growing by the end of the period. This is due to the aging of the population: from 2012 to 2030, the 0-to-14-year-old population cohort will see a decline of 1.2 percent per year, while the over-65 cohort will grow at 3.9 percent per year. Thus there will be fewer people available for the future labor force, and the likely result is that

the nonworking population will account for a larger share of the total. This demographic shift will affect migration from the countryside to the cities: while migration will continue on a large scale, it will be at a slower rate compared with previous years. From 2000 to 2010, the bulk of the growth in the urban labor force came from migration of rural workers to cities, accounting for 80 percent of the growth in labor-force expansion. But in the next decade, with the change in the population's age profile, there is likely to be a reduced supply of working-age rural migrants available to move to cities. Large-scale migration is especially likely to decline to the southern coastal cities, which have traditionally been home to export-oriented industries. Instead, rural workers in inland provinces are now more likely to want to work in cities close to their hometown. One reason is that workers in the emerging manufacturing bases of Henan, Hubei, and Sichuan provinces are seeing incomes grow more rapidly than in the past. In addition, as total employment opportunities expand in inland cities, rural inhabitants in these regions may prefer to stay close to home, retaining the residence privileges of living in their rural home areas but working in urban areas. Wealthier, more productive city dwellersThe urban population, meanwhile, will become increasingly wealthy. The tighter supply of workers could lead to further wage inflation in coastal cities. Already, manufacturing-labor costs in the Pearl River Delta rose 11 per cent during 2011 and wage rates at factories in Guangzhou and Dongguan have increased 10 per cent in the past year. The upward trajectory in wages is being supported by improving productivityThis has put China in the leading position when it comes to productivity growth compared with other countries—albeit from a low base. In the future,

productivity gains could be captured in the service sector, as well as in China's expanding high-end manufacturing sector. These developments will in turn require initiatives to improve education and training—both hallmarks of a blossoming urban society. Besides its higher income, the urban population will also benefit from the social-safety-net improvements, and it is likely to spend more, as discussed earlier in this article. By 2030, consumption growth will be dominated by rapidly growing middle- and higher-income urban population groups. Our projections suggest that the number of urban households in these categories will rise from 71 percent in 2012 to 87 percent in 2030. Within those groups, the wealthiest households will grow to account for a proportionately larger share of consumption—accounting for one-quarter of urban households by 2030 but fully half of total urban consumption at that date. The result will be a shift of spending toward discretionary categories, including personal items, recreation, education and cultural expenditures, and transportation and communication spending (Exhibit 7 and Exhibit 8). In the countryside, the market will grow even as employment shrinks. For those who remain, the Chinese government is instituting policies that aim to narrow the gap between urban and rural incomes by lowering rural taxes, increasing consumption subsidies, and putting in place measures to enhance the rural social-security net and improve rural living conditions. In addition, the rural population is seeing its income rise faster than in the past due to increasing agricultural product prices and productivity: in 2011, the former rose 16 percent and the latter 23 percent (McKinsey China, 2013). Education in Tier 2 and Tier 3 Cities In 2012, the post-graduate education enrolment was reported at 1. 720 million



students with 590 thousand new students and 486 thousand graduates (National Bureau of Statistics of China, 2013). The statistic for general tertiary education enrolment was 23.913 million students with 6.888 million new students and 6.247 million graduates. Various types of vocational secondary schools had a total of 21.203 million enrolled students, which including 7.610 million new entrants and 6.736 million graduates. Enrolled students in senior secondary schools was amounted to 24.672 million, including 8.446 million new entrants, and 7.915 million graduates. Junior secondary schools had total 47.631 million enrolled students, including 15.708 million new entrants, and 16.608 million graduates. Moreover, primary education enrolment in China reported at 96.959 million students, including 17.147 million new entrants, and 16.416 million graduates. In the same year, 379 thousand students were enrolled in special education schools, with 66 thousand new entrants and 49 thousand graduates. Lastly, kindergartens accommodated 36.858 million children (National Bureau of Statistics of China, 2013). Smaller cities will drive China's growth the quality and pace of urban development is likely to vary sharply across China. Cities are at different stages of development, and the development paths they will follow are likely to vary and reflect strengths specific to each city. Our projections suggest that growth will be fastest outside China's megacities. In the next two decades, the dozens of smaller cities with current urban populations of less than 1.5 million will make the largest contribution to growth. A large number of these cities—now at earlier stages of development than the larger cities and so with more growth potential—will expand to become cities with populations in the 1.5 million to 5 million range. This group will represent

the single largest growth cohort and contribute 40 percent of total China urban GDP growth through 2030. Cities that currently have a population in the 1.5 million to 5 million range will contribute about 25 percent of GDP growth over the same period, while cities with populations that are already above 5 million will contribute about 35 percent (Exhibit 9). The small cities will form hub-and-spoke-type clusters around the megacity or big-city hubs that are already in existence: we have identified 22 such emerging economic clusters, each the size of a midsize European country. For example, the GDP of the Shandong cluster (around Jinan and Qingdao) will by 2020 be similar to the size of Taiwan's today, while the GDP of the central cluster—cities around Zhengzhou in the center of China—will be similar to Denmark's (Exhibit 10). Cities will compete based on their comparative advantages in terms of productivity or population growth. For example, cities that are rich in natural resources and have an abundant labor supply but historically low productivity have typically developed "traditional" industry sectors such as mining, textile manufacture, or energy production. Those sectors have developed extensively over the past three decades since China's economy started to open up. Production processes in these industries tend to be mature and standardized, and as a result, simply increasing input (for example, additional labor supply) leads to growth. Zhengzhou, capital of Henan, one of China's most populous provinces, is an example of this development model.

### **3. 1. 4 Technological Factors**

Infrastructure in ChinaChina does not have a nationwide network of trucks, highways and cold storage warehouses that can efficiently deliver supplies

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from suppliers, manufacturer or importer to the store shelf. A lack of appreciation for the value of maintaining the cold chain creates special problems for temperature sensitive items. With some notable exceptions, distribution is handled on a store-by-store or city-by-city basis, with stores receiving most imports through a local distributor, often even when alternatives exist. Because of their relative size, stores are able to effectively pass all market risk onto the distributor. (copy from USDA 2012) As a general rule, the three cities of Shanghai, Guangzhou and Beijing have the best infrastructure and the largest number of experienced distributors.

Increasingly, those systems are being extended to the large webs of satellite cities surrounding Guangzhou, Shanghai and Beijing. Other major cities along the eastern seaboard, beyond the reach of the 'big three', generally have good logistics infrastructure, but most still rely on one of the 'big three' as an entry point for imports. Farther inland, there are a number of large cities with good market potential. Logistics can be problematic, but improvements in the national highway system have made trucking direct from Shanghai or Guangzhou far easier than it was just a few years ago. As a result, high value and temperature sensitive products shipped by truck directly from the importer to a local distributor do surprisingly well. Currently, many secondary cities have only a few distributors for imports, particularly for high-value or temperature-sensitive products. Multi modal refrigerated rail transportation to inland cities may become viable over the next several years. Several international companies are currently developing local partnerships to create modern cold chain and distribution systems across China. Logistics and distribution are serious problems for Wal-Mart too. In

China, however, Wal-Mart faces several difficulties. The 1st is China's infrastructure--- while more efficient than most developing countries, there are still plenty of bottlenecks. Some of these are physical, relating to roads, ports, and so on. Others are attitudinal—many Chinese suppliers have a hard time adjusting to the rigorous standards of modern supply chain management. A final bottleneck is one of scale: Wal-Mart's operations in China are not yet large enough to reap efficiencies from its logistics system (Harvard Business Review, 2007). Infrastructure in Tier 2 and Tier 3 CitiesChina central government has focus on investment in infrastructure in Tier 2 and Tier 3 cities through lots of construction of road air airports, yet focus on improving railroads and city utilities (EDC, 2012). Besides, many Tier 2 cities especially in central China, are given significant government support. The Chinese stimulus package help improving the infrastructure and transport links in that region. China and the InternetAccording to BGL (2011), as in many developed countries, the growth of internet usage in China has been phenomenal. By early 2005 there were over 100 million internet users in China, up from 87 million in mid 2004 and 68 million in mid-2003. These users connected to the internet through over 120 million access points of which roughly one third involved high speed access. Still, despite the rise of mobile telephony, the internet continues to grow in importance. In 2004, the number of registered websites in China rose 32% to 626, 000 sites. Not surprisingly, 84% of these websites are registered in China's coastal cities. The next big step in the development of the internet in China will involve rural usage. The government intends to establish an infrastructure to support the creation of internet access for 900 million rural citizens of China. The

implications of such a project are staggering. After all, most of the focus of China's economic development has involved the urban centers. Rural participation in that development has often entailed migration to cities or the absorption of rural areas into the periphery of cities. Now the government wants to bring the benefits of modern society to the entire country. This will mean greater access to economically useful information, more efficient rural-urban supply chains, and the ability to engage in distance learning. These influences could, over time, add substantially to rural productivity and, therefore, rural incomes. On the other hand, the government seems to have mixed feelings about the internet. It has worked hard to limit the free flow of information and clearly worries about how the internet could subvert its authority. Thousands are employed to monitor internet usage. How the conflicting demands on the internet will be resolved is hard to predict (China Consumer 2011). Although it is clear that the internet will rise in importance in the years to come, there are several issues that will determine the success of internet commerce. These include the reliability of the postal service, the ubiquity of credit and debit cards, and the degree to which store retailers will play a role in the distribution of goods ordered online.

### **3. 2 Industry Analysis**

The retail industry is basically dominated by few retail giants. Some retail giants are competing in several retail categories. Competition among retailers centers on pricing, store location, variations in store format and merchandise mix, store size, shopping atmosphere, and image with shoppers. Further analysis is provided by using Michael Porter Five Forces, diagnoses the competitive environment of the retail industry in China. 3. 2. 1

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Rivalry among Existing Firms/ Competing Sellers

The leading foreign retailers in China are Sun Art Retail (a Taiwan-French joint venture), Wal-Mart and Yum! Brands of the US, Carrefour of France, Tesco of the UK, and Best Buy (also of the US, through its control of Jiangsu Five-Star Appliances). The market leader in China is Sun Art Retail, which operates both the RT-Mart and Auchan chains, claimed a 12.8 per cent share of national grocery sales in 2011. (EIU, 2012)

Since the economy reformation in China, the number of competitors in Chinese retail industry is increasing rapidly. Especially after China officially became a member of WTO, the foreign retailers enter China market as well as expand in China in a significant fast pace. Most retailers are having substantial excess capacity and customers often have low switching costs in this retail market. According to Besanko et al (2003), these characteristics of retail market have triggered heated price competition. As a result, the Chinese retail market meets the criteria for fierce internal rivalry.

With a few number of international retail giants and also large domestic retailers, the competition in China retail industry is inevitably fierce and sharp. Table 4. 1 shows the a few top retailers in China consisting both domestic and foreign ones. From the table, it is easy to find that domestic retailers occupy the top five retailers in terms of sales in 2006, and they own a significant market share in Chinese retail market. Carrefour, the best performing foreign retailer took the sixth position and Wal-Mart took the fourteenth. However, in recent years, the openness policies become more relax and flexible, more and more foreign retailers landed in China. Most of them have completed their strategic layout of their stores over China perfectly. Therefore, although some of the domestic retailers have occupied

the leading position, they are still face severe challenges. It is estimated that in the next few years, 60% of Chinese retail market will be owned by 3-5 world-class retail giants, and 30% will be owned by Chinese national retail giants, and the rest of 10% will be owned by regional retail giants. According to Zhuang et al. (2003), general stores also posing competition to large scale retailers. General store is defined as a store located mainly in small towns and villages, with a limited but varied stock of merchandise ranging from foodstuffs to manufactured goods.

### 3. 2. 2 Threat of New Entrants

In the early years after economy reformation, Retailing was a highly protected industry in China, there was no foreign retailers allowed to enter into China retailing market. The state-owned and collective-owned retailers were the only dominant players in the market. They are protected by absolute entry barriers, hence they did not feel threaten from the new entrants though they were performing poorly. China central government was also strongly encouraged and supported the development of new retailers among Chinese. As such, the operating of small retail stores was considered as a good way to earn profit due to the small entry barriers. It does not entail significant economies of scale or experience curve, because small retail stores still able to make profits with lower cost. Retailers' reputations are not significantly important, as the products they sold to customers are less different. Retailers can access to buyers easily and there are no network externalities. Consequently, the number of retailers increased rapidly. Recently, China central government has introduced numbers of policies to regulate and promote the development of retailing, which encourages competitive firms to realize scale expansion, and to reorganize assets that are cross-sector,

trans-region and cross-ownership. According to Zhuang et al. (2003), China central government restored and developed free markets in both rural and urban areas. In addition to restoring the old free markets, the government also helped to build new markets both in the country side and in the cities. Individuals, therefore, are allowed to enter the industry more easily. Moreover, individuals, private enterprises, and enterprises in other ownerships are encouraged and supported by government to do business in the channels. Meanwhile, leading to these enterprises to become larger and stronger. Particularly when China central government completely reduced the barriers for foreign retailers to enter and develop in China, the constraints for both domestic and foreign retailers to enter and expand in Chinese retail market became smaller. More and more powerful domestic and foreign retailers will enter and expand in this market. According to Zhuang et al. (2003), in China, some of the individual retailers, with accumulated capital, will develop into private enterprises. Previously, individual retailers once were the major force driving Chinese traditional retail structure to change. Table 2 shows there was a large number of individuals were surging into free markets and the free markets boomed, as a result of immediate lowered entry barriers. Individual retailers gained a market share of xx% in 2012, which is increased from xx% in 1997. This is mainly due to the more rapid increase in number of outlets, personnel, and retail sales. Nowadays, many individual retailers have already become competitors in China retail industry, and there are still large numbers of individuals waiting to join this potential industry. According to Zhuang et al. (2003), those individuals are mainly composed of farmers who reside in the



suburbs or come from the remote countryside, laid-off workers caused by the reform of state-owned enterprises, and unemployed graduates. Such employment situation, which reported at about 7 per cent unemployment rate in cities, and low entry barriers may encourage more individuals to enter retailing industry. However, small entry barriers, on the other hand, discourage potential entry to this industry. A report from A. T. Kearney, had found that the attractiveness of Chinese retail market in 2006 showed a downward trend ([www.chinabgao.com](http://www.chinabgao.com)). As Besanko et al (2003) suggested expectations about post-entry competition are also important. As more and more retailers enter this market, it is inevitably to consider that there is fierce competition, and market is gradually become more saturated.

However, from Chinese retail market's overall growth trend, many experts conclude that there is still huge potential for further development and opportunities for investment. According to China State Information Center, the retail market in China will maintain an annual growth rate of 8% to 10%. Although there is potential for increasing number of retailers in China, however, unlike in the early years, entry barrier is becoming higher because of sizeable economies of scale and large capital requirements to compete with large scale and powerful retailers. Moreover, existing retailers in this industry will strongly struggle efforts of new entrants to gain a market foothold. In addition, the value of RenMinBi (RMB) will also influence the potential entrant to the retail market. First, if there is RMB revaluation, the consumers' real purchasing power will increase and hence the retailers will benefit from this, which will encourage more entries. Second, the RMB revaluation indicates the real prices of imported goods decrease, which will

benefit the retailers and encourage potential entrants. 3. 2. 3 Bargaining Power of Suppliers Weak: industry members account for a big fraction of suppliers' total sales and continued high volume purchases are important to the well-being of suppliers. In China, especially after China's entry to the WTO, relationships between retailers and suppliers have become increasingly important ([www1.chinadaily.com.cn](http://www1.chinadaily.com.cn)). With the great development potential of retailing industry, the retailing stores have become the most important distribution channels. Manufacturers are the most important suppliers for retailers. Specifically to China situation, there are consisting large numbers of medium and small suppliers. The keen competition often makes the fittest to survive. Whereupon, the suppliers have weak power over retailers. Moreover, with the further and fast development of retail industry, many retailers are becoming larger in terms of their operating scales and hence their purchasing scales. Consequently, those retailers are account for a big proportion of suppliers' total sales, and continuous high volume purchases are crucial for the well-being of suppliers. As a result, this will lead the suppliers to a position with low bargaining power. In addition, revaluation of RMB, exporting prices and exporting volume have great impact on suppliers' bargaining power. The revaluation of RMB leads to the decreased China's competitive advantages on exporting prices. Before that, Chinese manufacturers have significant competitive advantages in exporting. However, recently, in facing such a tough situation, manufacturers have to seek domestic retailing channels to distribute their goods and services. According to Zhuang et al. (2003), in order to get into a store, some producers in China offer retailers with consignment basis

arrangement, retailers are not required to pay for goods until the retailers sells the products. Accordingly, retailers would benefit in terms of their bargaining power as well as the prices and quantities these suppliers provide. Therefore, it is probably safe to argue that the suppliers of Chinese retail industry have low bargaining power, and they only posing little threat to the profit of retail industry.

### 3. 2. 4 Threat of Substitutes

Weak: Substitutes for big box retailers are smaller grocery stores; substitutes are higher priced relative to the performance they deliver. Substitutes is important factors influencing market demand. Substitutes would divide the profits and intensify the competition in this retailing market. Chinese traditional markets including wet markets and street markets, both are considered to be substitutes of retailing stores in Chinese retail market. Wet markets are characterized as large and enclosed, and space is divided among counter-service departments; whereas street markets sell fresh food in the open by private sellers with tiny stalls. The environments of both are dirty, crowded and noisy. The competitive advantages of wet markets and street markets are lying in fresher food and cheaper price. Therefore, in the early days, these wet markets and street markets are strong substitutes of retailing stores. With the improvement of people's living standards, a cozy shopping environment, with wide variety of products and outstanding services provided by retailing stores are attracting more and more customers. Smaller grocery stores are also substitutes for large scale retailers, but grocery stores are higher priced relative the performance and services they deliver to buyers. Zhuang et al. (2003) mentioned that distribution channels tend to be shorter and this reflecting the attempts of retailers and producers

with each other more directly. However, the strength of wholesaling in distribution has been discounting, therefore wholesalers were forced to find a different position in the new system. The boundary between retailing and wholesaling has become blurred as it has been broken by private wholesalers in wholesale markets. Private wholesalers selling goods to both wholesale and retail buyers, as same with the phenomena happened in developed countries in early years. Wholesalers are more often penetrating the retailers' domain, developing some new retail formats such as warehouse retailers. In the early years, Wal-Mart and Carrefour had introduced warehouse retailing into China major cities including Shanghai, Beijing, Guangzhou, and Shenzhen (Zhuang et al. 2003). As this trend is becoming more prominent, wholesalers most likely to use their inherent advantages as suppliers, who will build more warehouse-style retail stores, threatening retailers. In addition, sales on Internet and television also considered to be substitutes of retailing stores in China. Sales on Internet and television are becoming more and more popular, and also had become most of consumers shopping habits nowadays. Advanced technology enables the online and television shopping transactions to be gradually fast and safe. Furthermore, online and television shopping are considered to be timely, cost sufficient and efficiency. Combined with the increasingly fast pace of lifestyle Chinese society, the demand of online and television shopping is increasing. In 2001, the Internet retail sales had hit RMB 1200 billion that is more than one third of the traditional retailing format with sales of RMB3230.6 billion (euromonitor. com). There is no doubt that online and television retailing posting great challenges and threat to traditional brick-and-mortar

retailing stores. Both Chinese traditional market and modern online and television retailing reap the market demand in this retail industry. However, online shopping will complement and can boost the demand for brick-and-mortar retailing stores. The presence of retailing company on websites will increase the exposure of the retailer, and give the potential customers a full introduction of this retailer.

### 3. 2. 5 Determinants of Buyer Power

**Weak:** There is a broad base of buyers so no single buyer can demand price concessions; buyers purchase merchandise in small quantities; buyer loyalty for certain brands exists. Similar to suppliers, buyers can bargain away some of retailers' profits. Although the price is fixed in most store-based retail operations, but buyers have a form of bargaining power as they can choose to buy at this store or to buy from a competitor's store. The customers' power depends on factors such as the number of alternative retailers available to choose from. (Source Zhuang et al. 2003)

As there is sustained growth of GDP in China, citizens' household incomes are rising, and therefore this further stimulates citizen's consumption level. With the rapid economic growth, the Chinese consumption level is expected to grow continuously. This enables Chinese retail industry to enter a good stage of development. In 2005, China central government issued Central Government's proposal on the Fifteenth Five Year Plan Project of National Economy and Social Development. This policy was particularly issued to further increase the income of residents, enhance consumers' confidence, promote potential consumption, and hence to support the retail industry to develop more healthy and continuously growth ([www. gmw. cn](http://www.gmw.cn)). It is estimated that during the period of the fifteenth Five Year Plan (2006-2010), the growth rate of

consumption sales will reach between 13% and 15%. Consumers' lifestyle and psychology play very important role in retail market. With the increasing of their income levels, more and more people are seeking for a better lifestyle. The increase of car ownership and improved transportation links enable people to travel to and shop in farther retailing stores. In addition, because of the lower import duties and tariffs after China joined WTO, sales of high quality consumption goods have started rising among small market since more and more middle-class income citizens are able to afford the spending on those high quality products (China Country Report, 2002). Moreover, in tandem with suppliers losing bargaining power relative to retailers, recently, the buyers' bargaining power has been increasing. According to Zhuang et al. (2003), there are changes in retail industry such as, commodity supply moving from shortage to excess to meet buyers; demand; from few outlets to many outlets; from small operational stores to large scale; and also service attitude from cold to warm. This tendency is most likely to be continuing. Of course, the one who is the best, most efficiently, and be able to satisfying buyers' needs, will be likely to be the winner in the retail industry in the coming date. Table 4. 2 summarizes the five forces in the recent Chinese retail market. Generally, each retailer faces intensive competition and challenges as well as great opportunities in this market. The profitability of this industry depends on many factors, of which government policies play a more important role in China than in other countries.

## Chapter 4: Findings

### 4. 1 Expansion Opportunities in China Retail Market

4. 1. 1 Government supports and policies Concerning the Chinese government policies and supports, two major opportunities arise.

Formulation of relevant law and regulation Increases the support of the finance for the economy growth

4. 1. 2 Opportunity to occupy the rural market

The strategic emphasis of the foreign retailing enterprises for the development in China is mostly placed on market in the big, medium-sized and small cities with the relatively developed economy. Even the foreign retailing enterprises want to develop towards the rural market, since China has established the chain stores in the county, some stores are opened in the rich village and town that it not only has the convenient hardware condition in the store expansion aspect but also taken the first impression in the software aspects of the enterprise image promotion and culture color, etc (Wang, 2003). The income of the Chinese workforce is steadily increasing each year. This indicates that Chinese people are gaining more buying power. Next, with the China accession to WTO agreement, in which China opened up its retail market, it leads to more opportunities and easier for foreign retailers to expand their retail businesses to other regions in China and to grasp more market share. Chinese culture has an increased focus on quality of life and therefore shopping environment and quality of services provided retailers. Foreign retailers enjoy a credible reputation in Western countries due to their product safety and quality, and services quality. This makes Chinese buyers more comfortable to shop in foreign retail stores.

4. 1. 3 Economics Urbanization is perhaps the single most inescapable reality of

China's current economic development. McKinsey speaks of "China's urban billion" by 2030, predicting nearly 400 million new urban residents (an increase from 47% of the total population to more than 64%)<sup>12</sup>, exceeding the population of the United States. It is the rapid rise of 'second-tier' cities that changing the urban landscape, expressed by Euromonitor International. Economic growth and rising incomes in China Tier 2 cities have made entering these markets much more attractive than it was in the past. Nowadays the increase in consumer spending power in these cities is creating a rapid growth in demand for higher quality products. In particular, cities such as Tianjin, Nanjing, Suzhou and Hangzhou all offer strong commercial opportunities.

4. 1. 4 Low bargaining power of suppliers

As the bargaining power of suppliers is relatively low compared with retailers, this helps retailers in ensuring the supply for products to market and reduce price fluctuation.

## **4. 2 Expansion Challenges**

4. 2. 1 Excessive Competition

Low concentrative degree of market, small-scale of firms

In recent years, Chinese retail market has a tendency of big-scale, the expansion of pace is big, but the entire scale is not big, especially the scale of foreign invested retail firms is comparative small. The domestic retail market has not formed the big scale and big retail groups with strong power yet, particularly the big enterprises to combat with the international retail leader. The enterprise scale is an extension to focus on the website resource without reflecting the scale effect and there is greater difference with the big retail market in the world in the aspects of market sales amount or store number, etc. At present, the market concentration of the domestic

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retail market is only 10%. The Chinese top 100 chain enterprises realized sales of 1.66 trillion Yuan in total, occupies about 10.7% of the total sales of consumer goods in the entire society 30 (15,455.4 billion). Chinese retail firms are mostly made up of small-scale and middle-scale firms, which lack of large-scale retail firms, and then make Chinese retail difficult to form a scaled effect. In addition, the international retail leaders mostly adopt the central procurement policy to improve the negotiation ability with the supplier to reduce the purchase cost and maximize the access profit and meanwhile effectively prevent the happening of the business bribery and regulate the purchase behavior. However, the small scale of the retailing enterprises in China results in the high purchase cost and influences on the enterprise's competitiveness. Ability of making profits is comparative weak. In the cut-throat competition of Chinese retail market, price war is always regarded as a trump to vanquish the enemy for most firms, as far as depreciation; the names are numerous, such as: points accumulation, discount sales, return sales, buy and rewards and so on. Retail price war was started from 1990s, it continued for over ten years. In 1992, the famous "Zhengzhou commercial war" was started from the price war of Chinese retail and end up with the bankrupt of the famous department store "Asia" in Zhengzhou. But the price war of Chinese retail has not stopped, the heated competition is continued. In the Xi Dan shopping festival between 28th of December and 6th of November in 2005, Zhong You Corporation has the activity of "buy 200 get 216 coupon", Xi Dan Shopping Mall, "Buy 150 get 168 coupon", commercial war raise one after another in Beijing. These malignant competitions are the certain results of excessive competition in

Chinese retail (Chen, 2008). The excessive competition situation makes retail operate in low profits or even without profits. The entire retail is in a low level of profits. In recent years, the rapid expansion of the commercial network is greater than the growth of the total sales amount that the competition is rapidly intensified. The commerce enterprises enter 31 into the comprehensive meager profit times that the average gross profit is around 17% while the average net profit is less than 2% (the average profit rate of top 500 retailing enterprises in China is only 1.47% and the average profit rate of top 100 enterprises is only 2.56%). However, the gross profit rate of the large foreign transnational retailing enterprises is generally around 10% but has 3%-4% of the net profit (Jin, 2004). China's retail market still has the great difference with the foreign retail leaders no matter in sales amount, growth speed or the net profit rate aspect, etc. It can be seen from that, the excessive competition and the fierce domestic competitions all leads to the reducing profitability of the local retailer and comparative weak ability of making profits.

#### 4. 2. 2 Complexities of relation building

Another major threat for foreign retailers' expansion in China is that the concern for 'Guanxi', or relation building. This is highly important in order to become competitive in China retail market. Nevertheless, 'Guanxi' takes a long time and a lot of effort to build necessary relations. The threat in this part are more serious as China has the potential for foreign retail giant to become the market leader. Local retailers, particularly those are operating in large scale, they are developing and as they are practicing in the principle of imitating foreign large scale retailers. On top of that, local retailers are more adapt to local buyers' shopping style, tastes, and preferences. Moreover, Chinese

labour ( under manufacturing and retailing) cost is relatively low, which press prices down and can make ‘ Made in China’ products more competitively priced.