"Our view"
KPMG China, Deal Advisory

Tapping in to China's e-commerce sector

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With a retail sector set to grow from USD3.1 trillion in 2016 to USD4 trillion by 2020[1] – coupled with the world's largest e-commerce market (representing 40% of global e-commerce in 2016 and likewise set for growth[2]) – it would be fair to say China represents vast opportunity for firms that manage to get their growth strategies right.

Driven by a growing middle class with rising incomes, favorable spending habits of younger generations, and rapid growth in e-commerce given rising internet penetration via mobile devices, China's retail sector is projected to account for 27% of global retail sales growth over the next 3 years[1]. Furthermore, e-commerce in the PRC is shifting from C2C to more of a B2C market – driven by consumers demanding quality and platforms clamping down on counterfeits – with B2C forecast to account for 70% by 2020[3].

Currently, large e-commerce platforms such as Alibaba and JD dominate China's B2C sector (capturing over 90% of sales), giving rise to a highly competitive arena for merchants[4]. As a result, to succeed in the PRC's e-commerce sector, in-depth consideration of the three key pillars – *product*, *reach* and *capability* – is paramount.

Regarding *product*, innovation and adapting to Chinese consumer needs are key. Chinese brands have an increasingly sophisticated product offering with improved brand recognition in China. Local brands accounted for 46% of FMCG (fast-moving consumer goods) spend and 58% of market growth in 2015[5]; brands such as Yili or Bright in the dairy sector, for instance, grew at nearly twice the rate of peer multinationals (MNCs)[5]. Product innovations based on consumer insights and a rapid product launch have been essential to this success. In contrast, many global players in our experience have complex global approval processes that hamper go-to-market speed. To tackle this, innovative cross-border e-commerce trade models that simplify legal/regulatory procedures could be a solution.

In terms of *reach*, opportunity exists to leverage major e-commerce platforms to expand to lower-tier cities. Over 50% of China's population resides in such cities and rural areas[6], presenting vast untapped potential. As a result, large e-commerce platforms are extending their reach to Tier-4+ cities to capture new growth. In fact, over 60% of the ~200 million rural area Internet users do not yet purchase online[5]. Alibaba has built over 100,000 service centers to encourage rural residents to shop online[7]. To support e-commerce development, logistics networks to rural areas are being developed, while consumers in more than 85% of towns in China are accessible via the main delivery companies[8]. MNCs in China could leverage e-commerce to penetrate lower-tier cities for growth while defending their success in the coastal Tier-1 and -2 cities.

And from a *capability* perspective, in our view MNCs should focus on building up operational capabilities in China. Many MNCs in China currently rely on local e-commerce operation service providers, prompting high outsourcing costs, poor internal capability and delayed response to market. While third-party service providers may be effective in filling the gaps at an early stage, key capabilities must be taken back in-house to cash-in on in e-commerce – a segment forecast to account for over 20% of sales in China in the near future[9]. In particular, customer data analytics, online content management, customer service, and social marketing skills should be invested in early, as these directly affect customer-merchant touch points and do not require significant investment. Supply chain logistics and IT capabilities are must-haves for larger organizations, but entail greater funding.

Despite the recent growth in e-commerce, it should be noted offline retail will still account for 70-80% of retail sales in the foreseeable future[9], with e-commerce likely to remain a complement to offline sales. For new China market entrants, major e-commerce platforms can act as a stepping stone in the China retail market to build own capabilities, gain understanding of Chinese customer preferences and create brand awareness before launching an offline strategy. And for MNCs already present in China, major e-commerce platforms can be leveraged to increase reach and build awareness in lower-tier cities before expanding via a more costly offline network.

Overall, in our experience assisting global FMCG brands and retailers to leverage e-commerce growth in China, key focal points to consider include: (1) accelerating product innovation (with fast-to-market timeline) to cater to Chinese tastes; (2) leveraging e-commerce platforms for expansion to lower-tier cities and rural areas; and (3) building in-house capabilities for better control and higher margin.

1) Eiu.com (accessed 9 January 2017); 2) eMarketer.com (accessed 9 January 2017); 3) Bain; 4) iResearch (accessed 9 January 2017); 5) Kantar Worldpanel. com (accessed 9 January 2017); 6) China Bureau of National Statistics (accessed 9 January 2017); 7) InternetRetailer.com (accessed 9 January 2017); 8) Haitong Securities, Changjiang Securities; 9) Euromonitor (accessed 9 January 2017). Credit: KPMG China's Sébastien Lesieur (Senior Consultant)

Willi Sun
Director, Strategy
Phone: +86 (21) 2212 3740
Email: willi.sun@kpmg.com

Mark Harrison
Partner, Deal Advisory
Phone: +86 (21) 2212 3620
Email: mark.harrison@kpmg.com

KPMG China,
50th Floor, Plaza 66, 1266 Nanjing West Road, Shanghai 200040, China
Tel +86 (21) 2212 2888 Fax +86 (21) 6288 1889