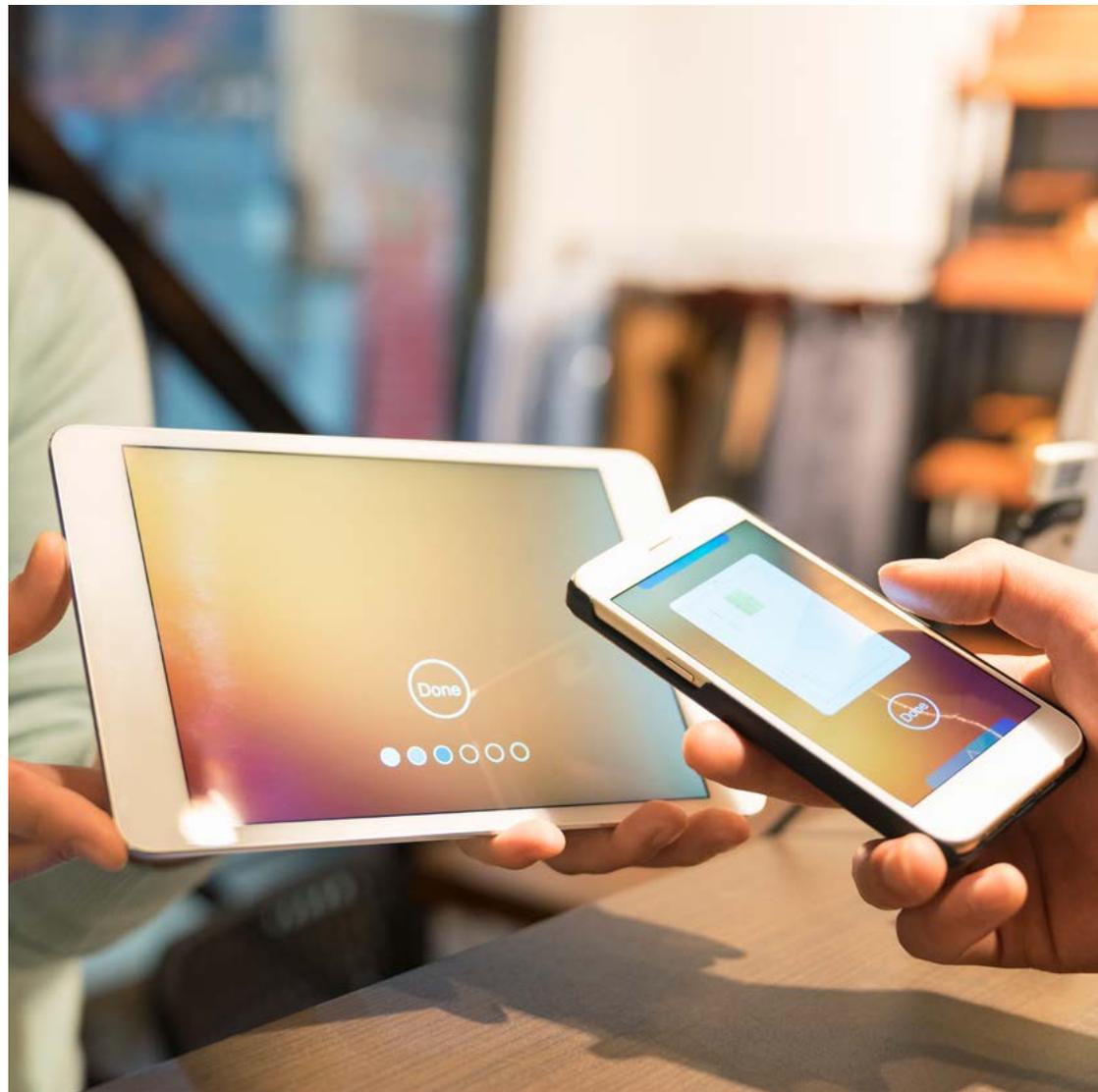


Trends in China's new retail landscape that spell investment opportunity for corporates and PE firms

July 2019





Introduction

The Chinese customers market, in all its vastness and vibrancy, is no stranger to anyone. China has close to 1 billion Internet users and the country boasts the largest eCommerce market in the world. We have all witnessed how digital advancement and eCommerce have transformed China's retail landscape and brought incredible growth. Yet, increasingly the question on everyone's minds now is how much longer digital innovation can further fuel the growth in retail, and what the next growth driver might be. Some would suggest that in the future "new retail" might be the key catalyst to unlock the next wave of retail growth.

While market practitioners see the potential of new retail, it is still very much in the concept stage and each person has a different definition of what it entails. Some say it is the integration of online and offline retail channels by leveraging digital technology such as mobile payments, the Internet and even artificial intelligence.¹ Others view it as the intersection of the customer and merchant value proposition.²

Among these views, one innovative model often used as a poster child for new retail is Alibaba's Hema brand. This is a supermarket where customers could browse and pay for their groceries in their mobile app and have their groceries delivered to their doorstep. There is also a supermarket with live seafood counters where customers can pick out their seafood and chefs will cook them a meal on the spot. This digitally-enabled innovation brings together retail, food and some could even say entertainment into a seamless experience.

No doubt Hema has illustrated a great example with many of the right elements of new retail. But we think it is also far from illustrating the totality of new retail, which we believe is still an evolving concept entailing much more than the end-to-end integration of online and offline ecosystems.

¹ [How China is leading the 'new retail' revolution, July 2018](#)

² [Alibaba's 'New Retail' Revolution: What Is It, And Is It Genuinely New?, November 2018](#)



Our view on new retail

Through our extensive retail work in China we have increasingly observed that new retail has extended into broader meanings and applications across the entire industry value chain. It is the means rather than the end to reflect the constant evolution of customer needs and preferences as driven by social, demographic and technological trends. In this article, we set out to explore three core propositions from our first-hand dialogue with many leading Internet giants, retailers and investors.



The customer is — and will always remain as — the centre of gravity propelling new retail growth



The business implications of new retail go beyond the digital front



There is scope for winning in and beyond Baidu, Alibaba and Tencent (BAT) defined playgrounds

The analysis that follows details the impetus for the evolution of new retail and what this means for customers and businesses. It outlines how corporates, portfolio companies and private equity investors can position themselves to take advantage of this next wave of growth.



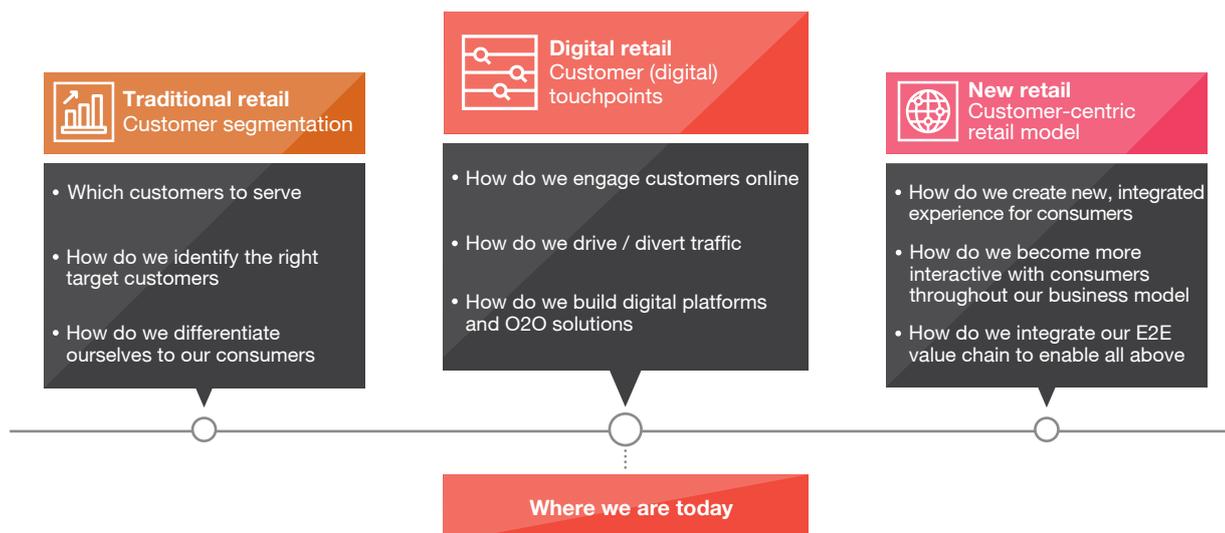
The customer is the centre of gravity propelling new retail growth

New retail means putting the customer at the centre of growth. It is about how retailers are completely integrating and embedding end-to-end capabilities (digital and non-digital) to bring about innovation in the customer experience. As such the customer can actively participate in and influence the retail model.

The growth in new retail is being driven by underlying customer trends in China. Recent trends include the rise of singles, the revolution of low tier customers, “healthy and green” living, the accelerating and shortening cycles of trends and the need for full “connectedness” and digitalisation. These trends are impacting the

market landscape and have real consequences for retailers. The customer-centric model has evolved from the “traditional retail” stage with retailers targeting a segment of the market, to “digital retail” where they are focused on talking to customers via digital touchpoints (e.g. smartphone, social media, and mobile apps). The next stage is not looking at touchpoints in isolation but how to create a new and integrated experience for customers using an interactive business model.

Figure 1: The evolution of customer-centric model



For retailers, a step-up in fostering a customer-centric model would mean emphasising on five dimensions:

1. From purchase to entertainment:

Retailers should ensure customers are no longer simply buying a product, instead they should embed purchases into an entire entertainment concept.

2. From consumption to co-production:

Retailers should cater products via interactive inputs from the customers themselves.

3. From personalising product to personalising an integrated shopping experience:

Retailers should offer customers a tailor-made shopping experience to suit their needs.

4. From marketing or brand impression to an interactive, continuous dialogue:

Retailers should engage in a continuous dialogue with customers rather passively communicating with them through advertising.

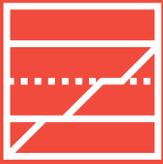
5. From supply chain improvements to mass customisation:

Instead of focusing on cutting time or reducing wastage, retailers should cater the supply chain to meet customer needs (for example through demand planning via automation and AI).

Figure 2: Where we need to be: Everything (front + back ends) connected around customer and customer experiences



Source: Expert interview, desktop research, PwC analysis



The business implications of new retail go beyond the digital front

Nowhere else in history were customers more empowered than in today's customer-centric world, where access to free information and ubiquitous digital technologies work to their benefit. In fact, the relationship between retailers and their ever-discerning customers has completely altered — and this has profound business implications for industry participants as new retail in China continues to stretch beyond digital transformation to encompass the entire value chain.

At the same time, **offline retailers also have innovations that fit into the new retail format**, such as community store operator Qiandama. The retailer puts customers at the heart of their service offering by connecting directly with suppliers to provide fresh food to neighbourhoods on a daily basis (i.e. no overnight stock). This new retail model — one that relies on serving precise customer needs rather than digital enablement — has proved success for Qiandama leading to rapid growth of over 1,200 new stores within the past few years in Guangdong area, where customers are known to value freshness and convenience.

In fact, **the pressing need to go customer-centric and do so in a cost-efficient way has prompted traditional and online retailers to rethink about their end-to-end value chain capabilities**. For example, Joy Wing Mau is a fruit trader that controls 20% share of imported fruit in China. Through upstreaming they have developed full supply chain traceability covering R&D, cultivation, processing, storage, delivery and distribution capabilities.

In China's low tier cities where growth is fast and opportunities to capture customer demand ample, a much more dedicated business model is required to capture the customer needs.

Pinduoduo has scored a stunning victory in this regard. As a specialised discount eCommerce platform, the company is thriving in low-tier cities with its social-group buying model where customers engage in virtual communities to achieve lower prices. This strategy has enabled the company to gain higher penetration than TMall and JD.com in select low tier cities.

On the other hand, **with the advent of emerging technologies standard purchases are being transformed into genuine shopping experiences and driving category excellence in areas** such as specialisation, retail-tainment, automation and mass customisation. There is no shortage of use cases to demonstrate such transformation. Fresh fruit retailer Pagoda's specialisation enables it to achieve 8-10x scale versus traditional sellers like Carrefour, so they could offering better prices, wider variety, and stronger partnerships with overseas suppliers. Health and beauty care chain Watsons offers customers a retail-tainment experience with their in-store augmented reality make-up mirrors. Retailer BingoBox leverages automation by offering 24-hour un-manned convenience stores in more than 300 locations in China, while vitamin supplier LemonBox engages in mass customisation by surveying customers on their physical and lifestyle traits before providing them with bespoke products under a subscription model.

In this digital era to better preempt, stratify, and respond to the highly diverse needs of customers, **retailers are also investing in and utilising big data analytics, integrated customer-relationship management (CRM) platforms and precision marketing** to more granular levels and driving micro-segmentation. Starbucks has taken this concept to practice by offering highly individualised marketing driven by micro-segmentation using advanced analytics and AI.



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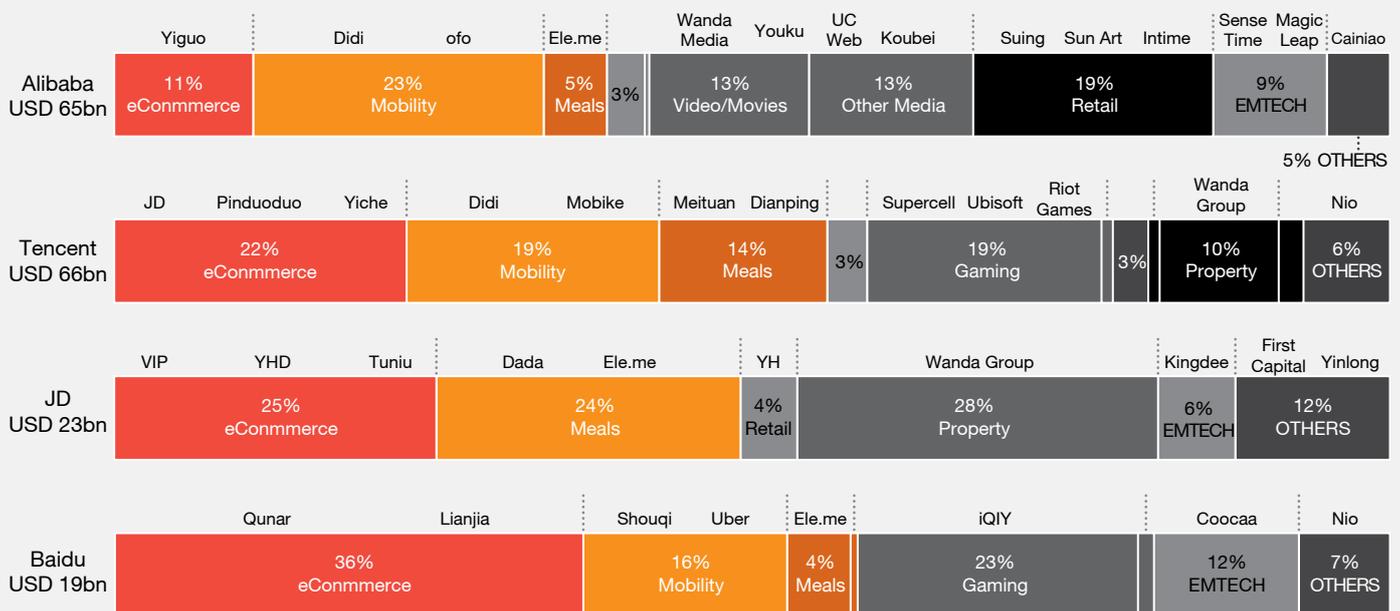


There is scope for winning in and beyond BAT-defined playgrounds

Today, the market for new retail is still at its infancy and is far from fully defined. China's trade buyers and BAT are ahead in investing and driving the new retail environment given their existing digital ecosystem, access to customer traffic and data as well as their strong financials and available capital to invest. As pioneers they

have a stronghold over China's retail channels for demand-generation, entertainment, commerce and fulfillment and control the majority of operations in this closed ecosystem — some would referred to as a “walled garden”.

Figure 3: BAT has been investing comprehensively across retail ecosystem Estimated investment value by sector, 2014 – 2018 May (USD bn)



Note: Analysis based on sample of 349 deals, in some cases deal size may reflect total funding versus company contribution. Sector classification based on PwC judgement.

Source: PwC analysis



Thus it's important to think about new retail more broadly than what the BAT ecosystem has now defined

It is therefore important for domestic and overseas corporates to define the right strategy on how and if they should partner with or play within the BAT ecosystem, particularly in terms of generating traffic and customer insights and data.

On the other hand, we also see many successful examples of retailers that have gone outside of the BAT ecosystem. For example Xiaohongshu or “Little Red Book” is a beauty and fashion focused social platform that targets post-80s and 90s women and is combined with an in-house eCommerce platform. Without relying

on the BAT ecosystem, the company reached 100 million users and US\$ 1 billion in sales. Ultimately the company raised US\$ 300 million in its Series D round of funding from investors including Alibaba Group (with a valuation of US\$ 3 billion), a clear sign that even the dominating players cannot afford to ignore the growth potentials of startups operating outside the BAT realm.³ There are many other similar stories out there. Thus it's important to think about new retail more broadly than what the BAT ecosystem has now defined.

³Chinese social commerce unicorn Xiaohongshu raises US\$300 million from investors led by Alibaba, June 2018

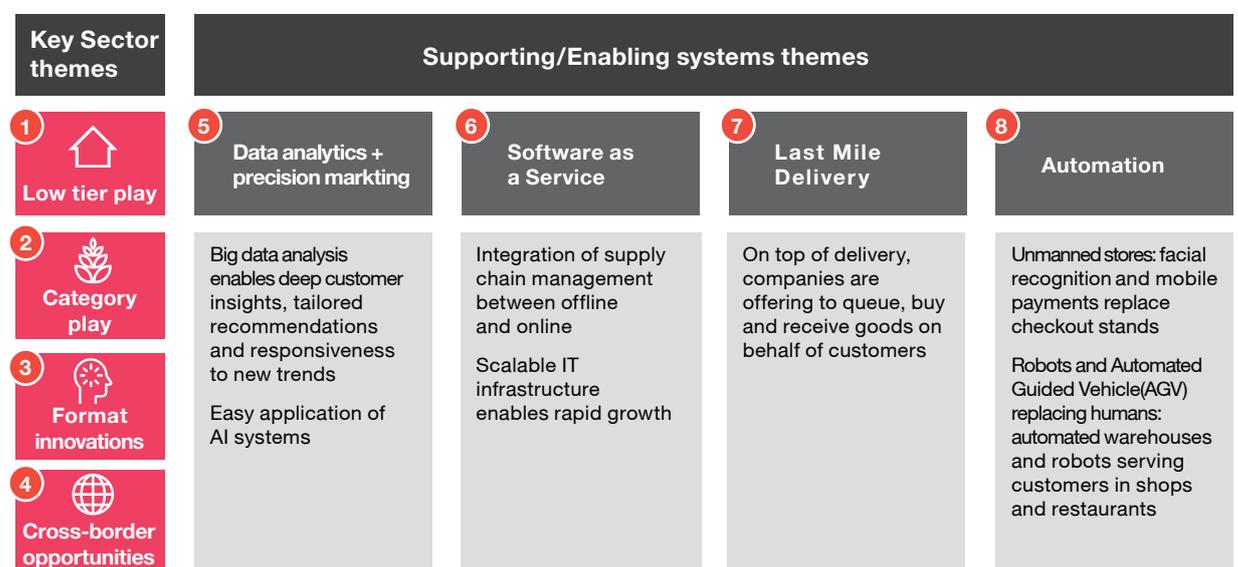
What does new retail mean for corporates and portfolio companies?

- Success in the new retail arena begins with how well retailers can execute their customer-centric models and how far they can go in articulating on customer needs.
- There are new and accelerated ways to serve the China market for overseas or Hong Kong-based companies by using digital platforms to expand, reach and build presence, and do so at an expedited pace.
- There's more to the retail landscape than just putting products on Tmall or JD.com, namely developing the end-to-end value chain, customer centricity and bringing the full power of analytics and precision marketing to bear.
- The key is building the right organisational capabilities by cultivating an integrated team with the right capabilities at top levels to drive transformation in the way the customer is served.

What does new retail mean for private equity investors?

- Going forward, there is scope for agile PE buyers to buy or invest in the high growth potential companies in the new retail space.
 - When considering an investment target, PE buyers should ensure the firm has a strong management team and robust business plan and that the investment would result in a strategic alliance.
 - PE buyers would also need to conduct adequate due diligence upfront to ensure that their target investments have the operational capabilities and governance framework to power growth, limit risks and ensure a sound return on investment.
- Having said that, this ongoing industry-wide transformation, along with the emergence of many new business models, has unearthed new gems of investment opportunities to the eyes of those who are agile and prepared. PwC sees potential along eight key investment themes relevant for PE investors namely: low tier play, category play, format innovations, cross-border opportunities, data analytics and precision marketing, software as a service, last mile delivery and automation.

Figure 4: Eight key investment themes



Source: Crunchbase, PwC analysis

Looking ahead

New retail is here to stay. Chinese companies are strategically positioning themselves to take advantage of the changing customer habits that are redefining the market, and are putting customers at the heart of the decision making process. Significant investment has already gone into new growth areas as well as the underlying infrastructure and while establishing new partnerships and ecosystems are important, it is also essential to preserve the core capabilities that created the competitive advantage.

How is your company navigating the new retail landscape? And where are you in the journey of transformation towards creating superior customer experience?

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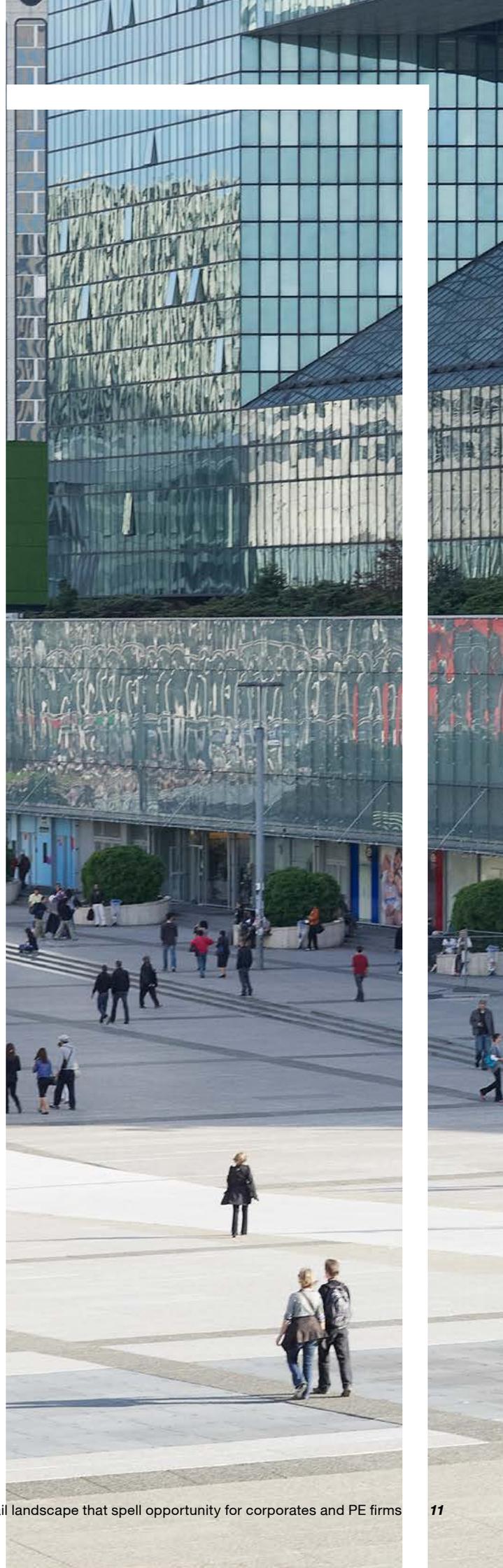
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