

RESEARCH

EXPERIENCE AT THE FORE IN THE NEW RETAIL TYPOLOGY

Spotlight on China's retail market 2014

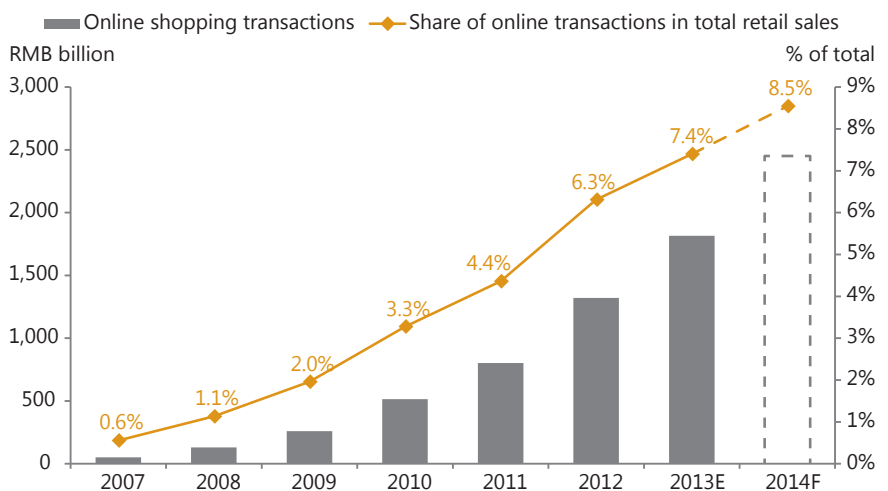
EXPERIENCE AT THE FORE IN THE NEW RETAIL TYPOLOGY

China has more Internet shoppers than any other country, at 220 million, and is shortly set to overtake the US as having the world's largest on-line retail sales market by total value, yet the supply pipeline of new mega sized malls in its cities show no signs of abating. The question naturally arises whether e-commerce represents a significant competitive threat to traditional bricks and mortar or whether the two can continue to coexist in a symbiotic relationship.

Retailers can shift their optimum blend of online/offline presence while still dealing directly with their customers, but landlords are one step removed from this relationship and must hope that in-store sales will yield sufficient revenue to claw back a good return in the form of rent. While online retailing is expected to grab a larger share of the sales market in China in the future, we do not predict an abrupt demise of malls. However, we do see a different typology of shopping centre emerging. This typology is still evolving, but it is clear that shopping centre operators

Figure 1

Online transactions as a proportion of total retail sales in China



Source: CECRC

need to find new ways to engage and entertain customers, while still advancing their traditional hallmarks of convenience, variety and service.

Supported by interviews with selected retailers, major developers and industry players, this paper aims to highlight how shopping centres are adapting to both the challenges and the opportunities that e-commerce presents.

E-commerce in China takes off

Online retail sales are expected to account for around 7.4% of China's total retail sales in 2013, up from 6.3% in 2012. The market penetration of the overall share is already higher than comparative figures for other countries, including the US and Australia, and is predicted to rise to 8.5% in 2014.

China has been enjoying double-digit year-on-year growth in retail sales since 2002. However, the rate of growth has recently slowed, particularly in Tier-2 cities. Once Internet sales are stripped out, the impressive growth in sales is more tempered, particularly when considered against the number of retail properties now fighting for market share.



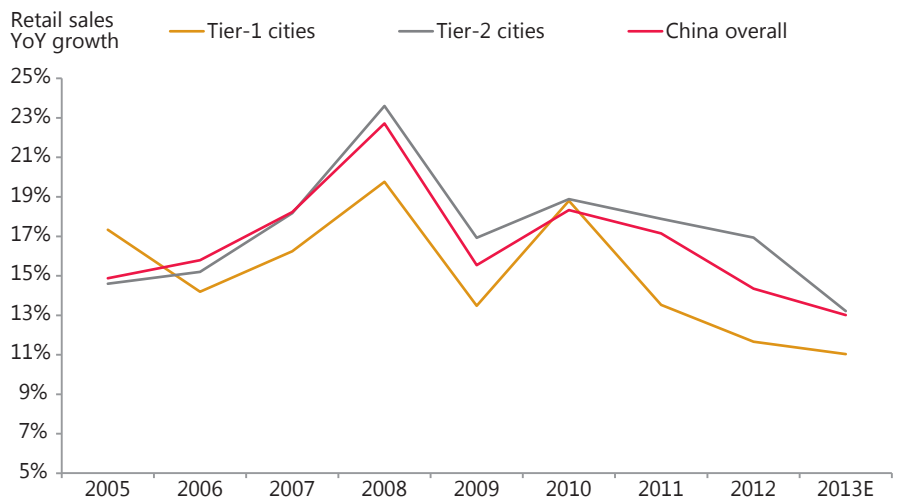


Chongqing Paradise Walk North

Pricing and promotions are driving increasing numbers of Chinese consumers to buy online — products online are often substantially cheaper than in stores although many are offered through non-official channels. On Single's Day (11/11), when big discounts were available, Taobao achieved retail sales of over RMB35 billion this year over a 24-hour period, compared to less than RMB\$2 billion for the same event in 2010. Taobao is now considering other major sales events in the future, such as a Double 12 promotion (12/12).

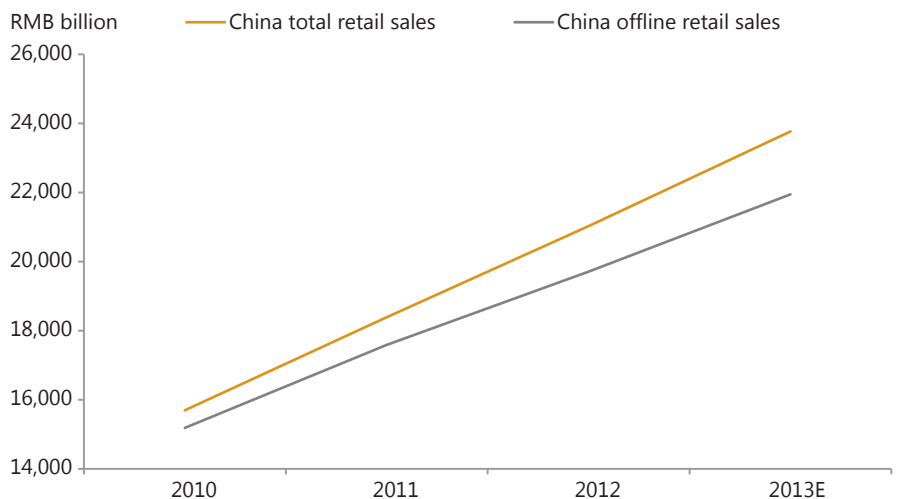
China's online shopping market has some very distinctive traits. Firstly, it is dominated by domestic operators, with Tmall.com (the B2C website of Taobao) and 360buy.com representing around 50% and 21% of the total B2C market respectively. International online shops represent less than 3% of the market share and, to date, have struggled to overcome domestic dominance. International retailers who choose not to launch a platform on Tmall, such as Zara and H&M, miss out on exposure to a massive customer base as well as open the door to imitators selling products that masquerade as their own. Other retailers, like Gap, have a genuine presence on Tmall but only limited space to market their full brand proposition to customers.

Figure 2
Retail sales growth



Source: Public sources / Knight Frank

Figure 3
Offline retail sales of China



Source: Public sources / Knight Frank

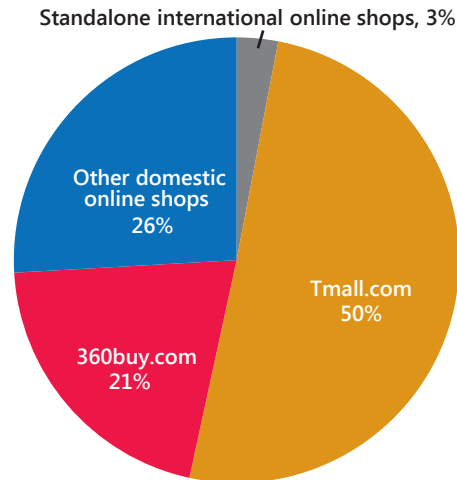
Secondly, while fashion and electronics are the two largest categories of product traded online, the average spend per item remains distinctly low. On Singles Day this year, the average transaction per item on Taobao was about RMB200, not much of an increase from the RMB150 recorded in 2010. Hence, to date, the impact on shopping centres has been felt more towards the lower end of the market. At the higher end of the market, the government's anti-corruption campaign, for example, has had a much greater impact on luxury goods sales, a sector which has also been hit by the increasing propensity of Mainland Chinese to travel overseas to cities such as Paris, London and New York. However, if the average-item transaction figure increases significantly in the future, then more middle- and upper-tier centres are likely to feel the pressure.

Mega malls remain the norm

On the supply side, the retail pipeline of new shopping centres continues. In 2013, a total of 68 new malls opened in the Tier-1 cities of Beijing, Shanghai, Guangzhou and Shenzhen and the Tier-2 cities of Tianjin, Shenyang, Chengdu, Chongqing, Wuhan, Dalian and Harbin compared to 52 in 2012.

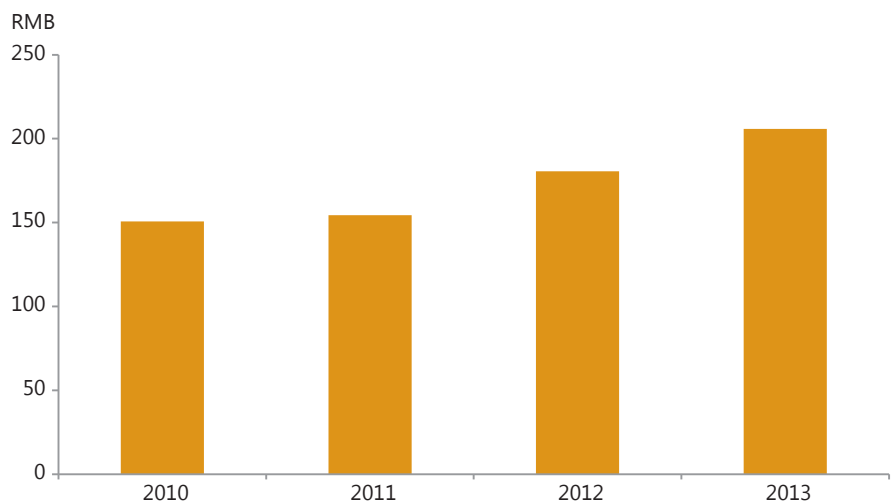
In our previous research publications on China's retail market—*Sorting the wheat from the chaff* and *Is the honeypot still as sweet as hoped?*—we highlighted our concerns about oversized malls. There is no strong evidence that floor space is being reined in and mega malls remain a strong feature of the retail landscape, particularly in Tier-2 cities. In Shenyang alone, seven new centres opened this year with Gross Floor Areas (GFAs) over 100,000 square metres (sqm), and today, over half of all shopping centres in the city now measure over 100,000 sqm.

Figure 4
Market share of B2C websites in China



Source: Local research institute
Note: International online shops include standalone websites setup by international brands

Figure 5
Average spending on one item recorded on Taobao on Single's Day (11 Nov)



Source: Taobao

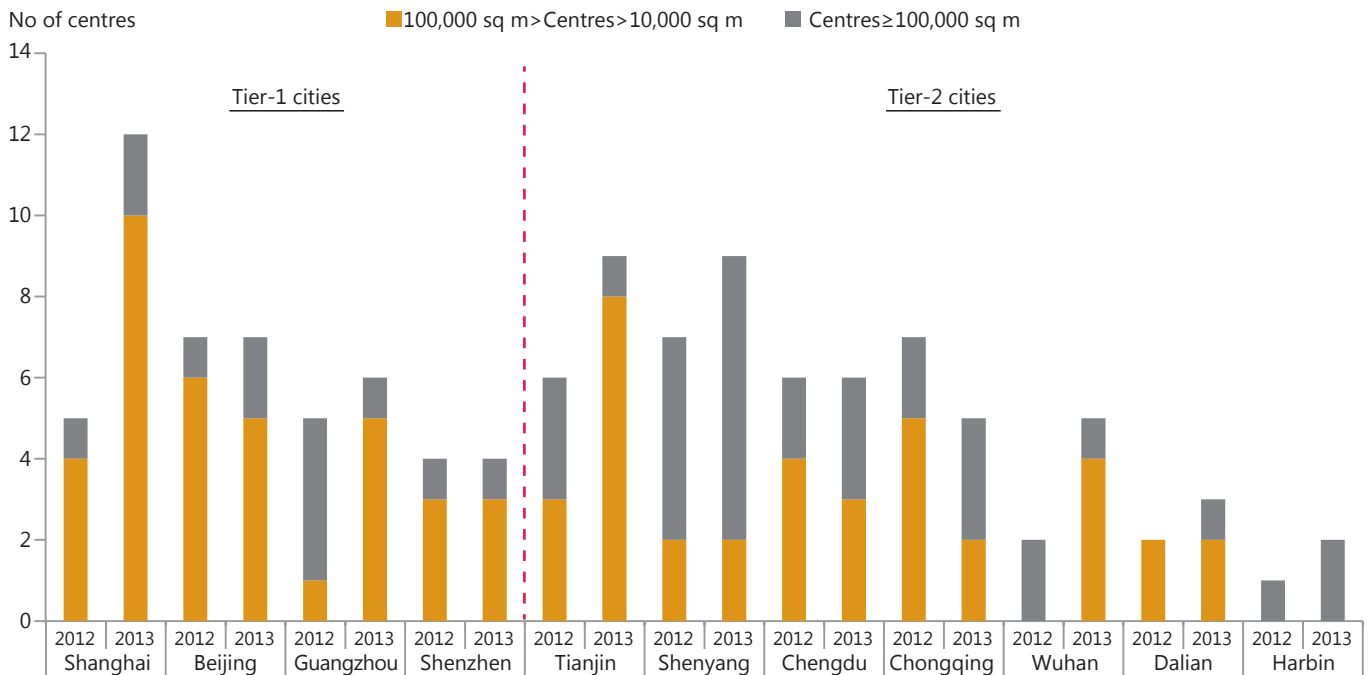
Figure 6
Total new shopping centre supply in major Chinese cities in 2012 and 2013

Year	No of centres with GFA less than 100,000 sqm across 11 major cities	No of centres with GFA of 100,000 sqm or above across 11 major cities	Total No	Total GFA (million sqm)
2012	30	22	52	6.1
2013	44	24	68	6.5

Source: Knight Frank

Figure 7

Number of new shopping centres in major Chinese cities in 2012 and 2013



Source: Knight Frank

Tenant demand – who are the space fillers?

Looking back at the rollout plans of the 45 international retailers we analysed last year, over 60% missed their target number of store openings for 2013. This can be due to a variety of factors, including the difficulty of finding good quality sites; the slowing down of expansion plans in the face of tightening government policies on anti-corruption (or 'gifting'); or a change in strategy for internal reasons. However, in broad terms, two notable aggregate findings can be noted from the table below:

- ◆ 65% of luxury retailers missed their expansion targets;
- ◆ All fast-fashion retailers, except Uniqlo, exceeded their expansion targets.

Figure 8

Share of shopping centres (GFA ≥ 100,000 sq m) in total shopping centres



Source: Knight Frank

Figure 9
Selected international branded retailers' expansion plans for China

Retailer		No of shops in China (2012)	Target for additional stores in 2013	New shops opened in 2013	Achieved vs target
Luxury fashion & accessories	Ralph Lauren	0	20	26	Exceeded target
	Paul Smith	0	5	2	Missed target
	Chanel	10	3	3	Met target
	Prada	25	7	4	Missed target
	Fendi	16	4	4	Met target
	Burberry	57	11	8	Missed target
	Gucci	57	10	0	Missed target
	Hermes	20	3	2	Missed target
	Louis Vuitton	43	2	4	Exceeded target
	Hugo Boss	86	20	19	Slightly missed target
	Stella McCartney	1	2	1	Missed target
	Longchamp	13	9	0	Missed target
	Ferragamo	58	2	3	Exceeded target
	J Lindeberg	1	53	48	Slightly missed target
Luxury jewellery & watch	Graff	1	2	5	Exceeded target
	Piaget	11	2	5	Exceeded target
	Cartier	37	6	-1	Missed target
	De Beers	3	5	3	Missed target
	Hublot	3	8	6	Slightly missed target
	Tiffany & Co.	14	2	11	Exceeded target
Mid-range fast fashion	Zara	120	8	22	Exceeded target
	H&M	88	44	49	Exceeded target
	Uniqlo	145	100	57	Missed target
	C&A	11	35	39	Exceeded target
	Gap	21	24	28	Exceeded target
	Forever 21	1	1	1	Met target
Mid-range others	Ted Baker	1	2	6	Exceeded target
	Muji	41	39	44	Exceeded target
	Holland & Barratt	16	100	0	Missed target
	Marks & Spencer	8	8	6	Slightly missed target
	Karen Millen	1	12	0	Missed target
	Timberland	150	40	32	Slightly missed target
	Mamas & Papas	0	18	1	Missed target
	Mothercare	22	65	18	Missed target
	Sasa	48	7	7	Met target
	Eslite Books	0	2	0	Missed target
	IKEA	11	2	2	Met target
Food & Beverage	Starbucks	500	200	300	Exceeded target
	Costa Coffee	164	100	27	Missed target
	McDonalds	1400	250	250	Met target
	Saica Coffee	1	25	0	Missed target
	Godiva	15	5	41	Exceeded target
	Burger King	63	156	76	Missed target

Source: Knight Frank / Woods Bagot

Fast-fashion retailers are not only one of the most active segments of the market but they are increasingly forming the corner stones to many mid-tier and mid-upper-tier shopping centres. Far from shrinking in size in the face of e-commerce, new fast-fashion stores are typically highly spacious, multi-level and take up some of the best locations in the centre. Some examples of the larger new store openings by these retailers for this year are listed in Figure 10 alongside their respective lettable floor area.

Figure 10
Floor area of major fast-fashion stores

Shop	Lettable floor area size	Location
Gap	1,100 sqm	Beijing
Zara	1,300 sqm	Shanghai
H&M	1,500 sqm	Hebei
H&M	2,500 sqm	Chengdu
Forever 21	2,000 sqm	Shenzhen
A&F	2,200 sqm	Shanghai
Uniqlo	8,000 sqm	Shanghai
Uniqlo	10,000 sqm	Guangzhou

Source: Knight Frank / Woods Bagot

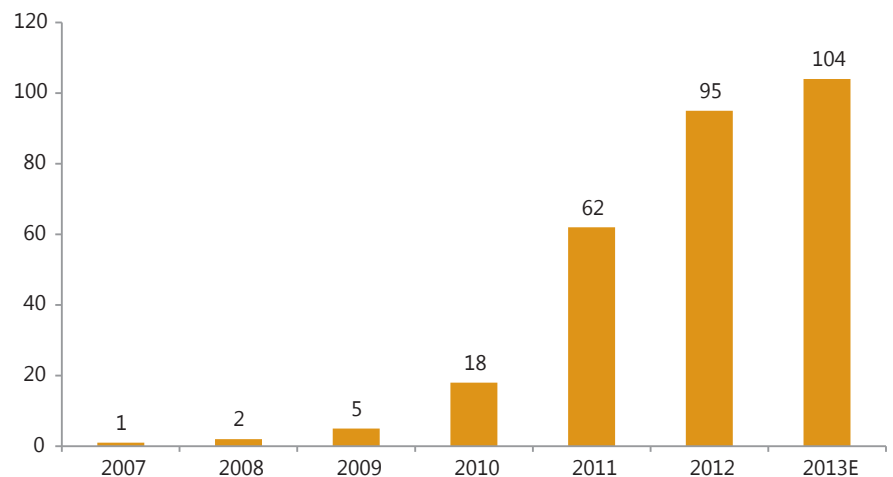
The rise of these mini-anchors is coinciding with the demise of traditional anchors such as old-format department stores (see analysis in 'Sorting the wheat from the chaff'). Rather than offering a value proposition of 'everything under one roof', these new concept stores offer highly curated environments and an opportunity to provide customers with a unique brand experience. Store design and touch points are all used to transmit core values and brand essence. The value of this is captured by higher brand loyalty, which in turn leads to increased sales through all channels, whether in store or online.

The new typology

No longer can shopping centres be viewed as a composite of tenanted areas and circulation space. Now retail environments need to engage and entertain in a wide range of innovative ways, with a view to provoking an emotional response in customers. Pop-up retail; art and cultural features; and performance spaces all help to create interest and elements of surprise that encourage repeat visitation and prevent monotony.

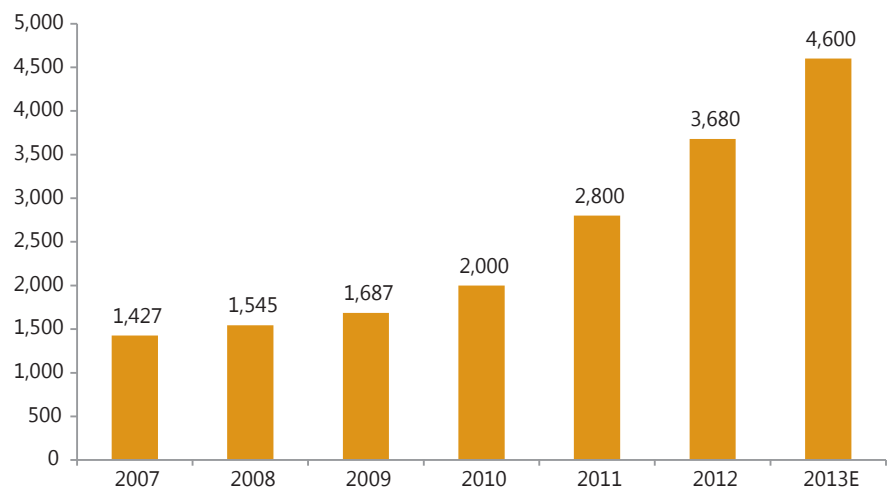
Entertainment is also becoming more important in the overall offer as an experiential use, which has spurred a rapid rise in the number of cinemas across China.

Figure 11
Total number of IMAX in China



Source: Knight Frank

Figure 12
Total number of cinemas in China



Source: Knight Frank

New entertainment uses are being incorporated into malls, particularly those targeting young families. One concept offers role playing activities for children. The worldwide leader in this is Kidzania and whilst this operator has yet to open in China, there are numerous other outlets which evolve around a similar format. Other entertainment uses, such as ice rinks and bowling alleys, have not found the same degree of popularity but we expect new attractions to emerge in the future. The challenge for landlords is that entertainment use is one of the lowest rent payers in a centre (by RMB per sqm) while taking up large amounts of space. Optimising the mix in terms of vibrancy and rent is one of the difficult balance points that developers need to determine and continually review.



Kidzania

Other changes in trade mix are emerging in response to the e-commerce challenge. Previously, the industry rule of thumb was that food and beverage (F&B) use should occupy between 20% and 25% of the total lettable area in a shopping centre. However, this proportion is now increasing, both in terms of quantity and quality, and now it is not uncommon to find F&B operators representing more than 30% of the total area.

Traditionally, restaurants—as a destination use—were typically allocated to one or more of the upper levels of a mall. Today, in the better quality centres, F&B is given greater visibility and used to animate key areas



Kerry Parkside, Pudong, Shanghai

such as entrance points, atriums and outdoor rooftops. Recent examples include iapm and Jing'an Kerry Centre in Shanghai.

In terms of design and layout, shopping centres are evolving from being inward looking, enclosed environments to ones which open out to their surroundings, bringing external spaces into the commercial realm. Al-fresco dining and outdoor recreational uses, whether active or passive, are breaking down the boundaries about where a shopping centre starts and finishes. We anticipate that rigid, standalone shopping centres are likely to struggle to maintain their vibrancy and footfall traffic throughout the day. Rather, it is mixed-use integrated developments that are increasingly forming the key components to successful retail spaces, using the synergy between functions and the overlap of uses to create highly activated environments. Mixed-use developments also allow other uses into the offer, widening the range of attractions to include after-work bars, fitness and health centres as well as educational or service-orientated uses. Good examples of this include K11 and Kerry Parkside in Shanghai.

Trade mix and design is no longer the domain of intuitive expertise. Experienced developers are adopting metrics as tools to guide optimum performance, including advanced systems for tracking shoppers and customer behaviour. The increasing

use of technology is not only a prerequisite for developers looking to maximise commercial potential, but being digitally wired is also key to the new generation of shoppers going online in store for immediate price comparisons and product reviews as well as receiving special promotions via smartphones.

As e-commerce heralds convenience to distinguish it from traditional shopping methods, malls must continue to find new ways to ensure that this territory is not completely relinquished. From opportunities to click and collect to smoothing out parking pains; obstacles and annoyances need to be replaced by a trouble-free, enjoyable experience. Services and comfort require added finesse by incorporating high quality washrooms, stylish common-area seating, welcoming concierge desks and informative shopping directories.

Brand value is as important to landlords as it is to tenants. Branding must be communicated in a cohesive and compelling manner, which is reflected throughout the design, trade mix and management. Those that only apply a superficial overlay or ignore it entirely by strata titling parts (or all) of a centre for example, are increasingly likely to fall by the wayside. However, those that present a clear, differentiated and highly enticing brand proposition to their customers are likely to forge ahead of their competitors.

Summary

Figure 13 aims to capture the key characteristics between the old style and the new typology of shopping centres. Developers lacking experience, particularly with oversized centres in peripheral, poorly located areas, will increasingly find it difficult to maintain high occupancy levels and customer traffic. Those with good accessibility and that are well integrated to surrounding uses have the foundation to thrive, if they can adapt to their changing customer and tenant needs.

Retail remains a dynamic sector requiring timely tuning as new trends develop. The gap between prime centres and non-prime centres is expected to widen in China, with the market becomingly marked by its increasingly polarity.

Figure 13

The traditional format and new typology of shopping centres

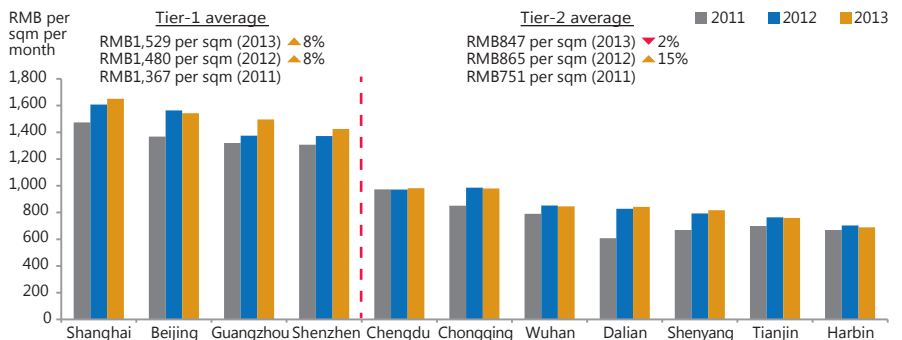
Traditional format	New typology
Standalone	Mixed-use integrated developments
Inward and enclosed	Range of indoor and outdoor environments seamlessly blended
Old-style department stores	Mini-anchor concept stores located in premium spaces
Limited entertainment	Range of entertainment uses offering new concepts
<20% F&B, confined to upper level(s)	F&B given greater share (>30%) and prominence
Narrow restriction of retail uses	Art / cultural / performance elements
Formulaic retail	Experiential retail showcasing highly branded environments
Management light and limited in scope	Management by metrics, intensive and analysis based

Appendix

“The gap between Tier-1 and Tier-2 cities has widened slightly with rental levels generally edging up in Tier-1 Cities whilst remaining flat in Tier-2 Cities. Vacancy rates also showed divergent directions.”

Figure 14

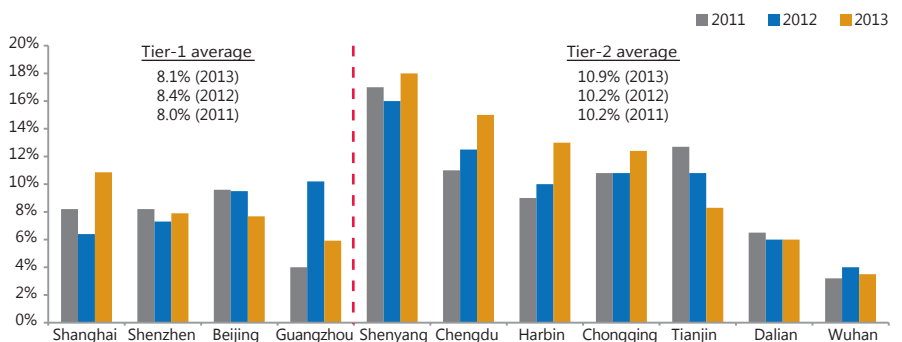
Prime shopping centre level-one monthly rents



Source: Knight Frank

Figure 15

Prime shopping centre vacancy rates



Source: Knight Frank

“Those centres with good accessibility and that are well integrated to surrounding uses have the foundation to thrive, if they can adapt to their changing customer and tenant needs.”

Figure 16

Retail market overview for major Chinese cities

City	Overview
Beijing	Paris-based Galeries Lafayette launched its first Asian store in Beijing's Xidan area, in the third quarter of 2013. Meanwhile, a few projects are set to open in the final quarter of the year, which will provide over 350,000 sqm of space.
Shanghai	In 2013, the majority of new supply was concentrated in Shanghai's prime areas, while in 2014, more new malls will be launched in emerging areas. International brands such as Ikea, Mulberry, Uniqlo and Zara Home continued to expand in Shanghai, underlining their sustained confidence in market.
Guangzhou	A number of shopping malls will be completed in Guangzhou in the final quarter of 2013, offering a total of about 400,000 sqm of retail space. The new malls, such as Wanda Plaza, will open mainly in Panyu, while few will open downtown. Meanwhile, CapitaMalls Asia made its presence in the city, acquiring a shopping mall at Baiyun Greenland Centre in Baiyun district.
Shenzhen	A number of large-scale shopping malls are expected to open in Shenzhen in the fourth quarter of 2013 and in 2014, providing a total retail area of some 770,000 sqm. This includes Vanke's Vmall, located in Longgang District.
Tianjin	International luxury brands such as Prada and YSL have been expanding in Tianjin. Meanwhile, a number of new developments will open in the city, including Aeon Center in Youyi Road South and shopping centres in core areas such as Nanjing Road, adding about one million sqm of new retail space in 2014.
Chongqing	With the launch of WFC Mall, Chongqing is set to see international brands such as Givenchy, Miu Miu and Prada enter the market. The rising trend of retail supply in the city is likely to continue in 2014.
Chengdu	Hong Kong and international players continued to increase their presence in the city. Department store Lotte has opened, while Chengdu IFC is set to launch in early 2014, introducing a number of brands to the city, including Lane Crawford, UA Cineplex and Dolce & Gabbana.
Dalian	Wanda Group established a new mall in Dalian—Dalian High-tech Park Wanda Plaza—in 2013, while domestic brands were relatively active in the leasing market. A number of new projects are expected to be completed in late 2013 and early 2014, such as Guotai Ganghui Plaza and Life Space Shopping Centre, adding over 300,000 sqm of retail space to Dalian.
Wuhan	Wuhan's retail market is expected to be boosted by the new metro line, scheduled to be completed in late 2013 or early 2014. Major renovations are evident in malls in the city's traditional commercial areas, such as Zhongshang Plaza in Zhongnan District which completed its renovations in the third quarter of 2013. Meanwhile, Prada and Miu Miu will reportedly enter Wuhan in 2014.
Harbin	Fashion brand QDA opened its flagship store in Harbin in the second quarter of 2013. Meanwhile, Haxi Wanda Plaza and three other centres will open in the city between the final quarter of 2013 and through 2014, adding over 600,000 sqm of retail space to the local market.
Shenyang	More Hong Kong developers are entering the Shenyang market. Hang Lung Properties opened Forum 66 in late 2012 and New World Development will open K11 in 2015, adding 260,000 sqm of space to the market.

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This research report has been jointly produced by Knight Frank and Woods Bagot combining deep retail design knowledge with real estate insight. Working collaboratively, we have set out what we see as the market trends for shopping centres in China. We believe an integrated approach can add enormous value to clients and deliver a better retail centre for tenants and consumers.

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