E-COMMERCE: 
THE NEXT FRONTIER

THRIVE IN THE WORLD OF NEW RETAIL
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NAVIGATING THROUGH
THE NEW RETAIL ECONOMY

The world of retail has gone through enormous change in recent years, ushering in a golden age for Chinese consumers. Today, an emerging breed of hyper-connected shoppers is facing a vast array of choices throughout an increasingly fragmented digital ecosystem. However, these same complexities are also giving consumers more control over their spending than ever before.

The dynamics of consumer demand and technological innovation have torn down barriers and blurred the line between online and offline, prompting companies worldwide to re-engineer their retail business models in order to unlock opportunities.

With all these changes, how should retailers and manufacturers evolve in order to adapt to market demand and meet the expectations of increasingly empowered consumers? How can businesses design a balanced multi-channel strategy to succeed in China? This report seeks to provide answers to these questions by leveraging trends and data-driven metrics obtained from across China’s dynamic market landscape.

CASHED-UP CONSUMERS ARE BECOMING MORE CHOOSY

Over the past 30 years, the shopping habits of Chinese consumers have changed dramatically, driven by rising disposable incomes and a proliferation of new products in the world’s largest market. Consumer-oriented companies have realized that they need to turn to China to fuel their growth, but doing so is a highly complex task because of how quickly the country is changing and because of the vast differences across the country, both economically and demographically.

Many consumers, with more money in their pockets, are trading up for products and services they could previously not afford. Most notably, the growth of premium segments is outpacing that of mass products. Sales of premium products — which Nielsen defines as goods that cost at least 20% more than the average — grew by 23% between 2012 and 2014 in China.

“Despite the global economic slowdown, demand in China remains undiminished, because consumers looking for quality goods are driving the demand for premium products,” said Yan Xuan, president of Nielsen Greater China. “China, with its huge population and expanding spending appetite, continues to be a highly lucrative market for companies and brands.”
As this golden age of retailing sets in, companies are revolutionizing the way they work, repurposing brick-and-mortar stores to merge online and offline shopping. Over the coming decade, retailers’ new channel strategies and innovative technologies aimed at making shopping a more enjoyable experience will become all pervasive, determining the very shape of retailing.

“When e-commerce had just begun, the experience for online shoppers consisted simply of searching for products, comparing them, and then leaving reviews and feedback once the purchase was complete,” said Vishal Bali, managing director of Nielsen China.

“But in this new world of retailing, we are seeing a rapid increase in interaction points, information sources and channels. The hyper connected shopper’s world has become more complex, fragmented and dynamic.”
Anyone wanting to get a handle on the new, emerging trends in retailing can do no better than by first looking at the present — but rapidly changing — economic and demographic profiles of consumers. Who is shopping online? What are they buying? And why, when, where and how are they making their purchases?

In China there is a vast difference between online and offline shoppers. Nielsen found that men account for approximately 44% of online shoppers, while only 20% of offline shoppers are male.
Online shoppers tend to be wealthier, younger and well educated. About 58% of them have a household monthly income of 10,000 CNY or more, an income level attained by just 21% of offline shoppers. Sixty-four percent of those who shop online are aged 18 to 35 years, whereas about 45% of those who shop offline fall within that age range. Among online shoppers, about 77% have a bachelor’s degree or higher, compared with 41% among offline shoppers who have similar academic standing.

In what situations do Chinese shoppers prefer online over offline — or the other way around? Most prefer to shop offline for routine restocking or urgent needs, whereas online is more popular when it comes to shopping for leisure and on special shopping days when there is a plethora of bargains to be had.

Notably, 24% of respondents said they prefer going online for leisure shopping, and 11% said they shop online to take advantage of special offers in holiday periods. Half the respondents used physical shops to do routine shopping, and 20% said they would turn to such shops for urgent purchases.
DIFFERENT CHANNELS, DIFFERENT EXPECTATIONS

Consumers in China are increasingly discerning. They are not just seeking quality products and services, but also expecting a combination of value, convenience and uniqueness. While retailers are keen on making shopping seamless for their customers, it needs to be stressed that no one-size-fits-all approach can be deployed across all channels.

Top Reasons For Shopping

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Online shoppers in China tend to seek quality products and deals, while offline shoppers care more about service and experience.

Those who prefer shopping online cited “affordable prices online” as their main reason, followed by other common features of e-commerce platforms such as “convenient home delivery”, “time efficiency”, and “unique products”.

Those who prefer offline shopping cited their primary reason as “immediate consumption,” meaning the ability to purchase and obtain goods immediately. Other reasons given for preference for offline shopping included the chance for “in-person experience,” “more reliable products” and “better service quality.” In other words, online retailers need to focus on product differentiation, while offline retailers should focus on service and experience differentiation to avoid price wars.
COMMON DENOMINATOR OF OFFLINE AND ONLINE: SHOPPING MUST BE EASY

Careful, innovative retail planning, whether by creating immersive experiences, putting together head-turning window displays, or something else, encourages customers to browse and buy. A well thought-out path can be critical to strategically coordinated foot traffic in stores.

The equivalent of foot traffic in online shopping is the user interface and the degree to which its design makes it easy, and even enjoyable, to use. On an e-commerce website such as JD.COM, there can be an average of more than 8,000 possible purchasing paths, and an estimated 85% of sales are likely to be generated on 32 high traffic paths.

MEET SHOPPERS ON THE TERRITORY THEY CHOOSE

Businesses should devise their channel distribution based on where their customers shop. Most online shoppers said they frequently visit three or more retail websites (44%), while most offline shoppers said they frequent two retailers (51%). But as e-commerce grows, online shopping remains a two-way street.
Over time, offline and online shopping have drawn more closely together and are now more complimentary than competitive. Consumers are not simply showroming, in which they are browsing in-store and then going to seek the most affordable option online, but they are also webrooming, meaning consumers research online before buying in physical stores. Products that consumers are most frequently webrooming for include those in the mother and baby category (39%), skin care and cosmetics (35%), packaged food (32%), personal care (32%), liquor (32%) and household cleaning (31%).

“Retailers need to determine the best mix of channels to promote their products and services and provide consumers with information that helps them shop, such as advanced order placement or mobile price-matching features,” said Yan Xuan, president of Nielsen Greater China.

“These days, consumers are highly savvy and can easily discern marketing messages simply aimed at making a sale.”
SPOTTING OPPORTUNITIES IN ALL CHANNELS

As online and offline merge, retail executives should be thinking ahead. Identifying online trends and opportunities, finding a balanced channel strategy and optimizing the effectiveness of advertising are crucial if long-term growth and profitability are to be sustained.

According to Nielsen’s Retail Index and E-commerce Tracking, online and offline sales combined since January 2017 increased 9%, with online sales accounting for 26% of revenue. However, the growth figures are more illuminating, showing that while offline sales grew 4%, online sales grew 25%.

While some larger format brick-and-mortar retail outlets have seen lackluster growth, the number of smaller format stores in China continues to rise as today’s on-the-go consumers are increasingly looking for convenient storefronts to make quick and easy purchases. Sales in hypermarkets have in fact shrunk (-2%), while the sales growth figures of supermarkets, mini markets and convenience stores have shown positive growth, at 1%, 4% and 8% respectively.

THE RISE IN CROSS-BORDER SHOPPING

Nielsen’s latest Shopper Trend Report found overseas shopping growing increasingly popular among Chinese consumers. The cross-border shopping penetration rate rose from 32% to 61% from 2013 to 2016. These shoppers were mainly millennials, with 70% of them aged 18 to 35. The reasons they cited for making purchases overseas were, in order of importance, the reliability of websites, the guaranteed quality of products and product variety.

Rising demand for foreign products and a government push is fueling the huge appetite for cross border e-commerce spending in China, and it is set to expand even more. The China e-Business Research Center estimates that cross-border e-commerce amounted to 259 billion CNY (40 billion USD) in 2015 — the equivalent of more than 6% of China’s total consumer e-commerce — and it is forecasted to grow at 50% a year in the foreseeable future. Government action is critical to its growth, too. China has created a new tax regime that typically waives postal duty tax of less than 50 CNY, while new distribution channels are opening up, and customs is clearing goods much faster than it used to.
GREATER OPPORTUNITIES FOR NICHE BRANDS AND NEW BRANDS

Under China’s highly fragmented online channel network, it has become easier for niche brands and smaller brands to compete with big companies. If retailers can draw on their niche brand resources they can effectively cater to specific niche consumers, generating tremendous returns on investment.

Most consumers find out about niche market products online (51%), according to Nielsen’s latest Online Shopper Trend Report. The report also found that the top 10 brands in China account for 19% of online sales and 58% of offline sales. Smaller long-tail brands and other companies generated 42% of online sales and 19% of offline sales.
So where does one shop for niche brand products? Online is the key channel. More than 51% of respondents buy niche brands online, whereas only about 30% said offline channels are their main sources for such products, according to the Nielsen’s 2016 Online Shopper Study.

Health-related product categories in particular are in high demand among online shoppers — a small but active segment of consumers. Nielsen’s data shows these shoppers spend the most on maternal and baby products, including baby powder and diapers, closely followed by health and pharmaceutical products.
Whether shopping is done offline or online, the product or service brand is the top consideration when consumers plan their shopping. About 78% of those who shop offline say they decide what brands they are going to buy before they shop, while 63% of those who shop online do that, according to Nielsen’s 2017 O2O study. To attract consumers, companies and brands need to recognize the importance of developing their brand equity and organizing resources to support it.

Retailers need to determine the optimum advertisement portfolio and reach customers at key marketing touch points. According to Nielsen’s Promotion Effectiveness Solution, 76% of offline trade promotions fail to break even. Most shoppers finish making a purchase within 3 exposure points — while the most cost-efficient touch point number for advertisers is 5.4.

Apart from efforts to maximize online path-to-purchase efficiency, businesses can allocate more resources for products that have been proven to generate high returns, increase reach through opening new physical stores and holding special promotional events, and determine the optimal discount levels for products.

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THINKING BIG AND SMALL TO BOOST PROMOTION MIX EFFICIENCY

Different packaging and promotional strategies online and offline can drive growth. According to Nielsen, a particular brand of sparkling water sold significantly better online when packaged 24x330 ml (36%) than when it was sold in packages of six bottles (5%) or 24x300 ml (4%). In offline channels the sparkling water sold best when it was offered as a 600 ml single bottle (23%), followed by 1x500 ml (21%) and 1x2000 ml (17%).
CASHING IN ON HOLIDAYS AND RURAL GROWTH

Chinese consumers are bargain hunters who love a good sale. As such, the local calendar is marked with heavy shopping carnivals and gift-giving seasons such as Singles Day, November 11, when China’s biggest annual online shopping festival occurs. Last year 17.8 billion USD in sales was racked up on Singles Day, compared with 14.3 billion USD the year before. Retailers should keep an eye on and plan to capitalize on these peak sale seasons.

According to data collected from Nielsen’s Retail Index and E-commerce Tracking, shopping seasons such as the Lunar New Year holiday and Singles Day in 2016 drove up online and offline sales, contributing to sales of fast-moving consumer goods.

I Online & Offline FMCG Sales Trend

![Online & Offline FMCG Sales Trend Graph]

1.2.12 End-Year Ceremony
3.8 Women’s Day
5.1 Labor Day
6.12 Chinese New Year
8.1 National Day
10.11 Singles Day Shopping Festival
EMERGING NEEDS

Across the country, in addition to shoppers in first-tier cities, rural inhabitants are becoming increasingly empowered. This largely untapped market is huge. According to China’s 6th National Census, more than 674 million people live in the countryside, accounting for 50% of the country’s population and 50% of total consumption. According to the latest report by the China E-commerce Research Center, the rural e-commerce market in 2015 totaled 54 billion CNY, and forecasts that this will increase to more than 150 billion CNY in 2018.

According to the Nielsen China Consumer Confidence Index for the first quarter of 2017, consumer confidence in eastern China continues to be the highest, but remains flat at 120 points (The Nielsen Consumer Confidence Index measures perceptions of local job prospects, personal finances and immediate spending intentions. Consumer confidence levels above and below a baseline of 100 indicate degrees of optimism and pessimism, respectively). Overall growth was primarily driven by western regions, where confidence rose 8 points, from 98 in Q3 2016 to 106 in Q1 2017. Looking at consumers’ responses in more detail, growing confidence in the west is fueled less by factors such as better job prospects and optimism regarding personal finance — though both slightly increased — and more because of an expanding appetite for spending.

“Strong consumer potential in western China was unleashed mainly because of growing employment opportunities and rising disposable income in that area,” said Yan, the Nielsen Greater China president. “Consumers in the West feel empowered to shop when they enjoy good living conditions, have sufficient income and feel secure, and those in the East tend to buy when they are offered convenience and a wide variety of choices.”

Tibet (14.1%), Guizhou (10.7%), Yunnan (10.4%) and Qinghai (9.8%) were among the jurisdictions with the highest per capita disposable income growth in the first quarter of 2017, whereas metropolitan coastal cities such as Shanghai registered growth of only 8.4%.
Over the past few years rural online shopping has grown rapidly with the guidance of government initiatives — such as the Chinese government's pledge to spend 140 billion CNY to have 98% of the country's rural areas connected to the internet by 2020 — and as a result of efforts of major online retailers such as Alibaba, JD.com and Suning.

The purchasing power of the rural market continues to be another important growth engine for the online retail market.
According to Nielsen’s latest Retail Index data and the China Consumer Confidence Survey, online overall FMCG sales are growing by 29%, but offline channels still account for 74% of total FMCG transactions in China.

Physical stores are not going to disappear any time soon, but they will be transformed as e-commerce grows and the way consumers make purchase decisions continues to evolve. Consumers have come to expect simple and seamless shopping, including the ability to return and exchange online purchases in brick-and-mortar stores.

For retailers, gaining clarity on how physical stores fit into their all omni channels strategy is critical to long-term success. When retail executives consider the role of brick-and-mortar stores, they need to ask themselves several questions:

- How do we create a meaningful connection with our shoppers? What services or experiences can we provide to differentiate ourselves and make consumers want our brand, as opposed to merely fulfilling a need?

- Are we managing the cost of core retail functions and back-office functions by considering a comprehensive set of efficiency levers?

- Are we maximizing the return on our real estate investment, or should we shed unneeded property and optimize our store networks?

- How does the level of service provided in store compare with the level provided online?

- How are our investments in analytics and data-driven insights creating value across the full business?

- As prices become more transparent, given consumers’ increased access to information, how are we adjusting our offerings and services to this new environment?
THE NEXT FRONTIER AND BEYOND

With rising purchasing power being realized across generations and geographies, there are opportunities abound in China. However, an ever-evolving retail landscape requires constant measurement and evaluation of market strategies. China is set to continue its march into the digital era for the foreseeable future, meaning that brands and manufacturers seeking to tap into the market's surging growth must be diligent in their assessment and execution in both online and offline ecosystems.

Having a firm understanding of shifting demographics, changes in consumer behavior, peak sales seasons and growing niche markets, while at the same time providing consumers with a seamless shopping experience across channels, will give companies an important competitive edge as they stake out territory in the new world of e-commerce.
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