



# THE GREAT MALL OF CHINA

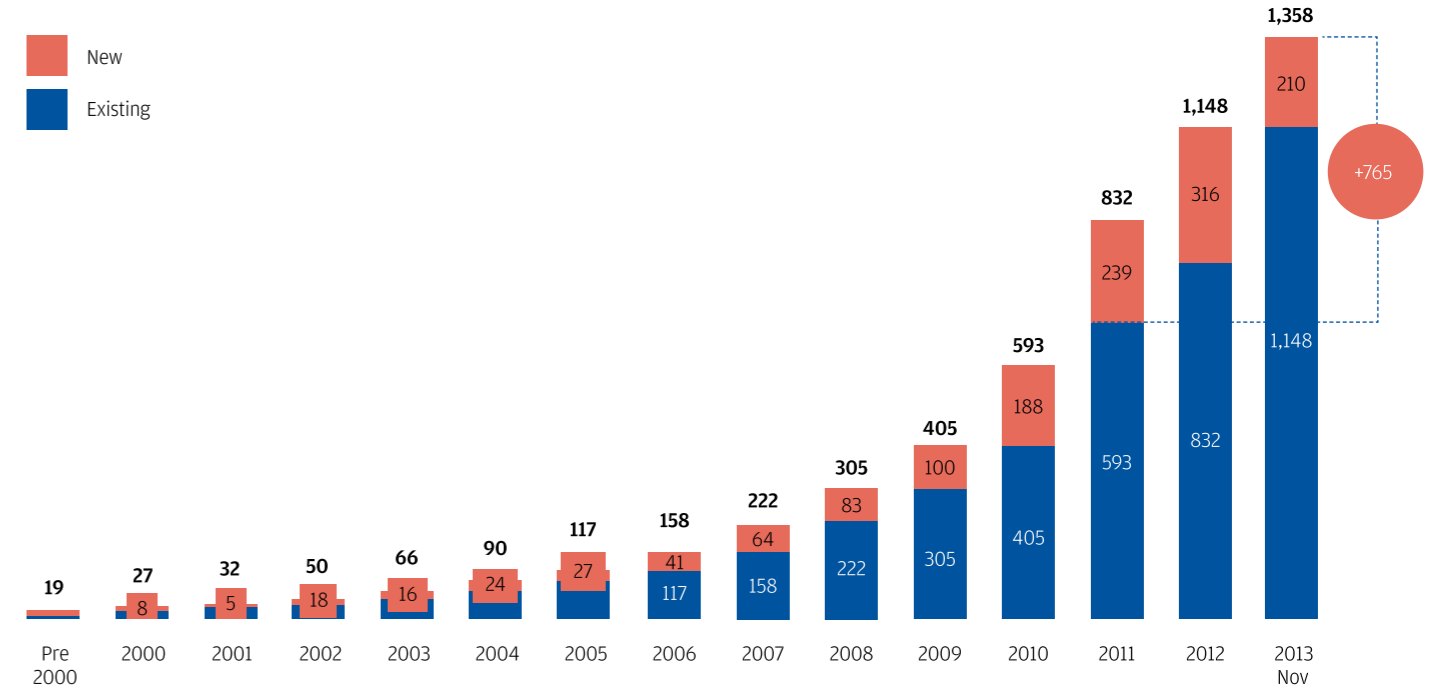
Boom and Bust

Retail sales in China are still showing strong growth (13% in 2013), not only driven by growing consumer incomes but also by a booming construction landscape. China is under construction as are its shopping malls: there are currently ~1,400 malls and another ~1,000 are under construction. 200-300 malls are being opened each year and more than half of all existing malls have only been opened in the past 3 years. Some of the best malls in the world from renowned developers are being built in China. Are all these malls going to be successful? How important is the shopping mall channel and how to select the right ones?

OC&C conducted extensive research on the shopping mall landscape in China through shopping mall audits in some 50

cities, consumer surveys across city tiers, interviews with leasing managers and brand/tenant productivity benchmarking.

## Number of malls by year



Wuhan CC Mall by Orsun Group - Opened in November 2013



Shanghai iAPM by Sun Hung Kai Properties - Opened in August 2013



Chengdu IFS by Wharf Holdings - Opened in January 2014







# SHOPPING MALLS ARE A KEY CHANNEL FOR BRANDS

The China retail landscape is changing rapidly and the online channel is growing at an incredible pace, taking share from the traditional channels. What will be the role of shopping malls in this future landscape? We believe it is and will remain a key channel for brands as malls offer the best offline experience, attract young consumers and are important for brand building.

## The best offline experience

Despite the tremendous growth of online, consumers will still be looking for an offline experience and shopping malls are the best positioned to offer this. For many, shopping is only one of the reasons to dwell in malls as there are plenty of

dining and entertainment options. New malls recognize this and are dedicating more space to experience over shopping and some even go one step further to differentiate themselves from the competition through for example offering

late night shopping and dining (Shanghai iAPM) or art exhibitions (Shanghai K11 and Beijing Parkview Green).

## Typical 'young' destination

Shopping malls attract younger consumers than department stores as they typically offer younger brands and more entertainment, and they not only have a cinema but also hold popular events inside the mall. Walking into a department store and a shopping mall, you will be able to immediately spot the difference in the type of consumers browsing around.

## Key brand building channel

Consumers see shopping malls as spacious and premium and like to go there for a taste of new brands and new stores. Shopping malls are therefore a key channel for offline brand building as well as customer acquisition. Brands should invest in store decoration and store execution in malls to stand out in the heavily competed Chinese retail landscape.

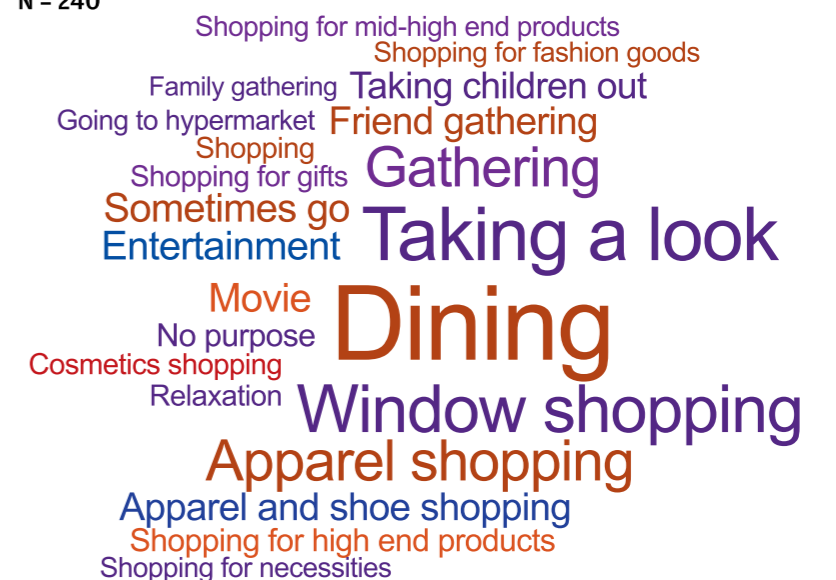
## Occasions for going to a department store

N = 240



## Occasions for going to a shopping mall

N = 240



# IT IS A DIVERSE CHANNEL

## Various positionings

Malls have different positionings in terms of both customer focus and price level. Some malls, with a fashionable brand mix and entertainment offerings are typically targeted at young consumers, while others are more focused on families and some try to capture all types of consumers. Most malls in China are mass malls with mainly

lower end local brands or unbranded stores being present: these malls represent ~80% of the ~1,400 existing malls. So shopping malls are not only about luxury and masstige, but more about mainstream and upper mass shopping. Some of these malls have the potential of being upgraded with more premium brands in the next

few years because of their location, good traffic and good mall infrastructure. As more world class malls are being constructed and international brands are expanding in China, more mid and high end malls will appear.

## Number of malls by price level

| Mall Price level | Brand examples   | % of malls |
|------------------|--|------------|
| High end         | LOUIS VUITTON, BURBERRY LONDON, GUCCI, PRADA                   | ~1%        |
| Masstige         | DKNY DONNA KARAN NEW YORK, MARC BY MARC JACOBS, COACH NEW YORK | ~3%        |
| Mid end          | Calvin Klein, ZARA, MISS SIXTY, G-STAR RAW, Massimo Dutti      | ~3%        |
| Mid end-mass     | H&M, ochirly, UNIQLO, La Chapelle, VERO MODA, ONLY, JNBY       | ~14%       |
| Mass             | Metersbonwe, GIORDANO, Semir 森马, BALENO                        | ~79%       |

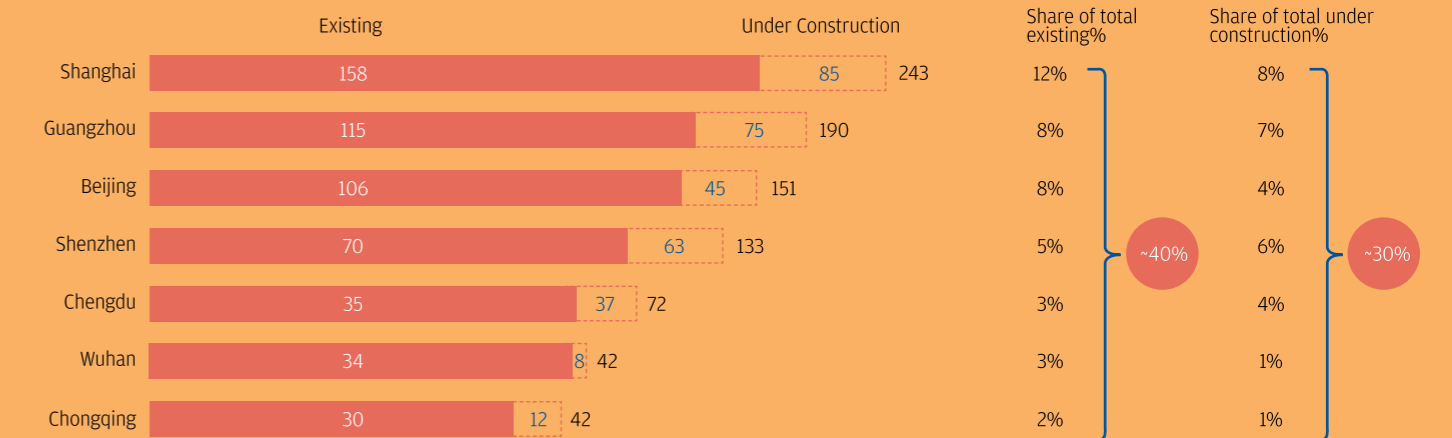
## Different dynamics across city tiers

The shopping mall channel is currently concentrated on a few key cities: 40% of the existing malls are located in the top 7 cities. Consumers in these cities are very familiar with shopping malls and new malls are focusing on a point of

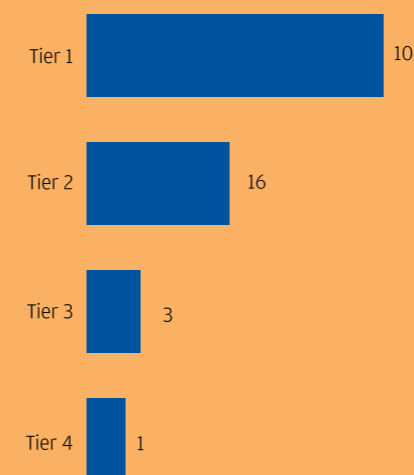
differentiation versus the existing malls in order to attract brands and consumers in this competitive landscape. Mall developers are now also rapidly expanding in lower tier cities, which are still largely dominated by department stores and on

average only have 1-3 malls. Each new mall will bring new brands and a new shopping experience to these lower tier cities and there is still ample room for growth.

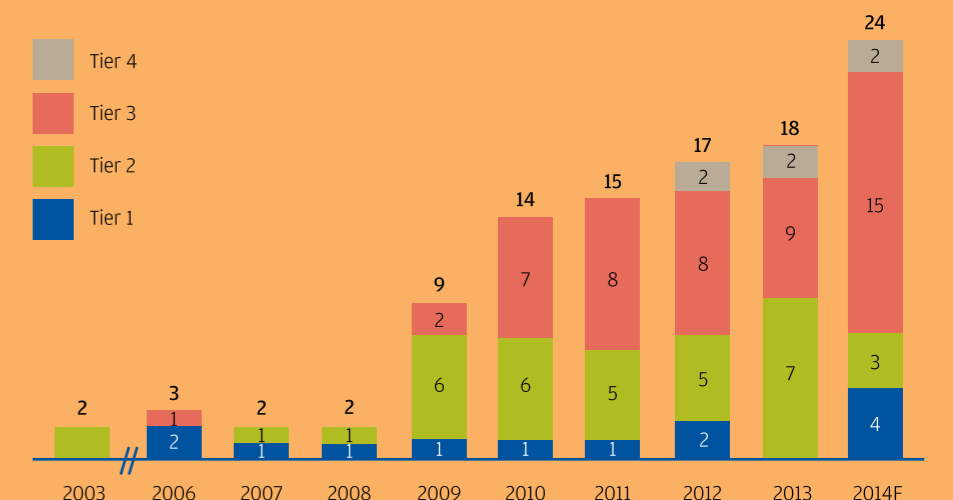
## Number of malls by city, November 2013



## Average number of existing malls by city tier, November 2013



## Number of newly-opened Wanda Plazas by year by city tier



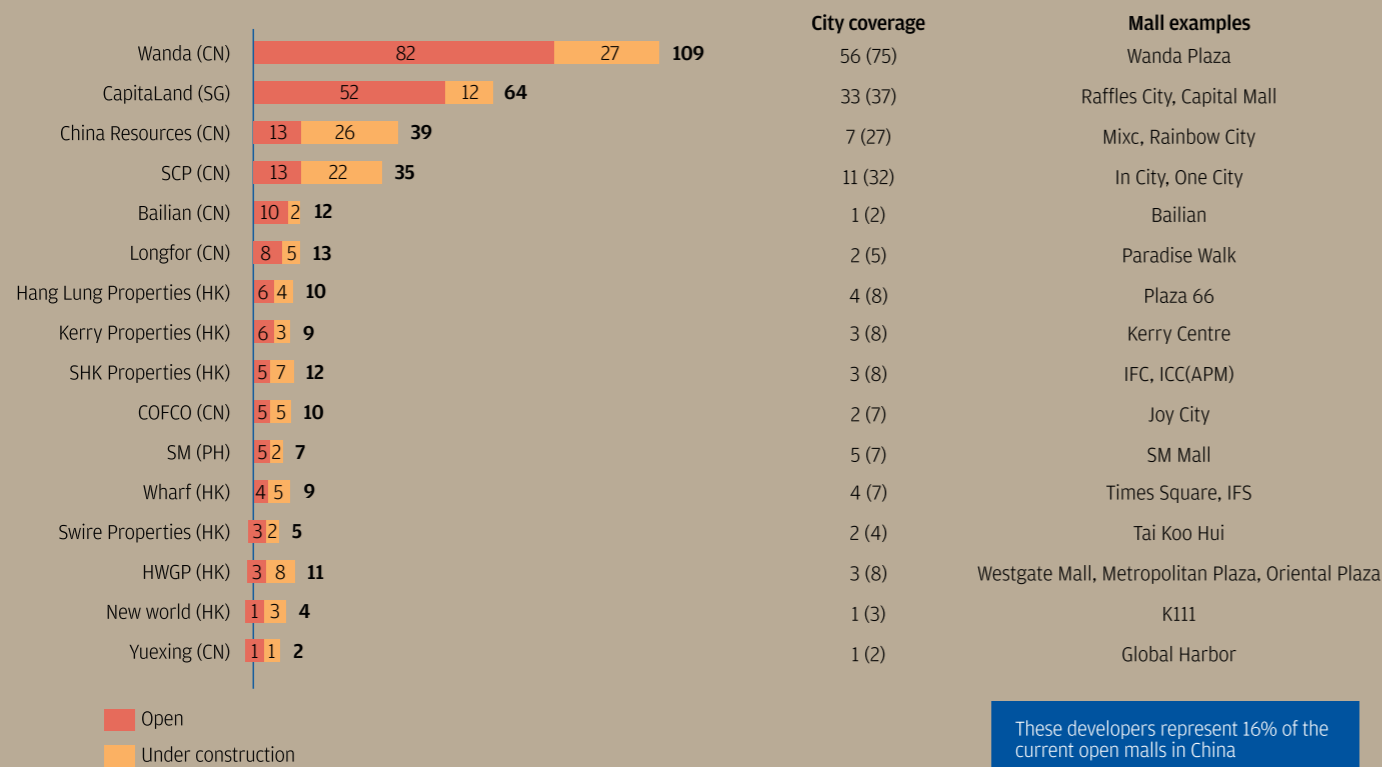
## Fragmented landscape

There are more than 1,000 mall developers in China, of which the majority has only one mall each. Wanda is the leading developer with 82 shopping

malls and another 27 under construction. CapitaLand from Singapore is the number 2 with 52 shopping malls and another 12 under construction. Hong Kong

developers like Hang Lung Properties, Sun Hung Kai Properties, Wharf Holdings and Swire Properties operate higher end malls and are expanding their China portfolio.

## Number of existing and under construction malls by developer, 2013



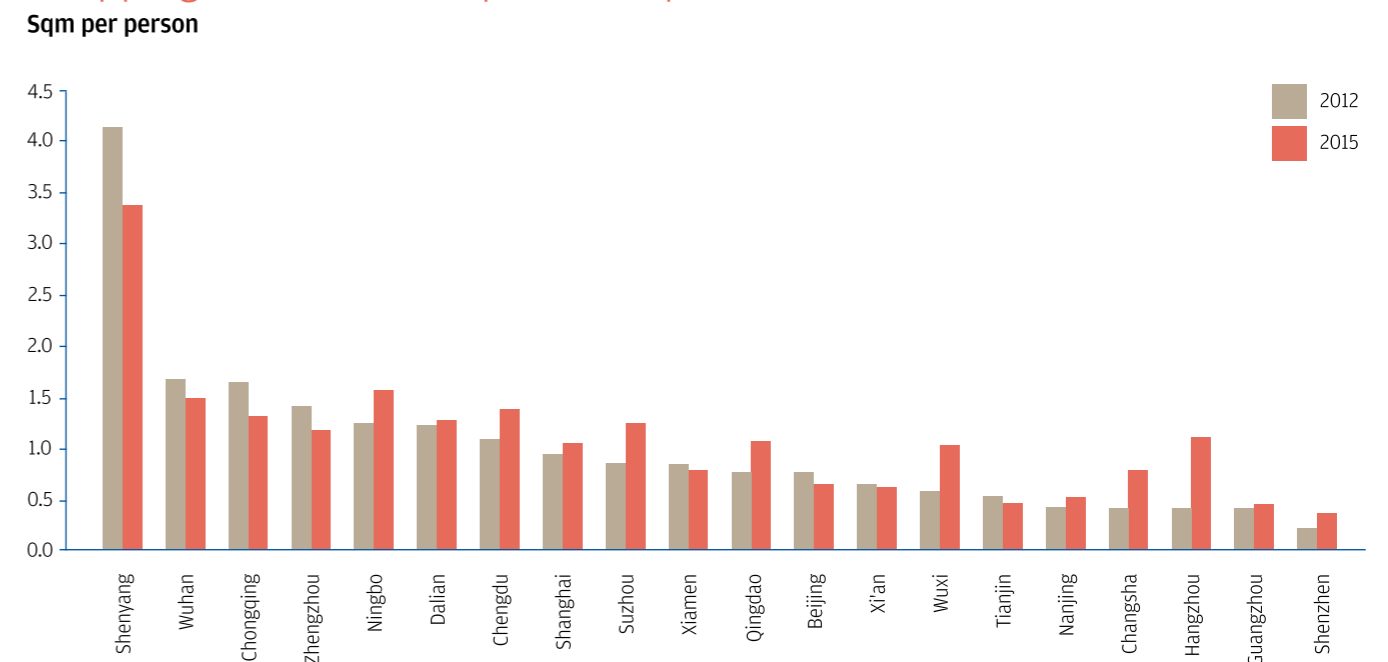
# NOT ALL SHOPPING MALLS WILL BE SUCCESSFUL

## Oversupply of retail space

Some cities have an oversupply of retail space which may come under more pressure due to growth of online. The impact is more significant on higher tier cities with a more developed retail landscape. Department store growth in

some higher tier cities is stagnant and consumers are spending more and more online. In lower tier cities malls are not yet a developed channel and there is still enough room for growth.

## Shopping Mall Provision per Metropolitan Consumer, 2012 and 2015



Source: Jones Lang LaSalle

## Many malls in new 'commercial' zones

Most new malls require some time for traffic to ramp up and location and accessibility are key to estimate how traffic will develop. Many cities in China have new emerging zones where new malls are being built and some of these

areas will never become successful. Talking to local governments about their city plans, mapping the construction of residential buildings and metro lines will help to assess if these areas are likely to generate traffic in the future.

## Poor skill set of some developers

Many malls in China are poorly managed with an unclear positioning, a wide range of brands and bad space allocation to brands. Unless these malls are in the key locations, they will not survive, unless they are supported by local governments. Even international developers are not a guarantee for success.



# HOW TO SELECT THE WINNERS?

With such a high number of malls being built, the retail landscape in China, especially in higher tier cities, is becoming more and more complicated. It used to be easy to select the winning malls or department stores as there were only a few and those were heritage malls and department stores at key locations in the city. Now, in certain cities and key commercial areas there are already plenty of options to choose from and there is even more under construction. Given that lease terms are mostly 3 years, it is expensive to make the wrong choice.

Brands should apply hard criteria when selecting malls and consider the following questions:

## For existing malls:

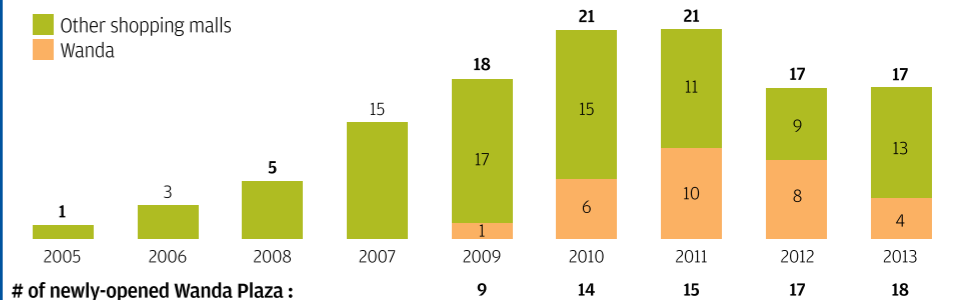
- ✓ How long has the mall been open? Has there been sufficient time to ramp up?
- ✓ How strong is the traffic and how has it developed in the past years?
- ✓ Is there evidence that existing brands have reasonable sales productivity?
- ✓ Is the positioning of the mall right for my brand?
- ✓ If a new mall has opened close by, what impact has it had on this mall?
- ✓ Which changes will make the mall more or less successful in the future?
  - Is the mall in the process of being upgraded? What evidence is there of potential for upgrade?
  - How is the neighbourhood developing?
  - Are new metro stations expected to open nearby that will improve accessibility?
  - Are new malls under construction nearby that will divert traffic?

## For new malls:

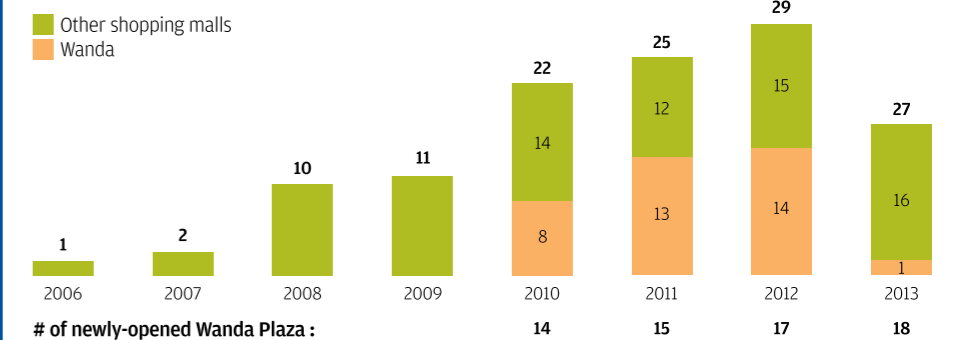
- ✓ Is the expected positioning of the mall coherent with my brand positioning?
- ✓ Does the mall offer any point of differentiation compared to the existing offering?
- ✓ Has the location potential?
  - Is it a heritage location or is it a new commercial zone?
  - Does the area have critical mass?
  - What is the average income level of the neighbourhood?
- ✓ Does the developer have a good reputation?
- ✓ Are there options to liaise with other brands to create critical mass for the mall?

After having selected the right malls for your brand, it is important to negotiate favourable terms, especially for the first years in the case of a new mall which needs a few years to ramp up. To attract a good brand mix, owners of new malls are sometimes willing to invest in store decoration and have revenue based rent from the start rather than a high fixed rent in the ramp-up period; for some brands this can be as low as 6% turnover rent. Strategic contracts with developers can also be an option for accelerated roll out of your brand, although this typically means you also need to open a store in less successful malls. Sephora and Zara are examples of brands that have a "partnership" with Wanda: in 2011 and 2012 half of the new Sephora and Zara shopping malls stores were in Wanda shopping malls.

## Number of newly-opened Sephora shopping mall stores by year by type



## Number of newly-opened Zara shopping mall stores by year by type



# BOOM AND BUST

## Our view for the future of shopping malls in China:

- As the shopping mall channel is becoming more developed and more competitive, it will become even more important for developers to have the best location, a clear and coherent positioning, a point of differentiation, and good mall management to attract the right traffic and brands
- There will be polarization in the shopping mall channel as there will be an increasing gap between the good ones and the poor ones. The good ones are the ones that are good today, plus those that come into this group given their positioning and strong execution. The challenge for brands will be to spot the malls that will enter the group of good performers. The poor malls are the ones that are poor performing today and given the competition will only get worse
- The winners will offer a one stop experience to consumers through offering alluring mall entertainment and dedicating more space to services and experience (eg. spas, hair salons, education, recreation)
- Not all malls will survive the coming years and some of the malls that are currently under construction will never open. However, bankruptcies of mall developers will not happen overnight. Many mall developers have an attractive financial structure and also receive income from attached offices and residential buildings, allowing them to stay in business without strong commercial traffic

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