



BITS & BYTES

The shift of FMCG to e-commerce

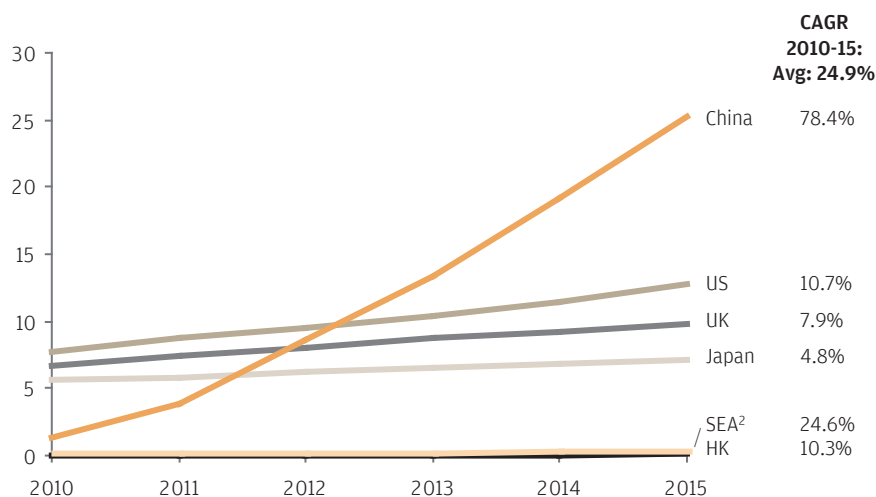
The Chinese fast moving consumer goods online market is worth more than \$25.3bn today, far surpassing any other country in the world. China has always been the winner in the e-commerce space – on the annual Single’s Day event in 2015, Alibaba alone sold almost double of Cyber Monday, Black Friday, and Thanksgiving combined – \$14.3bn. FMCG categories represent the largest area of retail spending overall, however it has lots of headroom to grow online.

To understand the role and relevance of FMCG in the Chinese e-commerce space, OC&C recently conducted a survey in Q3 2016 and looked into 13 selected sub-categories, ranging from infant milk formula, packaged food and soft drinks, alcoholic beverages, to beauty and personal care. The survey covers 4,600+ respondents across all demographics from 16 cities. The goal is to better understand the three key questions which are commonly shared among FMCG executives

- 1. HOW RELEVANT IS ONLINE FOR FMCG IN CHINA?**
- 2. IS ALIBABA THE ONLY BET?**
- 3. WHERE, AND HOW, CAN I PLAY?**

IT IS GETTING BIGGER... ...AND BIGGER

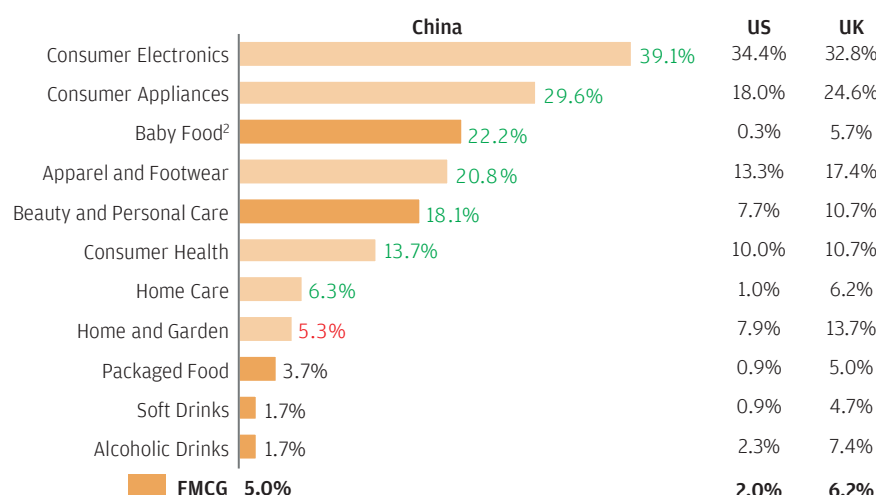
FIGURE 1:
Online FMCG¹ Sales by Country, 2010-15
USD, bn



The online FMCG market has come a long way in the past few years, growing rapidly at 78.4% CAGR (Figure 1) from 2010 to 2015 amidst weakening offline (15.4% in 2011 to 6.2% in 2015) and GDP (9.5% in 2011 to 6.9% in 2015) growth. Moving online for FMCG, however, has been structurally challenging when compared against other categories. For instance, consumer electronics enjoys one of the highest penetration rates across all countries (Figure 2). Pertaining partly to its one-off and high-value nature, consumers are therefore more willing to invest additional time across the purchasing journey: from researching on different products, reading customer reviews, and to comparing prices. More importantly, as most online channels can now satisfy all of those demands more efficiently than offline channels, consumers are utilizing e-commerce platforms more extensively to purchase consumer electronics, driving a much higher online penetration in the category. FMCG categories are a day-to-day expense, though, and are shopped very differently. Customers tend to buy impulsively and they want the products immediately, which historically has been tricky to achieve online.

1. Online sales of FMCG includes B2C (business to consumer) sales of baby food, packaged food, soft drinks and beauty & personal care. Alcohol and soft drinks online value is derived from online volume.
2. Indonesia, Malaysia, Singapore, Thailand and Philippines
Source: Euromonitor

FIGURE 2:
Online Penetration by Category, 2015
% of Total Value¹



China has long been labeled as the giant incubator of e-commerce thanks to its favorable macro trends: rapid urbanisation, increasing internet and mobile penetration, continuous innovations etc. In addition, its unique and fundamentally different dynamics have supported much higher online penetration rates, whereby most categories are over-indexed in China against both the UK and the US. So, what does that mean for the future of China FMCG e-commerce?

1. Value penetration for soft drinks and alcoholic drinks derived from volume penetration. All online sales exclude C2C (Consumer-to-consumer). Green = over-indexed in China; Red = under-indexed
2. c.90% of overall baby food market is made of Infant Milk Formula (IMF)
Source: Euromonitor

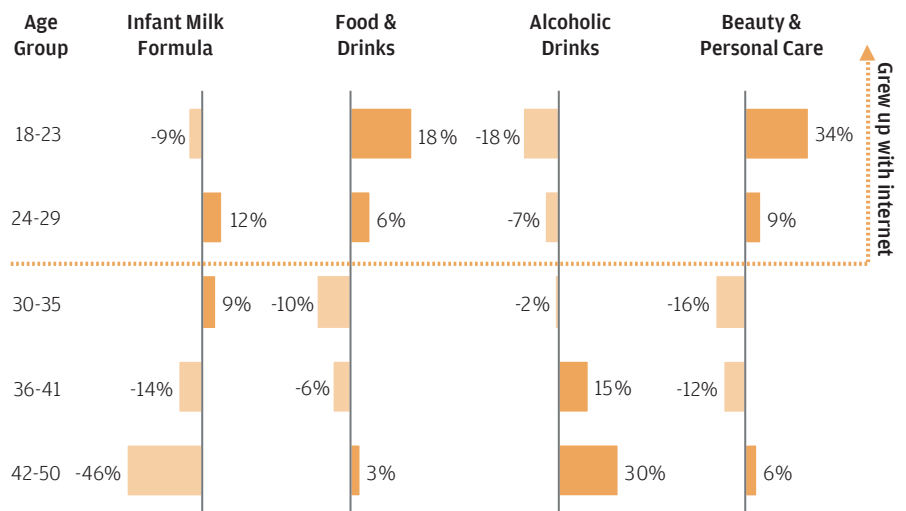
In China, we see a number of points of evidence that suggest that online penetration in FMCG will be significantly higher – and make it an imperative for FMCG companies to succeed.

The post-80s and 90s generation in China who grew up with the internet are coming of age, entering the workforce and forming families, increasing their ability and need to buy FMCG. They are indeed the people who are the most familiar with the concept of “FMCG Online”, especially in packaged food & soft drinks, and beauty & personal care (Figure 3). Today, 50% of the population is within the age group of 10-29 which, complimented by tailwinds such as the new two-child policy and increasing average household income, will see this post-90s generation becoming an important group in the coming years and driving the growth of FMCG e-commerce. Growth is not only coming from the younger generation though, in fact, there are also an increasing number of consumers from the 30-50 year-old bracket who intend to spend more in the next 6 months (Figure 4), suggesting growth of FMCG e-commerce will come from all segments.

Price and convenience related factors are consistently identified as top reasons for buying FMCG online in China. The growing middle class shows strong intention to save money from everyday consumables in order to support a better lifestyle, such as dining out more frequently or buying international fashion brands (see OC&C’s recent publication ‘Dress for Success’ and ‘Serving up a Winner’). They also live a very busy life, on average working 8.3 more hours per week than OECD countries. As such, consumers’ need for convenience has fuelled the surging demand to buy FMCG online anywhere, anytime. In addition, the rapid development of infrastructure and logistics across the country, vast improvements in both intra-country movement of goods as well as last-mile delivery to consumers, have effectively satisfied the consumers’ desire for convenience (Case study: Development of Logistics Network). With the concerted influence from multiple drivers, online shopping of FMCG in China has become seamlessly cheap, easy and fast.

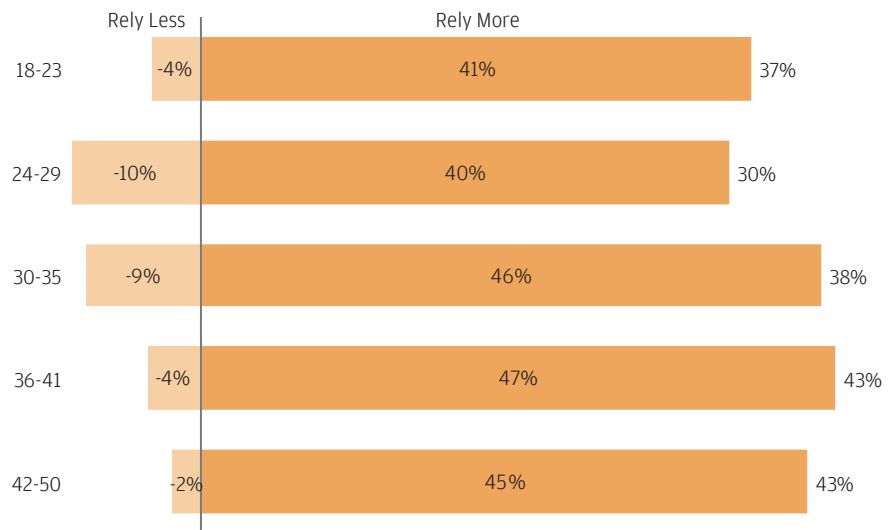
Incentivised by the favourable fundamentals, FMCG in China will unquestionably move further online and become even bigger. Recent successes of FMCG players like Costco, which has achieved a staggering US\$3.5 million of sales on Tmall’s Singles Day alone, have also proved the immense opportunities in the market. The question is – how should FMCG brands play online?

FIGURE 3:
Indexed Category Penetration by Age Group
 % of Category Penetration for Each Age Group Indexed Against Category Overall



Q: Have you purchased <category> online in the past 6 months?
 Source: OC&C FMCG e-commerce survey 2016

FIGURE 4:
Change in FMCG Online Reliance by Age Group
 % of Total FMCG Online Shoppers Within Each Age Group



Q: In the next 6 months, are you planning to rely on more or less online shopping for <category> compare to past 6 months?
 Source: OC&C FMCG e-commerce survey 2016

DEVELOPMENT OF LOGISTICS NETWORK:

The unrivalled development of the logistics network in China has been driven by both government-led and platform-led initiatives.

On the government side, in 2014, the State Council issued a document to iterate the long-term development of logistics in China. In particular, the document highlights the importance of mergers, acquisitions and partnerships of logistics enterprises in consolidating today's fragmented logistics market. In addition, the government also further increased investment in infrastructure, exemplified by the 1.65 trillion RMB investment in highway construction (up 20.6% from 2013).

On the platform side (Figure 5), JD.com started to build its own logistics system as early as 2007. With 7 mega warehouses, 234 large warehouses and 6,756 delivery stations throughout China, JD has the

largest proprietary delivery network of all the e-commerce platforms in China. Additionally, JD's extensive network of offline stores (i.e. JD Daojia) has enabled top-notch 2-hour FMCG delivery for consumers across 18 cities in China.

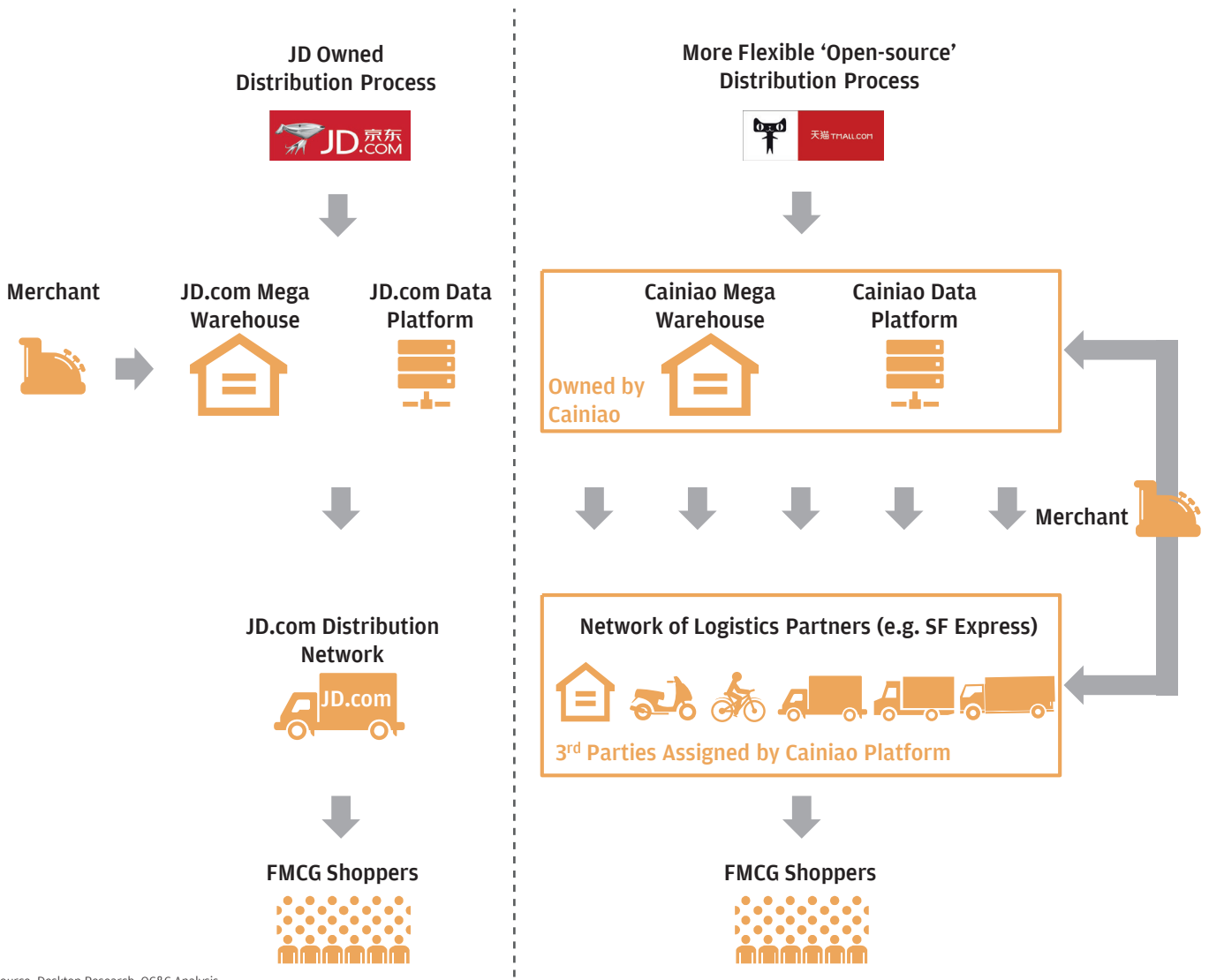
In 2013, Alibaba and various private equity funds have jointly invested and developed the Cainiao network – an open and shared logistics platform that partners with 15 third-party logistics companies such as SF Express. The platform has dramatically improved delivery efficiencies through the unification and digitisation of tracking numbers. For instance, while it took 7 days for Cainiao to ship 250 million parcels on 2014 Single's Day, it was significantly reduced to 1.5 days in 2015. Cainiao itself runs on an asset-light model (Figure 5), owning only 5 mega warehouses in Tianjian, Wuhan, Shanghai,

Chengdu and Guangzhou. However, as of March 2016, its network of companies employ over 1.7 million delivery personnel in 600+ cities and collectively operate 150,000 hubs and sorting stations.

Thanks to Cainiao, Tmall supermarket customers now enjoy same day delivery in 32 cities and next day delivery in 122 cities without incurring any extra cost. With merchants having access to a range of logistics partners on Cainiao, they are no longer bound to one single provider and they now enjoy more options of better quality. The more competitive environment will certainly encourage improvements in the logistics market.

Undoubtedly, last-mile delivery in China has become faster and better. And as China's logistics sector matures, adoption of FMCG e-commerce should also accelerate at an unprecedented pace.

FIGURE 5:
JD vs Cainiao



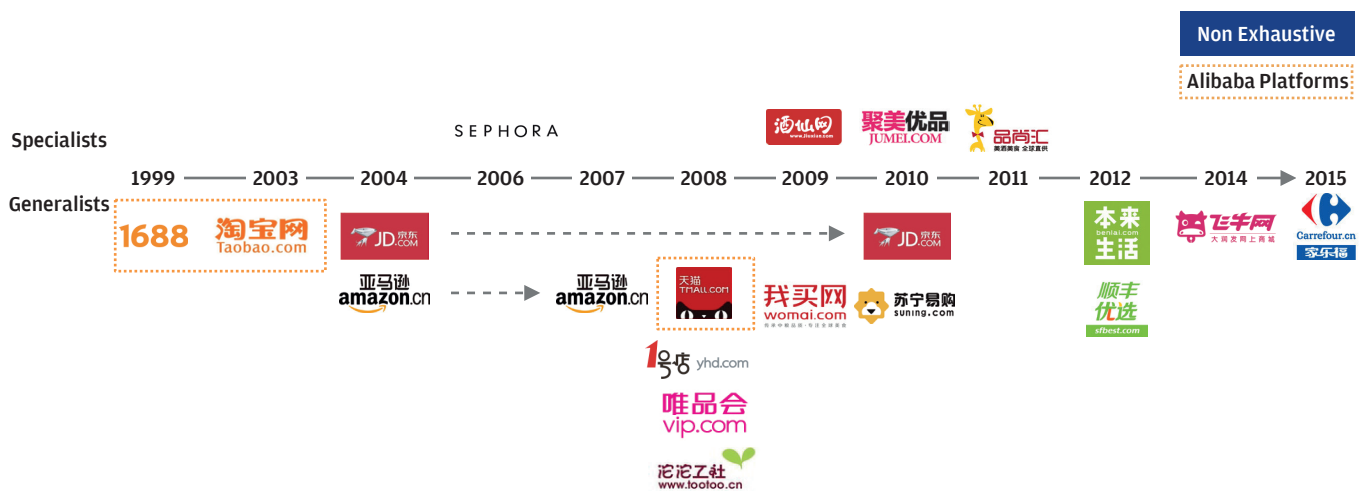
Source: Desktop Research, OC&C Analysis

ALIBABA?

YES...

Any conversation around online in China will certainly involve the largest e-tailer in the world – Alibaba. As one of the earliest entrants in the e-commerce space (Figure 6) with its eponymous B2B (business to business) platform in 1999, Alibaba has since then launched two more hugely successful platforms to cover the rest of the spectrum: Taobao for C2C (consumer-to-consumer) and Tmall for B2C (business-to-consumer). Over the same period, though, many other platforms have emerged to challenge Alibaba's dominance. While many tried, most failed, with JD.com being the most notable exception which has established a substantial foothold in the highly competitive China e-commerce market.

FIGURE 6:
Major FMCG E-commerce Platforms and Year of Entry



1. JD started in 2004 selling only computers, communication and consumer electronics products and opened its marketplace, expanding to other categories in 2010; Amazon entered China in 2004 selling books and expanded to other categories through the acquisition of Joyo.com in 2007
Source: Desktop Research

FIGURE 7:
Top 5 Brand Awareness and Shoppers Penetration by FMCG Category
% of Respondents

Infant Milk Formula			Packaged Food & Soft Drinks			Alcoholic Drinks			Beauty and Personal Care		
Platform	Aware%	Shopped%	Platform	Aware%	Shopped%	Platform	Aware%	Shopped%	Platform	Aware%	Shopped%
1 天猫 Tmall.com	94%	68%	1 天猫 Tmall.com	93%	68%	1 天猫 Tmall.com	86%	62%	1 天猫 Tmall.com	93%	69%
2 淘宝网 Taobao.com	86%	57%	2 淘宝网 Taobao.com	92%	58%	2 淘宝网 Taobao.com	88%	55%	2 淘宝网 Taobao.com	94%	64%
3 JD.com	91%	56%	3 JD.com	88%	54%	3 JD.com	85%	50%	3 JD.com	89%	51%
4 苏宁易购 suning.com	82%	40%	4 苏宁易购 suning.com	77%	37%	4 苏宁易购 suning.com	76%	36%	4 唯品会 vip.com	81%	40%
5 亚马逊 amazon.cn	71%	36%	5 1号店 yhd.com	78%	36%	5 酒仙网	70%	35%	5 聚美优品 JUMEL.COM	79%	38%

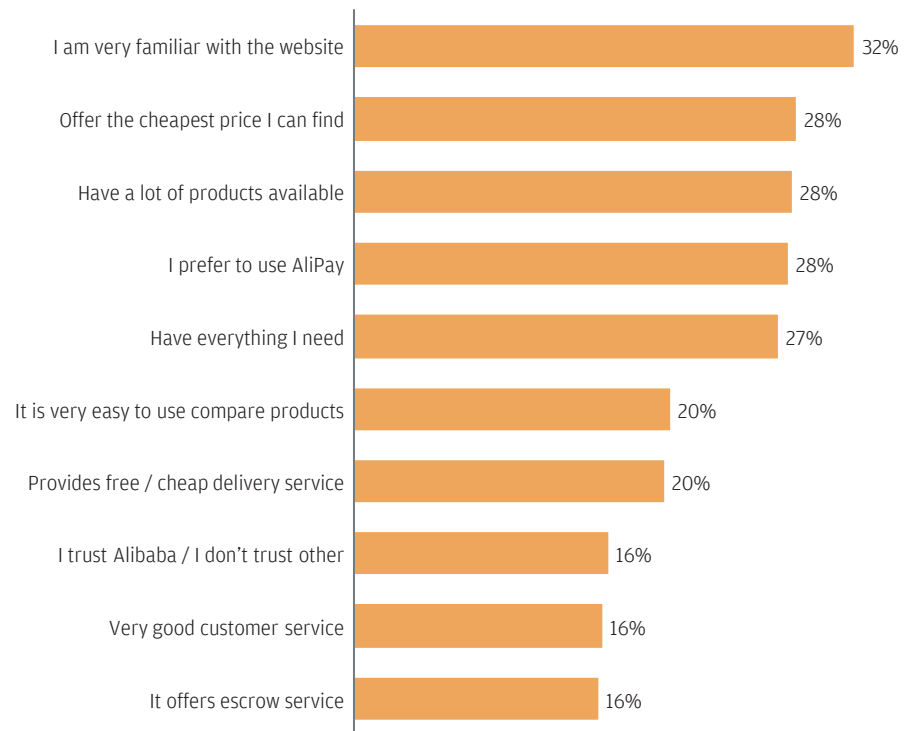
Q: In the P6M, what is your experience with the following platforms when purchasing FMCG online: Not aware; Aware; Know it sells FMCG; Have visited website for FMCG in P6M; Have bought FMCG from the website in P6M; Frequently buys FMCG from the website in P6M
Source: OC&C FMCG E-commerce survey 2016

The platform landscape in China is highly competitive, with rival platforms jostling for customer traffic and market share at almost any cost. Thanks to the aggressive promotional strategy, consumers widely perceive shopping on platforms like Alibaba as a bargain. The Single's Day event (11/11) is arguably the best showcase of how Alibaba delivers competitive price offering to customers. With over \$1bn gross merchandise value generated in just 8 minutes of trading, this staggering result has compelled offline players such as department stores to match Alibaba's steep discount on the same day.

In addition to its attractive promotions, Alibaba also presents Chinese customers with a breadth of categories that outclass all its competitors. Whether it is discounted apparel, the latest smartphone, wedding rings, fishing boats or even booking of medical appointments, Alibaba can always provide a solution. Their FMCG portfolio is also very extensive: c.23,000 chocolate & confectionary and c.25,000 shampoo listings are available today on Tmall, compared to c.13,800 and c.13,600 on JD respectively. They are not resting on their laurels though, as Alibaba continues to search for and introduce new and unique products to Chinese customers. For instance, in order to bring directly-sourced bottles to Chinese consumers, Alibaba launched the 'Tmall Vineyard Direct' program in 2015 and now collaborates directly with selected vineyards. Just a year on, Tmall also hosted the '9/9 Global Wine & Spirits Festival' where c.100,000 varieties of alcoholic beverages across 50 countries were available for sale on its platform.

Alibaba's proprietary payment system, Alipay, is also a driver of their success. Since 2004, Alipay has transformed from a pure online payment system into a giant lifestyle app, online and offline. From buying movie tickets, hailing a cab, ordering take-aways, getting lottery tickets, paying utility bills to investing, Alipay is always the central tool for handling transactions. Threatened by Alibaba's 43% share in the third-party payment market and its c.450m+ users, competitors such as JD and Suning, have therefore developed their own payment system and stopped accepting Alipay to minimize disclosure of sales data to Alibaba. This defensive move has come at some cost – as they are cut off from China's largest payment system.

FIGURE 8:
Why Alibaba for FMCG
 % of Respondents Who Spent 60% or More on Tmall or Taobao, N = 1,617



Q. Why do you prefer to shop <category> on Taobao/T-Mall?
 Source: OC&C FMCG E-commerce survey 2016

IT COMES AT A PRICE

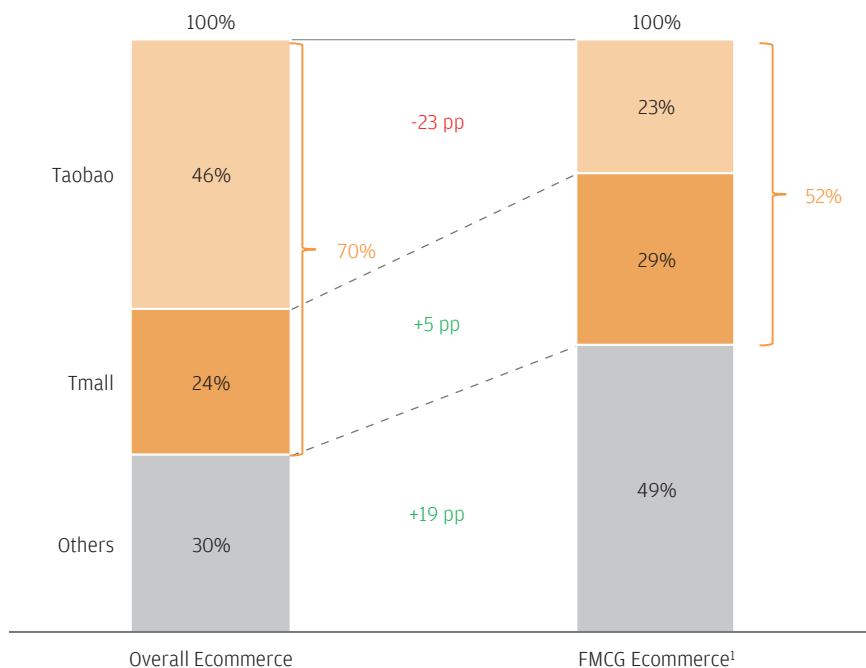
While Alibaba has a 70% share of the overall E-commerce market, its position in the FMCG scene is not as strong. (Figure 9). The online FMCG market is characterized by a much stronger presence of category specific / specialist platforms when compared to other popular categories like electronics and apparel. These specialists have captured the hearts of consumers, thereby limiting Alibaba's success to a certain extent. Furthermore, as Chinese consumers tend to rely less on C2C channels in purchasing FMCG products, the potential of Taobao is simultaneously suppressed. Given its unique dynamics, brands enjoy greater flexibility in the online FMCG market.

Working with Alibaba is undoubtedly the quickest way to access a sizable pool of Chinese shoppers, which is particularly attractive to new entrants in the Chinese market. However, it does come at a cost. In fact, credibility has always been a key issue for platform players, especially for Taobao. A survey conducted by CCTV in 2014 saw 68.2% of interviewees having received fake products from Taobao. Even the B2C platform Tmall, that partners directly with brands owners and distributors, has been plagued with credibility concerns in terms of fabricated customer feedback or sales records. 'Shuadan' has long been a popular method used by merchants to generate fictitious sales records and to improve their rankings, usually via 'fake customers' which merchants hire externally. This has driven some brands, such as the LVMH-owned Benefit Cosmetics in 2010, to pull out of Tmall in fear of hurting their premium positioning. In fact, these two concerns are both among the top reasons why some FMCG shoppers move away from Alibaba.

Moreover, brands typically incur much higher costs when collaborating with Alibaba. For example, in order to operate a flagship store on Tmall and to deliver Tmall-specific customer services, marketing activities, warehouse management and store webpage maintenance, brands sometimes have to hire up to 3 times more full-time employees than on other platforms.

Finding ways to differentiate amidst the large pool of merchants is not easy either, with many using services such as 'Zhitongche', a pay-per-click search engine optimisation tool developed by Alibaba and Yahoo China to drive traffic.

FIGURE 9:
E-commerce Landscape in China, Overall vs FMCG, 2015
% Market Share in Value



1. Derived from shoppers' penetration and share of wallet with Taobao and Tmall within each FMCG category with value share calculated as the multiple of % penetration and % share of wallet
 Penetration Q: In the P6M, what is your experience with the following platforms when purchasing FMCG online: Not aware; Aware; Know it sells FMCG; Have visited website for FMCG in P6M; Have bought FMCG from the website in P6M; Frequently buys FMCG from the website in P6M
 Share of wallet Q: Of all your online purchases for <category> in P6M, can you split your overall spending on online shopping with the below websites?
 Source: OC&C FMCG E-commerce survey 2016, Euromonitor data

DIVERSIFY YOUR LIKE YOU DO



FIGURE 10:
Top 5 Rated B2C E-commerce Platforms by Customers

Infant Milk Formula		Packaged Food & Soft Drinks		Alcoholic Drinks		Beauty and Personal Care	
Platform	Type	Platform	Type	Platform	Type	Platform	Type
1 amazon.cn	Generalist	本来生活 benlai.com	Food Specialist	品尚汇 WINE9.COM	Wine Specialist	顺丰优选 sfbest.com	Generalist
2 1号店 yhd.com	Generalist	顺丰优选 sfbest.com	Generalist	1号店 yhd.com	Generalist	聚美优品 JUMEI.COM	Beauty Specialist
3 我买网 womai.com	Generalist	亚马逊 amazon.cn	Generalist	家乐福 Carrefour	Generalist	1号店 yhd.com	Generalist
4 淘宝网 taobao.com	Generalist	家乐福 Carrefour	Generalist	顺丰优选 sfbest.com	Generalist	SEPHORA	Beauty Specialist
5 苏宁易购 suning.com	Generalist	我买网 womai.com	Generalist	京东 JD.COM	Generalist	唯品会 vip.com	Generalist

Q: How do you rate <platform> against the following criteria based on your experience about <category> shopping?
Source: OC&C FMCG E-commerce survey 2016

Traditionally, FMCG brands have thrived from establishing an extensive offline distribution network covering all store formats such as hypermarkets, convenience stores, specialist stores and even traditional mom-and-pop stores. This has allowed brands to reach multiple geographies and customer types. This should not be any different online. Winning online should not constitute just reaching out to a single key account. Moreover, while popular, Alibaba's platforms are neither the most highly rated, nor are they always rated amongst the top 5 in the FMCG categories which we have explored (Figure 10). Given the higher degree of fragmentation in the FMCG online market (c.50% non-Alibaba share in FMCG vs 30% overall), other players have a key role to play as well:

When it comes to infant milk formula (IMF), product authenticity and quality is critical. Driven by a mix of milk scandals and a rising middle class, Chinese parents are willing to pay a premium for imported IMF, in the hope of providing their babies with the same high quality nutrient

formula which foreign babies enjoy. In fact, the trend has become so significant that Hong Kong, a beacon of free trade, has passed a new law to restrict the amount of IMF which an individual can carry out of its borders, so as to inhibit parallel trading activities. In return, by taking advantage of, and capitalizing on, Alibaba's fragile credibility, platforms with an international origin have registered strong performances. For instance, both Amazon and Yihaodian have been hugely benefited from the phenomenon. (Case study: Cross-border E-commerce)

One way specialists can differentiate themselves is through providing great services. For example, each customer service manager from PinShangHui (Wine9) is paired up with a selected batch of customers and reaches out within 24 hours once customers have completed the online registration, while highlighting the latest promotions, and even suggesting the best grape varieties to go with an A5 Wagyu beef fillet steak. It feels just like walking into a wine store

and having a chat with the staff about your favourite French vineyard. This level of personal touch and interaction is not found in your typical hypermarket, or similarly, a large generalist platform.

Another example is Sephora, where it stands out for its wide product range offering. Like many other specialists who often struggle to generate high customer awarenesses and traffic, Sephora also operates a flagship store on 3rd party generalist platforms such as JD in addition to its own site. However, Sephora ensures that its site remains relevant by only listing about half of its product on JD. Consumers who want to purchase premium brands such as Lanvin and Estee Lauder's, for example, would have to pay Sephora's site a visit.

Just as one does not turn down a small mom-and-pop store looking to sell its products, the same should be true for online whereby one must not neglect the importance of 'the other' platforms.

CROSS-BORDER E-COMMERCE

Historically, Chinese shoppers could only turn to individual sellers who live or regularly travel overseas as ‘delegate shoppers’ (代购) for the access to imported goods, especially for IMF. However, due to the highly unregulated and high ease of tax evasion, it is often unreliable. For example, there was no channel to trace or dispute lost parcels.

International websites such as eBay US or Amazon Japan have therefore emerged and attempted to provide an alternative. But due to the hefty and lengthy delivery, especially for FMCG products where consumers usually want them immediately, ‘overseas treasure hunting’ (海淘) remains as an inconvenient option. However, despite the inconvenience, demand has been significant as parents consider quality of food to be very

important. According to iResearch, growth of the cross-border e-commerce market has jumped from 53.0% in 2013 to 111.8% in 2015.

As the market develops, the Chinese government finally stepped in and regulated the market. In 2014 and for the second time in 2016. Through levying taxes on small parcels, and reducing import tax for e-commerce platforms as well as introducing ‘tax-free’ bonded warehouses (where imported goods taxable when customers place an order) the Chinese government effectively promoted the formation of official channels to satisfy the population’s thirst for imported goods. Eventually, this has shaped the ‘cross-border e-commerce’ (进口跨境电商) model, through which

domestic players such as Tmall and JD have now opened dedicated sections (e.g. Tmall international, JD worldwide), which enable both direct sales and direct delivery of imported goods from overseas merchants to the doorsteps of Chinese households. While delegated shoppers and international platforms still exist today, consumers now benefit from cross-border e-commerce that is quicker, cheaper and much more reliable.

From brands’ perspective – this move has opened up a new, regulated and professional channel, especially for those who have not yet established a local presence, to sell into China with minimal capital investment. Brands can ‘test the water’ by partnering with platforms that provide ‘cross-border e-commerce’.



MAKE YOUR



ONLINE CHANNEL

REALLY WORK

1 Find the right platforms

Brands should partner with strategically aligned platforms to achieve their online objectives. Glengoyne, for example, exclusively sells its single malt whiskey on Womai due to the platform's reputation for authenticity and expertise in alcohol logistics. Montes also selected PinShangHui as its strategic partner pertaining to the platform's unrivalled knowledge on red wine. La Mer, a premium cosmetic brand also established its own-flagship store on Tmall for brand building.

2 Customise your offerings

Different customers prefer different platforms. It is important for brands to recognize this and adjust their sales strategy accordingly. For example, Elizabeth Arden targets price sensitive customers by using VIP.com as an outlet store, clearing its inventory by slashing price (e.g. Millennium Night Renewal Cream at 84% off RRP). Algenist, on the other hand, targets more sophisticated and attached customers by selling exclusive products on Sephora (e.g. anti-aging vitamin C+ serum).

3 Make it effective

Selling online in China is rewarding yet not easy. Brands need to understand the level of controls and capabilities required to decide whether to operate the online store in-house or rely solely on the platforms. Godiva, for example, runs its Tmall flagship in-house while Dove chocolate's JD flagship store is operated by the platform. A long list of Trusted Partners (TPs) with different strengths and weaknesses are also available in China to support brand-owners on operations along the value chain (e.g. flagship store layout, pricing, logistics and customer service). Making the right choice here, based on your needs, is critical for success.



FURTHER CONSIDERATIONS

Treat e-commerce not only as a sales channel but also a platform to build your brand. For example, premium players can educate a wide range of audiences on their brands by launching flagship stores, while brands without any physical presence in China can leverage cross-border platforms to 'test the water' prior to their full market entrance:

- How can I leverage e-commerce platforms to achieve my brand building initiatives?
- What are the roles and intersection of social media and e-commerce and how do I engage closely with my end-customers to gain real insights?
- What are the implications on costs, tax, logistics or potential cannibalisation with my existing presence in China of selling imported goods on cross-border e-commerce platforms?

Integrate offline and online channels to create a win-win proposition – either through leveraging existing offline infrastructure (e.g. distributor network) to facilitate online sales, or using e-commerce to facilitate offline strategies:

- How do I transform my offline distribution network into a potential competitive advantage in online play?
- How can I leverage e-commerce to facilitate offline strategies such as product launches, inventory management or geographic expansion?
- Should my product offering and pricing be the same or different online and offline?
- How do I safeguard the profits of my offline distributors, channels and existing investments when moving online?

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