The Future of Retail in China is Both Online and Offline

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Alibaba's investment in Suning is a signal that companies in retail in China need a multichannel strategy: embracing both the online as well as offline worlds.

In August, the world's largest e-commerce company Alibaba announced a $4.54 billion investment in Chinese electronics retailer Suning, which, in turn, bought a $2.2 billion stake in Alibaba. Alibaba accounts for about 80% of online sales in China, while Suning operates more than 1,600 electronics stores across the country. The news came unexpectedly, but in the context of the Chinese retail industry, it is by no means coincidental.

As the Chinese economy continues to cool, China's retail industry is feeling the pinch. The consumer market as a whole is rather weak, while competition over distribution channels is unprecedentedly high.

Data from China National Commercial Information Center (CNCIC) showed that last year, sales of the country's top 100 retailers only grew by 0.4%. In contrast, e-commerce companies are having it much easier. Statistics by iResearch, a consulting firm, showed that online transactions ballooned by

48.7% in 2014 to RMB 2.8 trillion, or about 11% of total social consumption.

The vulnerability of the traditional retail industry in China stands in contrast with the strength of many brick-and-mortar stores in the US, which have developed into multichannel sellers in order to compete with pure e-commerce competitors. According to a report published by Deloitte and STORES Media earlier this year, Wal-Mart retained its title of the most powerful retailer in the world. During the fiscal year 2013, sales at Wal-Mart's online stores, totaling $10 billion, ranked the third globally, after Amazon's $61 billion and JD.com's $11 billion.

In China, the level of integration of the retail industry is so low that traditional retailers have suffered a fatal blow from the rise of e-commerce players. Even though many companies have made efforts to transform themselves, it has been extremely hard for them to open their own channels online because they are either too small in size or too inexperienced to manage such transitions.

On the other hand, the government believes that from a macroeconomic perspective, a healthy retail industry should have a mix of e-commerce companies as well as offline stores. Therefore, it is trying to clean up the e-commerce sector, cracking down on fake products and imposing taxes on online sellers. These measures will influence the way e-commerce companies operate, possibly forcing them to look for opportunities offline.

The uniqueness of the Chinese market has motivated e-commerce companies and traditional retailers to work together and complement each other. Alibaba and Suning's decision to team up stems from the willingness of both sides to cooperate.

For Alibaba, the investment in Suning is an important step in its efforts to protect its advantage over rivals in China, notably JD.com, the second-largest e-commerce company in China. Operating like Amazon, JD.com curates most of the products sold on its website and runs its own logistics system, allowing better customer experience than Taobao, Alibaba's flagship platform that connects individual sellers with consumers. Taobao's advantage lies in long-tail products and markets where JD.com's logistics system can't reach; but as JD.com grows its delivery network, the company is gradually going to encroach on Taobao's territory.

In the face of the threat, Alibaba needs to team up with offline retailers on logistics, especially on the delivery of large-sized products like home appliances. For them, Suning is a good choice because the company has a strong brand image offline and it has also embraced e-commerce with an online offering of its own in the past two years. In the long term, the co-operation with Suning could beef up Alibaba's core competiveness, and if the model works out well, it may choose to team up with more offline stores in the future.

The collaboration between Alibaba and Suning is monumental in China's business history, but it doesn't necessarily mean that everything will turn out to be smooth. To make the partnership work, the two companies need to connect on a deeper level genetically. One negative example is the acquisition of AOL by Time Warner—a promising merger that ended as a disastrous failure, partially due to the incompatibility of their business cultures.

From the macro level, a robust retail industry should consist of a healthy e-commerce market and an integrated and efficient offline market. Chinese companies' approach to this rebalancing is going to be different from that in the US, and the partnership between Alibaba and Suning is certainly an interesting experiment to start with.

Xinlei Chen, Professor of Marketing, Cheung Kong Graduate School of Business.

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