



Alibaba’s Big Bet: Physical Retail and E-Commerce are a Winning Combination

Key Takeaways

- 1) On January 9, 2017, Alibaba announced a bid to privatize Intime Retail Group, a leading department store and shopping mall operator.
- 2) In our view, the significance of the privatization of Intime and Double 12 lies with its embodiment of “New Retail”, an enhanced, data-driven version of O2O that Alibaba is spearheading as its long-term strategy.
- 3) This note also draws from Alibaba’s Double 12 shopping festival as a case study for New Retail. In our view, the Double 12 shopping festival (December 10-12, 2016) was a success, not only because of the huge increase in both store and consumer participation, but also as it helped digitalize operations and empowered physical retailers.
- 4) We expect New Retail to gain momentum in 2017, on the back of policy support and cross-channel collaboration among retailers.

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Alibaba's privatization of Intime represents another step towards the digital transformation of traditional retailing.

Alibaba's Privatization of Intime Retail

On January 9, 2017, Alibaba announced a bid to privatize Intime Retail Group, a leading Chinese department store and mall operator. The privatization of Intime does not come as a surprise, as it is consistent with Alibaba's strategic goal of enhancing its integration with physical stores.

Details of the Privatization

According to an exchange announcement from Intime, Alibaba will take the company private by paying US\$2.6 billion, which will increase its stake in the retailer to approximately 74% from 28% before the privatization.



Source: Company data

We believe the privatization and Alibaba's support for New Retail bodes well for an improved operating environment for physical retailers.

Implications

Control of Intime should enable Alibaba to gain exposure to China's physical retail landscape, which has been slow to respond to the challenges brought about by online shopping. Alibaba made an initial investment in Intime in 2014, giving it a 28% stake, which resulted in Daniel Zhang becoming the chairman of Intime. Privatizing the company should allow Alibaba to experiment with the integration of online and offline shopping.

Background Information on Intime Retail

Intime Retail Group operates a department-store chain in China that sells a wide range of consumer products, including apparel, jewelry, home furnishings and electronics. As of June 2016, Intime operated 29 department stores and 17 shopping malls throughout China.

The company is headquartered in Beijing and was listed on the Hong Kong Stock Exchange in 2007.



Transformation of China's Retail Landscape

We believe Alibaba's privatization of Intime is consistent with Alibaba's long-term strategy of the "New Retail".

New Retail is More than Just O2O

The gist of New Retail is to transform commerce through a seamless integration of online and offline channels, supplemented by data technology and the supply chain.

The concept of New Retail assumes that physical stores are a driver of online sales.

The concept of New Retail was propagated by Jack Ma, Chairman of Alibaba, in October 2016, and the transformation of retail was christened by China's State Council the following month. In short, Alibaba believes that the era of pure-play e-commerce retailing will soon be a thing of the past, and that New Retail will be the focus over the next 10–20 years.

Offline businesses are upgraded by internet technology.

The concept of New Retail encompasses O2O and added components of a reconstructed supply chain, upgraded logistics and big-data analytics. O2O enables retailers to enhance brand awareness on online channels and direct customers to make a purchase at physical stores. New Retail goes a step further by digitalizing operations and empowering retailers. E-tailers can leverage physical stores to breed customer loyalty, which in turn, drives online sales.

China's State Council issued "Opinions on promoting the transformation of physical retail" 《关于推动实体零售创新转型的意见》 in November 2016, which encourages the transformation of retail supported by data technology. The gist of the guidelines is about speeding up the structural adjustment, innovation and cross-discipline integration, and improving the efficiency of the supply of goods and services.

The repositioning of Alibaba and Amazon suggests that a pure e-commerce model alone may no longer be sufficient for long-term growth.

Alibaba's Repositioning to New Retail

As a start, Alibaba has rebranded itself as a data company, rather than an e-commerce company. In December 2016, Alibaba restructured its e-commerce business to one that builds digital and physical infrastructure to pave the way for New Retail. During 2016, Alibaba also invested and partnered with physical retailers (such as Intime, Suning and Sanjiang Shopping Club) and piloted the integration of online and offline retail. In our view, Alibaba's partnerships with physical retailers are considered test cases for its integration of the online and offline channels powered by its big-data and mobile-payment technology.



Figure 1. Alibaba—Expansion into New Retail

| Period | Event | Significance |
|--------|---|---|
| Jan-16 | Alibaba opens a physical store in Tianjin, China. | The company’s first venture into offline retail. |
| Jun-16 | Alibaba increases its stake in Intime to 28% from 10%. | Intime Retail is a Chinese shopping mall and department-store operator. Through the partnership with Intime, Alibaba seeks to integrate in-store shopping and mobile payment. This is considered a pilot project for Alibaba to explore new ways to help traditional brands transform in the digital era. |
| Oct-16 | Alibaba sets up an e-commerce firm with Suning. | The joint venture aims to innovate the online-to-offline operating models by combining Alibaba’s online assets and Suning’s physical store network and distribution. |
| Oct-16 | Alibaba repositions in anticipation of New Retail. | Alibaba Chairman, Jack Ma, propagates the data-driven New Retail concept. |
| Nov-16 | Alibaba announces its acquisition of a 32% stake in Sanjiang Shopping Club, a regional supermarket chain. | Alibaba gains access to Sanjiang’s offline retail network and consumer data at physical stores, to drive the grocery business and synergies. |
| Dec-16 | Alibaba announces plan to restructure its business ahead of New Retail. | The company will explore opportunities in digitalizing existing businesses, build digital and physical infrastructure and make better use of data to empower retailers. |
| Jan-17 | Alibaba announces bid to privatize Intime. | The privatization is consistent with Alibaba’s strategic goal and enables the company to experiment with furthering the integration with physical stores. |

Source: Company data, FGRT

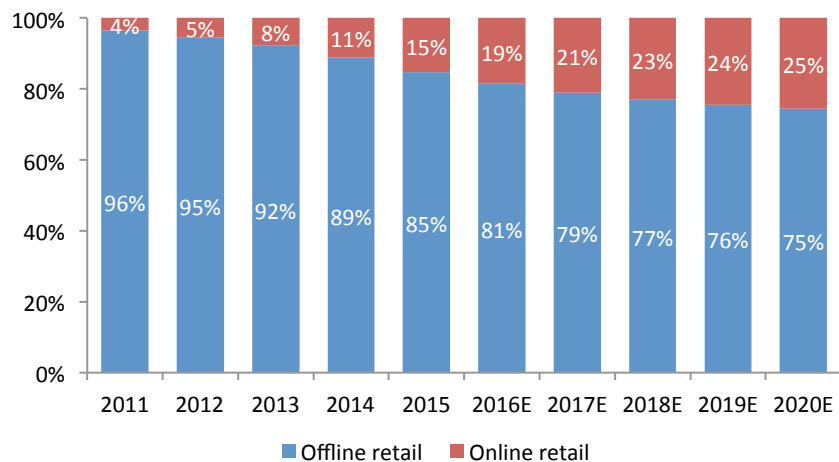
Offline retail will continue to be a major driving force, despite the appeal of online retail.

Promoting Consumption

In our view, offline retail has and will continue to account for a lion’s share of consumption, which drives both online and offline retailers to integrate and sell across channels.

Most spending took place at physical stores, with offline retail comprising 85% of China’s total retail sales in 2015.

Figure 2. China—Online and Offline Retail Sales



Source: Euromonitor, National Bureau of Statistics



Success is not shared.

Drawing a Parallel with Other Players

Both physical and online retailers have also entered the race to transform their businesses in order to remain relevant to consumers. However, they have not always shared in Alibaba's success.

Amazon (+)

In the US, Amazon has entered the brick-and-mortar space with its physical bookstores, and has plans for physical checkout-free grocery stores. See [Amazon Planning Expansion into Brick-and-Mortar Stores](#) and [What is Amazon Go, and What it Means for Amazon and its Competitors](#).

Wanda (-)

In China, the much heralded O2O strategic partnership among Tencent, Baidu and Wanda ended in disarray. Formed in 2014, in response to the growing dominance of Alibaba, the partnership aimed to revolutionize mall shopping by matching shoppers with brick-and-mortar stores through an online platform. Tencent and Baidu exited the partnership, which was disbanded in July 2016. Dalian Wanda is the operator of China's largest chain of shopping centers.

Conclusion

We expect New Retail to continue to gain momentum in China in 2017 and beyond. The development of the New Retail concept, defined by the empowerment of physical retailers and digitalized operators, bodes well for brick-and-mortar retailing in China and elsewhere. We expect a further round of consolidation of the retail industry, led by e-commerce players such as Alibaba in China and Amazon in the US.

Alibaba 2016 Double 12 Festival: A Successful Foray into New Retail

Double 12 emphasizes the engagement of physical retailers and customers, facilitated by Alibaba’s online assets.



In our view, this year’s Double 12 shopping festival was a success, based on the increase in the scale of the event and its ability to live up to and embody the concept of “New Retail”, an enhanced, data-driven form of omnichannel retailing.

Alibaba expanded coverage of the 2016 Double 12 shopping festival to capture more merchants (1 million versus 20,000 three years ago) and verticals (expanding to leisure and fashion, etc.). Although the absence of disclosure of gross merchandise volume (GMV) or total transaction volume—unlike Singles’ Day—may be a caveat, we believe this should be overlooked. Double 12 is considered as a pilot to implement New Retail, and in these terms, this year’s Double 12 was able to drive the level of customers’ engagement of physical stores to new heights with Alibaba’s online assets.

We believe Double 12 is a manifestation of the trend of data-driven retailing, which combines online and offline channels, supplemented by data technology. Both in China and the US, and elsewhere, internet platforms are opening up their data and information-management tools to offline merchants.

Physical retailers are also increasingly leveraging data management to upgrade their operations and better manage customer flow. The core value of the internet lies with data, and it is this data that can help physical retailers make better decisions in targeting customers and improve profitability.

We believe data-driven New Retail—which represents the symbiotic relationship between online and offline retail channels, supported by data—will supersede pure-play e-commerce in the future.

Going forward, we expect data-driven New Retail to supersede pure-play e-commerce.

CASE STUDY



Given its offline nature, Double 12 offers a win-win solution for customers and merchants via Alibaba's assets.

CASE STUDY

Recap of Double 12

We view this year's Double 12 shopping festival (December 10-12, 2016) as a success, measured in terms of the scale of the event and the level of engagement of physical stores and Alibaba's online assets.

- **Merchants:** The number of stores participating this year increased to 1 million compared to 20,000 three years ago, including more than 70,000 overseas merchants.
- **Consumers:** Over 110 million consumers participated this year, according to official statistics from Alipay, of which, 68% were born after 1985.
- **Consumers' engagement with brick-and-mortar stores:** This year's Double 12 shopping festival achieved considerable success in channeling traffic to physical retail locations. On the first day of the event, over 1,000 large-scale shopping malls nationwide saw customer traffic and transaction volumes double compared to a regular shopping day. Traffic at Shanghai Cloud Nine Shopping Mall on December 12 was roughly twice that of a typical weekend, and 20% higher than during National Week.

Introducing the Double 12 Shopping Festival

Alibaba's Double 12 shopping festival (December 10-12, 2016) is the offline sequel to its better known Singles' Day shopping festival. The emphasis of Double 12 is to channel traffic to physical stores and boost sales. In contrast, the primary focus of Singles' Day is e-commerce, and is characterized by heavy discounting.

This year, the Double 12 shopping festival was extended to three days from one day previously. Alibaba has continued to increase coverage for Double 12 over the years:

- **2014 Double 12:** covered supermarkets, convenience stores, taxis
- **2015 Double 12:** Expanded coverage to include F&B
- **2016 Double 12:** Expanded coverage to include karaoke, family, travel, beauty and fashion

2016 Double 12 Shopping Festival Themes

The theme of 2016 Double 12 is New Retail and going global.

- New Retail
- Going global
- Entertainment

The Push into New Retail

The Double 12 shopping festival embodies the concept of New Retail (新零售), which has been promoted by Alibaba and the Chinese government. In short, New Retail represents an enhanced, data-driven version of omnichannel retailing, which Alibaba expects to supersede pure play e-commerce in the future.



Alibaba aims to increase foot traffic and sales at offline stores through the Double 12 shopping festival, which is consistent with its goal of ultimately boosting consumer spending by blending online and offline retail, and offering big data and value-added services for merchants.

Going Global

This year's Double 12 shopping festival saw an increased focus on overseas expansion. Over 70,000 physical retailers in 16 countries—including duty-free shops, supermarkets and department stores—participated in the festival through Koubei, an O2O local services app. Overseas transactions conducted with Alipay also more than tripled year over year.

Entertainment

Similar to Singles' Day, celebrities played a pivotal role in promoting products during Double 12. Within the apparel category, seven of the top ten e-shops by sales volume belong to the celebrity store category. Common tactics include live broadcasting and interaction with fans.

The Alibaba Solutions that Made it Possible

Alibaba was able to direct traffic to physical stores through its suite of offerings. Customers can identify discounts through Koubei and pay at physical stores with Alipay, which drive up merchants' operational efficiency.

Koubei

The Alibaba-backed O2O local services app, Koubei (口碑), boosts offline store sales by directing traffic to their stores.

Koubei is a local service discovery platform within Alipay that allows users to search for local merchants, place orders, conduct payments and write reviews. On the first day of the festival, users could search for participating merchants using Koubei and then go to the store to take advantage of the Double 12 promotions.

Koubei was established by Alibaba in June 2015 to compete with Tencent-backed O2O platform Meituan-Dianping. Currently, more than 1.5 million offline businesses have set up virtual stores on its platform, according to the company.

By partnering with Koubei, physical retailers can attract traffic to their stores.

CASE STUDY

Figure 3. Koubei



Source: Company data

Alipay

The Alibaba-backed mobile payments provider, Alipay, launched promotions and discounts to its users during the Double 12 shopping festival. More than 1 million physical stores that participated via Alipay could gain access to user analytics on Alibaba’s platform, enabling them to better target customers.

Others

Live streaming and social-media platforms were used as promotional tools during Double 12.

Taobao Live (淘宝直播): A platform that allows shoppers to preview products and to convert fans into buyers.

Guang.taobao.com (淘宝爱逛街): A sharing platform for merchants to promote their products to online shoppers.

How Did Other Companies Compete In Double 12?

Other internet companies also participated in this year’s Double 12 shopping festival.

JD.com: Overall GMV for JD.com was twice that of last year’s Double 12. Sales in lower-tier cities (tier 3 to 6) increased threefold.

Lazada: Southeast Asia’s largest online shopping platform, Lazada, recorded sales of US\$40.5 million on December 12, 2016. Some 60% of orders were made on the mobile app. Over 1,000 brands and 55,000 merchants participated in this year’s promotion.

Mobile payment providers also sought to tap into additional revenue opportunities in offline retail.

WeChat Pay: Tencent-backed WeChat Pay introduced rebates for those consumers who purchased products via the app.

China UnionPay: During Double 12, China UnionPay launched a payment option via a QR code.

CASE STUDY



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