The market-entry factors for success aimed at small foreign mid-market fashion retailers in Shanghai

A survival guide to a more successful market-entry strategy

Picture of Nanjing Dong Road made in June 2011 in Shanghai

Bachelor Thesis

Amsterdam Fashion Institute, Amsterdam

Carmen Kha-Munn Cheng
Student number: 500234518
Email: Carmen.KhaMunn.Cheng@gmail.com
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Prepared for: Dhr. Joop Smit
Preface

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This thesis has been an assignment for the Amsterdam Fashion Institute, an education branch of the Hogeschool van Amsterdam. It is written for my graduation for the bachelor course International Fashion Management. It is written for the Amsterdam Fashion Institute, the retail industry and small retailers who are interested in branching out to China, the city Shanghai in particular.

The origins of this thesis began when I interned for a Dutch fashion brand in Shanghai. Through this company I came into contact with several foreign and local retailers. It came to my attention that small foreign retailers were having a difficult time compared to the local retailers. Armed with this fact I organised preliminary talks with foreign retailers and active professionals, who all gave me information on how to write this thesis. By using major players like H&M, Zara and Bestseller (Vero Moda and Only) as my benchmarks, I can use their market-entry strategies to improve the overall business activities of smaller retailers.

There are sufficient reports, studies and literature written on the internet and in books about how the major foreign fashion companies are conducting their retail business in China. More business information was found on the companies H&M and Bestseller but Zara’s Chinese business strategies and annual numbers are not published. Although statistical information was hard to find and unclear, it still satisfied what I demanded of the information. Armed with this information I interviewed the smaller retailers which gave me additional information to support my recommendations to all the small retailers who would like to invest into China.

I would like to thank all the people who have helped me find all the information and who have taken their time to be interviewed by me.

Furthermore, I would like to thank Mr Smit for his support and patience and his efforts to improve my thesis.

Carmen Kha-Munn Cheng
Thesis summary
The first chapter explains what the purpose is of this thesis. The purpose is to recognise the factors that will influence the success rate of new small mid-market retailers in the Shanghainese market and the survival recommendations that can be given to them. This thesis should act as a survival guide for interested small retailers who want to expand their business into China. The results will be supported with facts from books, reports and information found on websites. The main difficulty of this research is bound by the limitation of finding true and trustworthy information, considering the information does not come from a non-objective source. Therefore facts need to be double-checked.

The second chapter explains to the reader why history plays an important role in understanding the target market and why it cannot be ignored by new foreign market entrants. The Chinese consumers share one thing and that is their long history and their traditions. When it comes to fashion the Chinese consumers still look back to their history. For instance, the younger generations still wear the Shanghai dress and the Mao-suit to show their Chinese heritage. New and upcoming local designers come up with their creative ideas from looking into the old silk and embroidery techniques and they use intricate embroidery patterns from imperial times in their designs. The market has changed dramatically since the market liberalisation and that created some interesting social outburst for instance, the pyjamas worn in daytime in Shanghai. Nowadays the market is very diverse and fast-paced serving all the different wants and needs of the different Chinese consumers. This makes the Chinese consumers more critical and more consumers are moving away from conformity purchases to individualising their styles.

The third chapter is a DESTEP-analysis of the Shanghai retail market. Demographics show that the Shanghai market is one with still a lot of potential. Economic statistics lure new-entrants to invest into the country but high retail rentals and high labour costs are an important factor to consider. Social-cultural factors should not be overgeneralised by foreign retailers and should be an important factor which needs a lot of attention. Technical factors show that internet retailing is an expanding business. Ecological factors are not that important yet as Chinese consumers are not in that mind-set yet. Political factors show that the Chinese government is still keeping an eye on foreign businesses by limiting and controlling foreign business activities with a lot of regulations and rules. Overall the market shows there are a lot of advantages and threats in this market as it has not completely matured yet.

The fourth chapter guides the reader through the marketing mixes of the three major foreign players: H&M, Zara and Bestseller (Vera Moda, Only, etc.) which will serve as good examples of how smaller companies should do business in Shanghai. The quality of products sold in China by these companies are the same as in Europe but also priced the same as in Europe which is very peculiar as their garments are produced in the very same country. Instead of selling it for lower prices they sell it for European prices which make it very expensive for Chinese consumers. The goal of these brands is to be perceived as premium brands. The brands do have broader product lines and different product mixes to attract the diverse Chinese consumers. Standardisation practices are
not successful in China. The retail channels are in specialty shops in shopping malls or on high streets. Employing good staff and organising trainings is one of the main priorities of foreign retailers to promote their brands. Packaging has to be non-plastic and traditional promotion platforms prove to be ineffective, so foreign retailers need to find more creative ways to promote their brands.

The fifth chapter explains what all the market factors and necessary marketing mix updates lead to for new-entrants per expenditure. All the factors influence the start-up costs of every new foreign entrant. The average start-up costs are as high as back in Europe, so is it still worth the investment as low start-up costs were the luring factor for new-entrants?

The sixth chapter concludes the results found through the previous chapters with a few recommendations with the future expectations. Foreign retailers will still be lured by China’s impressive economic development but hopefully the small retailers will learn not just to look at profits but also to consider the high start-up costs and operational costs which will increase in the future. The time is right to invest into Shanghai as small retailers as high-end brands and mid-market brands have entered the market successfully for further expansion into other parts of China. The Chinese government has assured the people in these few years the targets are still aimed at economic growth and stability.

The factors that can influence the retailers’ success rate and the recommendations:

1. **Get to know the target market:** Do not overgeneralise there are too many differences amongst the Chinese consumers.

2. **Create efficient and smart marketing mixes:** The majority of foreign marketing mixes are still too standardised for the whole of Shanghai. There should be an in-depth research targeted only on the Shanghai market.

3. **Strong branding:** The amount of local and foreign new entrants is very high in Shanghai. To keep the consumers interested the foreign retailers need to think of new ways how to position themselves in the market and what kind of promotion activities need to be done. Creating a strong lifestyle around the brand will keep the customers interested and keep new advertising ways effective for SME’s.

4. **Unique retail concepts:** To break away from a big market with competitors selling the same kind of merchandise it is advised to create unique retail concepts and designs.

5. **The rise of well-known local brands:** The foreign brands used to have a competitive advantage over the local brands. But now the local brands are fighting back by learning and imitating retail concepts and product choices.

6. **The growth of E-commerce:** E-commerce has grown very rapidly these few years and when entering the Chinese market every retailer should consider if they would like to participate with this trend.

Extra material is given in a form of a case study about Kuyichi. This company has a unique business concept (sell sustainable and honest fashion for high prices) but one which has to be educated to the Chinese consumers as the majority of the consumers are looking for affordable luxury through cheaper foreign chain stores.
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Chapter 1: Introduction

1.1. Research purpose
My internship in Shanghai for a Dutch brand has encouraged my interest for foreign fashion companies based in Shanghai. During my stay in Shanghai I met foreign small to middle-segmented fashion retailers who have stumbled upon problems whilst doing business in Shanghai. The issues would vary from governmental policy and procedure changes to internal human resource problems. And on top of that they experienced problems understanding their market and how to keep their concepts original and fresh amongst the ever-growing fierce competition.

When I wanted to start a boutique with my Shanghainese friend, she bumped into less problematic issues. Therefore the question arose whether it is easier to work together with a local partner or not? Will foreigners bump into more problems, just because they do not speak the language? Or is there truly a different business climate with unknown rules and regulations for foreigners? This triggered my interest and by conducting several preliminary conversations with foreign and Chinese fashion retailers in Shanghai I came to the conclusion that indeed, there were several factors that can influence the success level of any foreign retailer in Shanghai.

For instance, the results showed interesting details. It is very important for foreign retailers to master the Chinese language and etiquettes to build any business in Shanghai. Also maintaining a useful network of ‘friends’ is very beneficiary to any foreign retailer. Foreign retailers should also master some degree of knowledge about the Chinese history which is closely linked to customer behaviour, tastes and habits and which is importantly linked to the future as Chinamen still look back to their interesting past. Without doubt several governmental factors influence the success rate of any foreign retailer. And with the growing interest of other foreign brands, it is best to know all your competitors and potential competitors in the Shanghai fashion market.

The research purpose is to search for the major factors that will influence the success rate of small retailers in Shanghai and try to inform and advise the new retailers who are interested to expand to China what to look out for.

1.2. Research question
Which factors influence the success rate of small foreign mid-market fashion retailers in Shanghai and what survival recommendations can be given?

1.3. Objective
My objective with this thesis is to put all the experiences of other foreign retailers who have tested Shanghai waters into an advisory guide for future SME’s fashion companies. The main problem for starting retailers is that they lack important information and resources when entering the Shanghainese market. Much literature is written on subjects as conducting business in China, etiquettes, cultural differences and about the Chinese language. However, there are not many books sharing the problematic hurdles and sharing advice how to overcome the current problems. My
thesis will therefore provide information and advice on the current market situation and how major fashion retailers are managing their businesses in Shanghai. It will guide and advice any future foreign fashion retailer who wants to expand their fashion business into China and it will inform the reader about a diverse and difficult market which has not fully developed yet and one with a lot of potentials and pitfalls.

1.4. Limitations and boundaries
The first boundary of this thesis is the place of research. This thesis is solely focused on the Shanghai fashion market. The main reason is that Shanghai is the place where many foreign fashion brands enter China for the first time. And to them Shanghai is seen as the perfect testing ground. It is the most famous cultural and fast-moving fashion city within China next to Hong Kong. Nearly all high and middle-segment European brands start their brands in Shanghai to research sales opportunities, target groups and competitors. Mainly because the population of Shanghai is diverse and the city houses the most people with the biggest high-to-middle incomes of China. Even Shanghai’s local government has set goals to make Shanghai even more popular amongst other cities in China. 

1 (Shi, 2010)

The second boundary has been defined for research only targeting the small foreign (European and North-American) mid-market fashion brands. The main reason is that foreign high-end luxury brands have already entered the Shanghai market successfully in these past few years and they have successfully expanded their businesses beyond Shanghai. (KPMG, 2007) Most of the problems occur with small mid-market foreign fashion brands because they do not have the capital and resources to afford to make any mistakes or do in-depth research before entering the market.

The last boundary will be targeted on which business sector I will research. The research will be limited to retailing. Nearly all books on business set-ups in China are generalised for all different industries together. Specific information for fashion business set-ups in Shanghai are rarely seen. For most retailers it is most interesting for them to read how the current market is divided, how all the other competitors are managing their market-entry strategies and what their experiences and what the best recommendations are for them before entering the market.

The main limitation in this thesis will be the amount of information and its accurateness. The amount of information is troublesome because China lacks trustworthy and clear information databases to do any research on. Therefore facts need to be double-checked.

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1 http://www.chinadaily.com.cn/china/2010-08/24/content_11191767.htm
1.5. Methodology
Proceeding to this thesis there were 4 introductory talks with foreign SME’s retailers in Shanghai. They all were lured into business with promises of high turnovers and profits. But with the set-up of the business they have experienced more problems than ever and after one year they all complained about disappointing profits due to high operational costs and problematic internal management problems. Some small retailers have even considered terminating their businesses and cutting their losses as soon as possible. When choosing to exit the market, it will mean that they will lose any future re-entry chances. Exit strategies damage the brands image too much.

These introductory talks lead to more research. The method used to search for factors was done with desk research performed with literature about how to conduct and set up businesses in China. In the desk research I found factors that could cause eventual problems to new market entrants. And on the World Wide Web there were several articles that supported my research. A list of factors was composed out of the research. With this previous information a topic list was composed. Which lead to qualitative research in the form of interviews with active professionals (including the same 4 retailers who also did the preliminary talks before) based in Shanghai. Each question was composed out of the factors that could influence the success rate of any new foreign fashion retailer.

I have decided to use the companies H&M, Zara and Bestseller (Vera Moda and Only) as my benchmarks to find the factors that could influence small foreign mid-market entrants. The reason to use these 3 companies is that they have proved to be successful (the top 3 mid-market chain fashion retailers in Shanghai) in the Shanghainese market and a lot of research can be found on these brands. They also share the same product lines and target groups. The SME’s should look up to them as examples to follow in this new market.

Quantitative research has not been done within this thesis. The main reason was the lack of research resources and the speed in which changes occur in the Shanghainese market. All databases will be absolute when publicised.
1.6. Thesis set-up
Chapter 2: History of Shanghai fashion

2.1. Fashion influenced by dynasties and traditions

Female fashion in imperial China was ruled by different dynasties. Each dynasty had its traditional dress. For instance the Tang dynasty had robes which looked like the Korean dress (wide dresses clinched into the waste) and the Qing dynasty had the Manchurian dress (forerunner of the Qipao dress). All fashion and clothing rules were introduced to the lower ranks of society when another clan/dynasty took over China.

Chinese fashion changed dramatically in revolutionary times. Times were unsure but in that time a lot of different fashion styles became popular. For instance the Manchurian court dresses were changed into more easy-to-wear dresses, the Qipao. This Qipao was worn by the majority of Shanghainese women influenced by movie stars. Also Western fashion became popular during these times with the influence of foreign expats and Chinese students repatriated back to China.

During the communist years the Chinese population had to rebuild their country what was needed after the war with the Kuomintang and the Japanese. Mao Zedong took leadership and promised to build a country where the Chinese could be proud of again. The people followed his simplistic style and dressed like him: the Mao-suit. A simple black/grey suit which also proved to be functional work wear and showed political devotion to Mao Zedong.

History has showed that the Chinese population was forced into different fashion styles. They have never experienced fashion in the western sense since the ‘opening up’ of the country 30 years ago. Even now you see the people who have money to spend on clothing, they will put functionality first whether it is fashionable or not.
After the market liberalisation a wide variety of famous brands started to enter the Chinese market, for instance, Louis Vuitton and Gucci were the first high-end brands followed by the Hong Kong mid-market brands Baleno and G2000. Women firstly followed mainstream fashion blindly and purchased all the western fashion trends without thinking about whether it would fit them personally but to show off their new acquired wealth.

2.2. Current and future fashion
With the further development of Shanghai into a metropolitan, most of the modern women (city people) are starting to follow their own fashion sense rather than adapt to mainstream fashion. They are wise enough now to judge what beauty is by combining elements of Eastern and Western dress. Men and women now mostly adapt to western or neighboring Japanese/Korean fashion. But the qipao with its traditional elements and the Mao-jacket prove to be popular garments and are worn to show their history, traditions and roots. Moreover Shanghai with its different inhabitants with different likes and dislikes, they wear their garments with diversity in colors and styles. Shanghai’s fashion shows its culture proudly in modern days. Beginning local and foreign designers in Shanghai are there to meet the needs of all fashionable Shanghai women and men who are looking beyond mainstream fashion to increase their personal style by mixing Western and Eastern fashion.(Anon., 2006)

In these few years Shanghai has developed its own fashion week. It is organized twice every year in October and in April. This event is supported by the People’s Republic Ministry of Commerce and hosted by the Shanghai Municipal Government. The event is to build up a strong platform for Asian fashion creativity.

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3 http://www.smartshanghai.com/print/blog.php?a=253
4 http://en.wikipedia.org/wiki/Shanghai
Chapter 3: Current analysis (DESTEP-analysis) of the Shanghai Fashion retail market

A before and after picture of Shanghai’s development. The top left-hand picture shows Shanghai before 1990. And the right-hand picture shows the development 20 years later, taken in 2010.

3.1. Demographic
Shanghai is a migrant city attracting residents from all over the world. Shanghai consumers are made up out of its residents and visitors. Entrepreneurs, workers, tourists, expats and business travellers from all over mainland China and overseas have flocked over to Shanghai to spend money. All consumers vary greatly in income level, occupation, consumption attitudes and consumption preferences.

Population count:
The population of Shanghai is shown in these graphs. This information has been found with the latest Shanghai population census (6th census) held in November 2010⁵ (Anon., 2011)

<table>
<thead>
<tr>
<th>Population</th>
<th>Floating population of migrant workers</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td>23.019.148</td>
<td>8.977 mln</td>
</tr>
</tbody>
</table>

Gender composition:

<table>
<thead>
<tr>
<th></th>
<th>Population</th>
<th>Gender composition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>11.854.752 mln people</td>
<td>51.50%</td>
</tr>
<tr>
<td>Female</td>
<td>11.164.396 mln people</td>
<td>48.50%</td>
</tr>
</tbody>
</table>

Women in China have always been second rank citizens in the Chinese society. But recent years have shown that women are gaining more economic independence, having more money to spend on clothing. This trend is set as women achieve higher education levels and careers. ⁶ (KPMG, 2007)

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⁵ [http://jfdaily.eastday.com/j/20110503/u1a878723.html](http://jfdaily.eastday.com/j/20110503/u1a878723.html)
Age composition:

Age structure of Shanghai population

Note: The statistics show that Shanghai has a low fertility rate compared to the ever expanding older generation as a result of the one-child policy. According to the latest research 7 (Kotler, Philip et.al., fourth European edition, pp. 95) this will cause serious problems for the younger generation to take care of the older generations when they grow up. It is forecasted that the people between the ages 22-45 will be the richest in China because this is the generation that is higher educated. This group forms a big one in Shanghai which means it will be a very interesting target group for fashion retailers. 8 (Chao, 2012) Amongst this group you can find the trendsetting part of the population.

The ethnic composition:
People from Shanghai are of the Han population of 22,743,327, accounting for 98.80% and the minority population of 275,821 people, accounting for 1.20%. There are 56 official registered ethnic groups in China. All of them have their own traditions and clothing. In Shanghai the majority are of the Han population, so it will be much easier to adapt to the same holidays and traditions that this group shares. One of the most important traditions of this group is to celebrate Chinese New Year. All people buy new clothes for and after Chinese New Year celebrations. This 2 week holiday is the most important date for high turnovers and sales for most of the fashion retail business.

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8 [http://www.wikinvest.com/concept/Rise_of_China’s_Middle_Class](http://www.wikinvest.com/concept/Rise_of_China’s_Middle_Class)
**Education levels:**

<table>
<thead>
<tr>
<th>Education Level</th>
<th>People</th>
</tr>
</thead>
<tbody>
<tr>
<td>University degree</td>
<td>5,053,071 mln people</td>
</tr>
<tr>
<td>High School degree</td>
<td>4,826,118 mln people</td>
</tr>
<tr>
<td>Primary school degree (including graduates, dropouts and</td>
<td>8,393,031 mln people</td>
</tr>
<tr>
<td>students at school)</td>
<td></td>
</tr>
<tr>
<td>Illiterate population (aged above 15)</td>
<td>631,018 people</td>
</tr>
</tbody>
</table>

Note: The amount of people getting a higher education is growing each year. When trying to define a trend in the growth of the middle-class groups of Shanghai, it is best to look at the education levels. The major forces behind China's economy are the consumption levels made by the middle-class of China which consists out of university graduates. This group has a salary more than 50.000 RMB a year. Therefore looking at education levels is a very important statistical indicator on how the market is growing in Shanghai. 9 (Shanghai Daily, 2006)

**Foreign expats:**

According to the latest statistics of the Shanghai national census 10 (Anon., 2011) 208,300 foreigners have chosen Shanghai as their current place of residence. That means 9 out of 1000 Shanghai residents are foreign. This year they have added residents from Hong Kong (19,300), Macau (900) and Taiwan (44,900) and from other countries (a total of 143,200 from 214 countries) who are living in Shanghai for more than 3 months. The last group was headed by Japan (29,700), the US (23,600) and South Korea (19,800) residents. The main reason for the foreign residents to live in Shanghai was pursuing their careers. The statistics showed 47,500 are doing business, 56,800 are working, 41,200 are studying and 20,400 are trying to live in Shanghai permanently. This group also has very high consumption levels as they have a more luxurious and expensive lifestyle. And between these foreign expats you can find a lot of them work in the fashion business and they are considered as the trendsetting ‘population’ of the Shanghainese fashion business.

**3.2. Economic**

China has the second largest economy after the United States and has a 2011 GDP of $5879 billion dollars. 11 (Anon., 2012) Which compared to last year was a growth of 9.1%. China’s economy has changed rapidly in the last 30 years. They have changed their centrally planned economy into one which is mostly dependant on market-orientated international trade of export products.

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10 [http://www.echinacities.com/shanghai/city-in-pulse/more-than-200-000-foreign-residents-in-shanghai.html](http://www.echinacities.com/shanghai/city-in-pulse/more-than-200-000-foreign-residents-in-shanghai.html)
11 [http://www.tradingeconomics.com/china/gdp](http://www.tradingeconomics.com/china/gdp)
As the rest of the world has been dipped into economic crisis, major buying powers: the US and Germany are importing less as consumer confidence is at its lowest in their own countries resulting in lower export numbers for China according to latest research (Lumiani, Merita., 2010). To steer away the Chinese economy from any financial crisis, they have introduced a stimulus package of $586 mln dollars to give their national market a boost, it has stimulated a GDP growth of 8.7% in 2009, targeting a 8% growth for that same year and an expected growth of 9% in 2011 and a slowdown of 8% in 2012. (Bank of Finland, 2011) The stimulus package mainly targeted government invested companies, for instance, infrastructure and technological manufacturing-based companies (home-appliances, computers etc.). The main goal was to keep domestic consumption high and secure jobs in major manufacturing industries.

By 2010 the results were clear and the package was positively conducted. The consumer confidence index has not declined as hard as they thought and unemployment rates have not risen explosively. But by the end of 2010 it showed that this method was only perfect for a short-term period, as an economy can overheat and cause higher inflation rates increasing prices of food, clothing and rent. By 2011 the consumer confidence index has fallen to 103.4 in September compared to 105 in August. This decline has been linked with on-going bad world economic news and high Chinese inflation rates (5.5% by October 2011) caused by rising consumer prices connected with the successful implementation of the stimulus package and unemployment rates have risen slightly to 4.3% in Q3 of 2011 compared to 4.15% in Q1 of 2011.

We cannot ignore Shanghai’s share on those numbers as Shanghai is China’s most important economic hub within mainland China, next to the special administrative region Hong Kong. The largest service-based industries are in the financial services, retail and real estate. And Shanghai houses the main industrial centres within China for steel, ship and automotive manufacturing. Also Shanghai houses the busiest container port within China. (Anon., 2012) Shanghai’s GDP of the first half year of 2011 reached RMB 916.4 billion ($143.2 billion). With a disposable income per capita reaching RMB 18,381 (US$2,872) in Q2 2011. (HSBC, 2011) Urban households spend an average of 1,444.3 RMB on clothing, accounting for 10.7% of their income. (Li & Fung, 2011) The high inflation rates have slowed down the speed of Shanghai’s consumption sales to 497.323 billion Yuan ($6.09 bill) in 2011. (HSBC, 2011) But it is already forecasted with

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15 [http://www.hsbc.com.cn/1/PA_1_083Q9FFKG80E20RA9Q00000000/content/china/personal/hsbcpre_mier/images/DTZ_Shanghai_en.pdf](http://www.hsbc.com.cn/1/PA_1_083Q9FFKG80E20RA9Q00000000/content/china/personal/hsbcpre_mier/images/DTZ_Shanghai_en.pdf)
17 [http://www.hsbc.com.cn/1/PA_1_083Q9FFKG80E20RA9Q00000000/content/china/personal/hsbcpre_mier/images/DTZ_Shanghai_en.pdf](http://www.hsbc.com.cn/1/PA_1_083Q9FFKG80E20RA9Q00000000/content/china/personal/hsbcpre_mier/images/DTZ_Shanghai_en.pdf)
the upcoming traditional shopping seasons (Christmas and Chinese New Year’s) that numbers will increase again. 18 (HSBC, 2011)

These numbers suggest a potential lucrative market for foreign retailers as Shanghai’s high-educated consumers have the highest urban disposable income compared to other regions in China. In the year 2009 Shanghai housed 116.000 multimillionaires and 7000 billionaires. 80% of China’s luxury shoppers are under 45, compared to 30% in the US. And that amount counts for 8 billion US Dollars, which is 3% of the global luxury sales. 19 (Curtain, Andrew, 2010, pp.84)

The high-educated urban Shanghainese citizens have an average monthly disposable income of 3899 RMB (389 euros) and the people living in the rural areas have an average of 1672 RMB (167 euros). The high-educated people have occupations varying in the following sectors: finance, information technology, healthcare, science, education, culture and public administration. The low-educated people have occupations in the rural sectors farming, mining and construction. Annual salaries vary widely from the people working in the financial sector with the highest average earnings of 94674 RMB to the people working in the residential services (residential security guards) with an average low salary of 18287 RMB. In the manufacturing, wholesale and retail sector, which accounted for the largest workforce, there was a high of annual income 30700 RMB and an annual low of 24001 RMB. 20 (Anon., 2010)

These statistical indicators have attracted more foreign retailers to set up their fashion companies in Shanghai as it proved ‘resilient’ against the world financial crisis in these coming years. This will attract more foreign retailers in the near future as that is the only place where still a lot of foreign brands have not set foot in and where the financial crisis has not set in yet. They all are lured by the numbers and the potentials of the Shanghainese fashion market. To show this fact (HSBC, 2011) in these last year’s Shanghai’s retail rental prices have gone up for retail spaces, the average rent is now up to 48.5 RMB p/sq. m per day at prime rental locations. 21

Below you can find a table of the sales divided by popular retail channels in China. A penetration rate of 5% of the total retail sales accounts for the foreign fashion companies. 22 (Thomas White global investing, 2011)

<table>
<thead>
<tr>
<th>Total retail sales in China of clothing, shoes, hats and textiles</th>
<th>S45 bln RMB 23 (Li &amp; Fung, 2011)</th>
</tr>
</thead>
</table>

18 http://www.hsbc.com.cn/1/PA_1_083Q9FFKG80E20RA9Q00000000/content/china/personal/hsbcpremier/images/DTZ_Shanghai_en.pdf
20 http://www.hktdc.com/info/mj/a/bgdsn/en/1X06818P/1/Guide-To-Selling-In-China/Selling-In-China-Shanghai.htm
21 http://www.hsbc.com.cn/1/PA_1_083Q9FFKG80E20RA9Q00000000/content/china/personal/hsbcpremier/images/DTZ_Shanghai_en.pdf
<table>
<thead>
<tr>
<th>Department store sales in China (37%)</th>
<th>201.650 bln RMB(^{24}) (Li &amp; Fung, 2011)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Specialty stores and boutiques (38%)</td>
<td>207.1 bln RMB(^{25}) (Li &amp; Fung, 2011)</td>
</tr>
<tr>
<td>Online (all consumer goods) (2.98%)</td>
<td>16.2 bln RMB(^{26}) (Anon., 2011)</td>
</tr>
<tr>
<td>Outlets, Hypermarkets, fashion markets (22.02%)</td>
<td>120.041 bln RMB</td>
</tr>
</tbody>
</table>

### 3.3. Social and Cultural

The Chinese consumers have not been freely consuming for a very long time. It all started with the economic reforms 30 years ago. That is why their market changes very rapidly as its economy grows stronger.\(^{27}\) (Hays, Jeffrey., 2008) That is why the best way to describe the typical Shanghainese is through their age, because they differ greatly in their consumption attitudes as in the rest of China. \(^{28}\) (Anon., 2010)

#### 60 and older

Like many other societies in the world, Shanghai also has a big aging (over 60) population. This group consumes relatively traditionally and are more conservative: they buy their food from the food and peddlers markets, they do not go out to restaurants, are very mindful of the value of money and the things they wear and use. They are very sensitive to price changes and they do not like to use credit cards and are not interested in credit consumption.

This group still shops at the family specialty stores to buy their basic garments. These specialty stores attract the older customers with price promotions. And these specialty stores are often found close to compounds where the older generation live and relax. For example near the older downtown residential complexes and close to parks. This group has no need to follow fashion and only buy clothes when needed. They often opt for functionality of the clothing and not for how it looks. They are seen as the consumer group which still holds on to the old traditions.

#### 35-59

Brand-name clothing and cosmetics are most common in this medium to high-income groups of white-collar workers, corporate executives and private entrepreneurs. They have big interest in purchasing brand names as their main concern is service, quality and product design to show off their wealth. Owning these products is a ‘face-giving’ factor. By buying these brand names they get a guaranty of these requirements. They

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\(^{28}\) [http://www.hktdc.com/info/mi/a/bgdsen/en/1X06818P/1/Guide-To-Selling-In-China/Selling-In-China-Shanghai.htm](http://www.hktdc.com/info/mi/a/bgdsen/en/1X06818P/1/Guide-To-Selling-In-China/Selling-In-China-Shanghai.htm)
are not sensitive to price changes. This is also the group that travels to Hong Kong to purchase brand name products. Because items purchased with a foreign visa is more ‘face-giving’ than items purchased in China. Since a few years certain high-end niche brands, for instance, Marni, Stella McCartney have found interest in the Shanghai market. The reason is that this group is tired of the main stream high-end brands and are looking for more specialised brands to increase their status and style. This group has modernised Chinese consumerism by accepting new trends and styles in fashion. They do not often opt back for the old Chinese traditions and beliefs. This group consists out of parents of the younger generations, teaching a generation with less traditional buying behaviours.

18-34
College and university students mostly depend on their parents for living expenses, that is why their consumption levels will vary with the economic levels of their families and there are wide differences. Students are generally very interested in famous brand names for their clothing, shoes and bags. But when they are studying they can only afford brands in the low-to-medium segment. For instance, H&M, Zara, Vero Moda, Mango etc. are very popular with the younger generation. The ones that want more unique items will even go to the low-segmented boutiques or markets, for instance, on Qipu Road to find fashion from Korea and Japan. This generation seldom buys luxury brand products.

A minority of students may be more advanced in their consumption level as they have extra income from private tutoring or they have a part-time job in their spare time. This small group shops at the middle-segmented boutiques to find unique garments to enhance their personal style which is not dictated by big chain stores.

This whole group will spend more on high-end fashion when they start to earn money after their degrees. Eventually they will follow the path of their parents and will be interested in buying high-end brands to show off their capability to earn more money than the average people.

Under 18
The consumption market for Shanghai children is expanding. Most children are the single child in their families and so their parents and paternal and maternal grandparents are willing to spend a lot of money on them making them the new princes and princesses of China. Most of their parents are the new generation brought up after China’s reform period. While their spending power is rising, their knowledge structures and their consumption attitudes are more modern than those of their parents. They focus on scientifically proven and modern methods of raising and educating their children. Besides spending on the usual children’s products, parents are also making purchases intended to develop their children’s knowledge in arts, cultural studies and social sciences. Children’s products are also presented as gifts and famous brands are most welcome by gift buyers or gift receivers. But the children are
making their own mark by telling their parents what they want and their parents listen. They are easily lured by advertisement.\(^{29}\)\(^{\text{Anon.}, 2010}\)

After the reform, the Chinese population had the desire for competitive and conformity consumption to ‘keep up’ with the trends and what other people might think of them, fuelling the success of foreign high-end brands. Now this kind of consumption is decreasing and diversifying further. Often foreign luxury companies have profited from this development after the economic reforms. Consumers are however no longer passively induced to consume by advertisements and publicity. Now rational consumption, autonomous and individualized consumption are on the rise, they are now trying their best to reflect their unique style and establish unconventionality and individuality through their clothing, outward appearance and fashion accessories.

Like other Asian consumers (Hong Kong, Korean and Japanese), Shanghainese are brand- and price conscious. The typical consumer spends less than 200 RMB for casual wear. The Shanghainese are too fickle to stay loyal to a brand and they like trying new trends and new products. A fact that cannot be ignored is that the Shanghainese have their own dialect and traditions and they are very proud of their heritage. They can be called ‘arrogant’ and can be often seen together bad-mouthing the “other” Chinese people from other parts of China.

There are several trends seen in the future that will influence the retail environment:

The younger generation who can afford chain brands will not be interested in them anymore. The foreign chain brands will see a shift towards upmarket boutiques selling individualistic designed garments and specialty stores offering custom made garments. These youngsters are shifting towards a style that can enhance their personal style and will not let the big fashion corporations dictate what they wear. They are adopting individualistic fashion trends from Japan and Korea for a more personalised style mixing Western and Eastern trends.\(^{30}\)\(^{\text{Yang, Chen., 2010}}\)

Another important topic is that sportswear will still be a very popular market. This is due to the Chinese government campaigning for healthy lifestyles and more movement. The Shanghainese have high enough incomes to buy foreign and domestic branded sportswear in the middle to high-end market. The demand for higher quality underwear is also rising. Comfortable, hygienic and well-designed underwear will be very popular with the increase of income. Parents will demand high-quality, well designed and safe clothing for their children. For now the domestic market for children’s clothing cannot offer this, so with the increase of income the parents will buy foreign branded children’s clothing. The one child policy of the government is also

\(^{29}\) \text{http://www.hktdc.com/info/mi/a/bgdscn/en/1X06818P/1/Guide-To-Selling-In-China/Selling-In-China-Shanghai.htm}\n
\(^{30}\) \text{http://business.globaltimes.cn/comment/2010-07/557098.html}
fuelling this trend, because parents and grandparents want to buy the best for their little princesses and princes.  

A new trend is emerging according to a survey in Brandweek which was held after the Beijing Olympics the researchers found out Chinese customers were now more attracted to their own domestic brands. The reason was that China is growing into a strong country and the people are proud of their products and achievements. Before the Chinese felt that their products were inferior to the foreign products. But with the increase of knowledge and experience within the domestic companies, they have shown the world that the Chinese products are equal to foreign products or sometimes even better. The Chinese government is now campaigning for the Made in China logo to create more trust and national proudness for their domestic brands.

Various research articles have emphasised the importance of history, beliefs and traditions on the buying behaviour of the Chinese population. For instance, all festivities and holidays, defined by traditions and history, require traditional outfits or elements of traditional clothing. As an example we can say that the New Year’s festivities are the most busiest and profitable for fashion retailers. Therefore retailers should stock up and also stock up on garments with touches of red. The colour red symbolises happiness and fortune.

When a foreign retailer studies the Chinese history and background, it could help him/her a lot when understanding their customers buying behaviour better. They would understand their market better and create opportunities and avoid any pitfalls.

3.4. Technological

When it comes to retail, we cannot ignore the internet. According to the latest information from the Shanghai Municipal Statistics Bureau there were 11.6 million internet users in Shanghai at the end of 2008. The penetration rate of internet users was 61.4% of the total Shanghai residents. In that year e-commerce was worth 275.8 million RMB. The answer for EBay in China is Taobao. The consumers can find everything on this website supplying garments from different parts around the world. For example you can get the latest fashion from Korea or get real Levi’s jeans from last season with discount from a local factory in China.

31 http://ta.di.dk/sitecollectiondocuments/foreningssites/ta.di.dk/downloadboks/medlemsfordele/markedsinformation/sverige%20sektoranalyse%20furniture%20clothing%20and%20design%202010.pdf


With the locals growing attention for internet buying between the ages 18 and 30\(^\text{35}\) (Anon., 2010), E-commerce is the best way to expand the traditional retail business in Shanghai. But as a foreign SME it is very difficult to start selling on the internet. All E-commerce activities need to be invested with extra capital into the business (the registered capital could be higher, due to the complication of the business model) and they need to add the hyperlink of the online sales address to the business license, before the foreign investor can retail in China. All information given on the website should be true and a separate license needs to be applied with the local SAIC (State Administration of Industry and Commerce) to add online trade in Shanghai. The person needs to register the virtual address with a registered service operator, who will check the websites on wrong content. \(^{36}\) (Anon., 2010)

On the website the customer must be informed about the product: type, quantity, quality, price, shipping charges, delivery methods, payment methods and return and/or exchange policies of the goods. The foreign investor should also clearly place a hyperlink on the virtual address with its business license to show the customers that the link is a trustworthy website to purchase from. Further they need to offer a secure and reliable environment for transactions and deliver the goods on time with sales receipts. Also they are prohibited to give out personal information (from customers) to any third party. All personal information should be stored, secured and destroyed in a safe way. Trademarks and copyrights are not allowed to be infringed by the company. \(^{37}\) (Anon., 2010)

Still a lot of regulations and laws are missing in this area. And not all Chinese have access to a computer and to credit cards. So payment methods are often very different from Europe’s or in the US. Also delivery systems in China are not that safe yet. Therefore still a lot of foreign small investors have not operated virtually yet: the risks are still too big. They are hesitant to invest more money into their first market-entry strategy and rather chose the traditional B2C method: retail shops. The Shanghai government has also raised the import tax and delivery costs to protect their domestic businesses and slow down foreign internet purchases from outside of China.

The state government is trying to enforce more regulations to protect their civilians by putting “wrong” retailers in jail for punishment.

In the last few years credit card promotions have increased in Shanghai. The banks are offering relaxed credit terms and bonus point schemes for purchases made with credit cards to boost card applications and usage of the cards. The cards are accepted by the majority of customers, but they are not used often by the elderly population. It is widely accepted by the young and middle-aged group, but it is mainly used to buy

\(^{35}\) http://www.hktdc.com/info/mi/a/hkthk/en/1X07MMWA/1/Hong-Kong-Trader---Hong-Kong-Edition/China’s-Online-Youth---.htm
\(^{37}\) http://www.hktdc.com/info/mi/a/bgdscl/en/1X05VJIW/1/Guide-To-Selling-In-China/5-5-Consumers-Rights-And-Manufacturers-Obligations.htm
property or cars and not for buying clothes or accessories (online). Only bills worth several thousand RMB will be paid by cards and payments are made upon receipt of the credit card statements. However retailers still complain about the costs and availability of a bank card automated systems. The dial-in connections are often very bad and the monthly costs are very high and not all bank cards are accepted on the systems. So often shopkeepers prefer cash payments instead.\(^3\)\(^8\) (Anon., 2010)

**3.5. Ecological**

In the last few years China has been in contact with foreign and domestic chain brands who sell affordable middle-priced garments. For instance, the Hong Kong brands Giordano and Baleno, the domestic brands Metersbonwe and Me & City, the European brands H&M and the US brand GAP. All these brands have rapidly expanded their businesses together with the expansion of the middle class in China. This sector will be the most fast-growing sector in these 5 years, more and more urban people will have higher disposable incomes to spend on fast-fashion. There is also a downside to this development. A lot more quality problems were found and it is considered a very non-environmental friendly business model as worn-out garments are not re-used again, but thrown away each season.\(^3\)\(^9\) (Yang, Chen., 2010)

Nowadays ecological problems are not the Chinese consumers’ main concern. They are in the stage of pursuing a wealthier lifestyle and by buying affordable garments they show off their new wealth. However, the Chinese buying behaviour will not follow the North-Americans’ spending behaviour. The Chinese will not be inspired by environmental concerns but by a traditional desire to live within one's means, making them spend money wisely.\(^4\)\(^0\) (Hays, Jeffrey., 2008) However the younger Shanghainese generations are noticing these problems and are searching for brands which promote a more ecological friendly business model in fashion. A shop called Nest in the trendy Taikang road area has introduced an ecological friendly fashion retail shop to promote more environment-friendly fashion items to tap into this new demand.\(^4\)\(^1\) (Anon., n.d.)

As for Shanghai climate and weather, the weather is dominated by all 4 seasons. The average weather in Shanghai is around 15.7 degrees Celsius. It is a humid subtropical climate and temperatures can vary from -10 to 41 degrees.

Summer starts around June and July and August are the hottest months with an average of 35 degrees Celsius. It is very humid and hot in the summer and there are frequent rain storms. Spring starts around March and has frequent downpours and the temperature varies a lot. Autumn start around September and has the same weather pattern as spring. Winter starts around December. Temperatures drop to below zero

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\(^3\)\(^8\) [http://www.hktdc.com/info/mi/a/bgdscn/en/1X06818P/1/Guide-To-Selling-In-China/Selling-In-China-Shanghai.htm](http://www.hktdc.com/info/mi/a/bgdscn/en/1X06818P/1/Guide-To-Selling-In-China/Selling-In-China-Shanghai.htm)

\(^3\)\(^9\) [http://business.globaltimes.cn/comment/2010-07/557098.html](http://business.globaltimes.cn/comment/2010-07/557098.html)


\(^4\)\(^1\) [http://www.ecofashionworld.com/Store-Review/Nest-Shanghai.html](http://www.ecofashionworld.com/Store-Review/Nest-Shanghai.html)
and it is very chilly outside and inside, because houses and apartments do not have central heating. During the year the city experiences typhoons. The retailers I spoke to told me that the seasons go by very quickly. They often buy in or design only 2 collections for the whole year: spring/summer and autumn/winter. It is also advised to buy dehumidifiers to reduce the risk of mould and mildew in the stockrooms.

The retailer's advice is to source for garments or design garments that are suitable for the different seasons. For instance, polyester linings are too sticky for summer garments and will not sell in the shops. Clothes should also be designed to the living standards of the customers. The majority of the local and foreign people live in small apartments with limited space to hang out the laundry. Therefore materials should dry quickly and because people have ayi's (cleaning ladies) the materials should also be durable. (The ayi's are famous for 'destroying' their clients' clothes.) As for opening hours in the summer the weather conditions are so hot, sometimes it is even necessary to close the shop as you will not find many people walking on the streets.

3.6. Political

There is only one leading party in China, The CPC (Communist Party of the Republic of China). They are in charge of the whole political process in the country and are authorised to make decisions on their own with no opposition at all. China operates under a strict political communist socialist system with a combination of a free liberal market economy. This means that retail companies can have the freedom to do business in China but will have to adapt to socialist political decisions from the CPC.

Shanghai has a different story, as a municipal government, they have their own city (local) government (smaller and local division of the CPC), with their own policies. They have more freedom to make decisions but always under the watchful eye of Beijing (state government).

The Shanghai government strives to build itself into an international center of finance, trade and commerce. To do so they have implemented regulations to make it easier for foreign international retailers to locate their businesses in Shanghai than somewhere else in China. To control the (foreign) companies the Shanghai government has implemented a licenses and registration process. Each process has its own individual license. The foreign investment services companies know exactly which license each foreign company need, but all policy changes can change overnight without notice. Therefore it is very important to contract the right foreign investment services company to apply for all the necessary

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registration paperwork for the new company. The deskresearch showed that most of the business application processes will not be a major hurdle for new foreign entrepreneurs as long as they have the right amount of start-up capital, network of people and patience. Also choosing the right business structure is very important as different business structures have different regulations and different tax rules. When companies have registered for the wrong business structure it is a very difficult process to change it in a later stage.

Each foreign retailer should also understand that the Chinese government is not democratic. As a foreigner you are not allowed to discuss or even criticize the working methods of the Chinese government. To keep control of the masses, the Chinese government has its famous (fire)wall and censorship on all (foreign) news coming into the country. The (fire)wall contains a list of thousands of websites containing ‘wrong’ information. For instance, erotic websites, social networks Facebook and Twitter, YouTube, websites with information on political incorrect and social incorrect issues are all banned or censored. When logging on to these websites the browser will give an error. Some information on world affairs is not reachable for the Chinese people. For instance, news on the Chinese Nobel prize winner was never published or has reached China.

The government has established the rules that each foreigner should obey the rules and foreigners who violate this can be detained or exiled without any chance for appeal. To control the foreign workforce they have also implemented a strict visa-application process, forcing each foreigner to give out a lot of private details.

When it comes to doing business in China foreign retailers can get into trouble with this. Whatever rules and regulations (now policy tightening measures to control price fluctuations in property, which can influence retail space rental prices) they are bound to change overnight without notice. For a foreign retailer it is more difficult, because they do not speak the language or do not have the right network to warn them. So often it happens that retailers are fined, because they had no idea that some rules have changed. There are no ways to fight your way out of it. It is advised by other expats to just pay any fine and not discuss about it.

It also happens to retailers that one can get a license and one cannot in the same industry. When the government decides to deny you the license you cannot fight their decision. You will have to change the business plan and apply for it again. Therefore the grey areas are very big in China’s law system. It is written in a way that everybody can work around it. The official, who is in charge, will give his verdict which will be the final decision. Often foreign retailers find themselves in questionable situations. There is a very thin boundary of what is considered corruption. Corruption is when somebody pays an official to get something done. For example paying a money amount to a government official to ensure a contract/license is illegal. But taking him out for diner and giving him presents to maintain ‘friendly’ relations with him/her is legal. The Chinese government is very strict towards corruption cases and it is punishable with death. There are a lot of foreign investors who maintain these ‘friendly’ relations,
because it often secures the business future. It eases the process and they help their ‘friends’. That is why retailers advice to secure these relationships in their ‘guanxi’ network.

Chapter 4: Current retail marketing analysis (7 P’s analysis) of foreign retailers
This analysis will be a guide on what some of the major foreign players are doing in Shanghai’s retail industry. (See appendix A for the company list)

4.1. Products
All foreign fashion companies have a marketing team making decisions how to enter the Chinese/Shanghainese market with their products. They make their decisions based on individual product choices (product attributes (quality, style and design), branding, labelling and services), product lines and product mixes. The small-to-middle segment retailers should try to follow their example, as they are serving the same target groups and they have more capital to spend on marketing solutions.

Individual product choices
Product attributes (Quality & style and design)
Quality choices are based on what the target market wants and what the competitors have. At this moment the quality sold in the foreign mid-segment of Shanghai are the same as in Europe or in the United States. The main reason is that the bigger chain brands are selling the same merchandise as back home. So why are the foreign brands so successful then? The Shanghainese perceive foreign fashion as qualitative better and the styles and designs are more unique compared to their domestic brands.

This advantage creates a problem, concerning counterfeit items and copycats. China has been recently often in the news for Intellectual property infringement law suits organised by big foreign retailers. Most of the cases are about counterfeit or look-alike products of the real brands. For instance, China has their own Crocodile brand, which looks very similar to the western Lacoste logo. It is very important for foreign retailers to protect their designs. For small to middle segmented brands it is more difficult to fight of copies. Therefore it is important to import design products which are not easily copied, for instance, by using difficult designs and better quality materials. Copied products are often inferior in quality of materials and in the finishing of the end product.

In December 2010 the Chinese government has vowed to protect the registered intellectual properties better of registered companies foreign and local alike. Vice-premier Wang Qishan has said that he will launch a half-year campaign to investigate and punish companies that produce fake products (accessory market, fashion clothing market and in computer software) or even companies (even inside government) that use these products.

Branding
According to experts in the retail business, the most important rule for a retailer is the name on your front door: The brand. A brand is a symbol of identification for your customers and it should create positive reactions amongst your future customers, such as familiarity, reliability, service, quality, consistency, security, value, speed and strength. To create these positive reactions, it is for every retailer, foreign and local, to get to know your future customers. Already mentioned above is that foreign retailers, for instance, H&M and Zara, already have an advantage by being foreign. They are already perceived as better and more unique. \(^{45}\) (Segal, Rick., second edition, pp.27)

The problem for foreign retailers is the registration of the foreign brand name in Shanghai. The name has to consist out of: location (city)+business name + main business activity + legal structure. For example: Shanghai + style + retail + Co.,Ltd. The translation of your business name can be phonetic or by product description. For example “Mai Dang Lao” is the phonetic translation for McDonalds and “Wei Ruan” is the translation for Microsoft by product description. The foreign business can only register the Chinese name of the business. The use of the words China, Sino and/or International is prohibited. If there is still a need to use these words, it has to be approved from the central government. A company name registration is separated from a trademark registration which means that the name cannot be protected by IPR laws. To register for a trademark is a longsome, complicated and expensive procedure. \(^{46}\) (Anon., 2010)

The basic rule for naming the foreign enterprise is that it can only choose a name which has not been taken by another business entity in China. Due to the vast amount of registered businesses in China, there is a big possibility that the company name has already been taken. Therefore it is better for foreign entities to go through the pre-registration process before applying for the business application procedure and to have 4 more name options before going to SAIC (State Administration of Industry and Commerce) to register the name.

The main point is that every beginning small retailer should choose a business name, which creates a strong identity amongst your Chinese and foreign target groups. The store will become a recognizable strong brand with strong business values to the local Shanghainese market and the foreign expat market. This is the only way to survive in Shanghai’s over-crowded and fast-changing marketplace.

Labelling
The Chinese government has made regulations on garment labelling. The regulations which have to be on the label are: the product name, name and address of manufacturer (for any claims and complaints) and the (special) care instructions must be printed in clear and concise pictures or in word. The language has to be written in

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\(^{46}\) http://www.wfoe.org
simplified Chinese characters. And any foreign language can be attached together. The 
letters cannot be less than 1.8 mm in height. 47 (Anon., 2010) 
Note: With my experience I have found that often Chinese consumers want to know 
where there garments are made. When you tell them it is made in China, they often 
will not purchase it. You have to explain to them that the products are made in 
factories where they also produce garments for the major foreign brands for export 
purposes. The majority of the richer Chinese still have a distrust towards their own 
domestic factories and quality.

Product-support services
The concept of service in China is fairly new. The foreigners always say that in China 
there is no service in retailing compared to back home. The sales staff are always 
conceived as very pushy, often very rude and lack product knowledge. That is why a lot 
of foreign investment services companies add Human resource training facilities to 
train the staff of foreign companies to western standards.

Product lines
According to the experts having a broad product line will increase the popularity of the 
brand. 48 (Harris, Dan., 2010) The domestic brands are packaged as foreign brands and 
product designs are closely tied to foreign trends. Brands such as Elegant. Prosper are 
Chinese-foreign joint-ventures. Already the high-end luxury market brands are adding 
diffusion lines to their collections to reach the ever-growing influence of the middle 
class. 49 (KPMG, 2007) For instance, the high-end brand Hermes is trying to keep their 
customers interested by creating Chinese ‘signature’ lines, created to the tastes, 
demands and needs of the Chinese market with the brand Shang Xia. 50 (Anon., 2010) 
And Levis is doing so with Denizen. The sizes, prices, tags and collections are altered to 
attract the domestic market. 51 (Anon., 2010) For instance, the company Bestseller (Vero 
Moda, Vila, Only etc.) has successfully penetrated the middle-segment market in China 
by introducing all the brands of the company in all price ranges. 52 (Emausbot, 2012) And 
H&M has entered the Shanghainese market as a brand selling ‘cheap chic’, using 
foreign famous singers and designers, for instance, Madonna and Karl Lagerfeld and 
Stella McCartney, to promote a more expensive feel to the brand. 53 (Kingsbury, Kathleen., 
2007)

47.http://www.hktdc.com/info/mi/a/bgdsen/en/1X05W3ZS/1/Guide-To-Selling-In-China/6-1-General-
Provisions.htm
50.http://www.google.com/hostednews/afp/article/ALeqM5iy3rpnUSYHsTKen5dA9dANJaoGWg
Product mixes
Most of the companies carry the same merchandise as in the other countries due to standardisation of product mixes. This reduces manufacturing costs and eliminates duplication of research and development, advertising and product design efforts. But standardisation does not always work in the Chinese market. For instance, sizes are much smaller in Shanghai than in Europe. That is why H&M and Zara carry sizes starting from size 32 to only 40. The bigger sizes are very difficult to find. That also counts for shoes and underwear.

4.2. Place
The success and speed of the market-entry of H&M, Zara and Vero Moda was that most of them have already sourced a big percentage of their garments in China. They already have forged strong relations with their manufacturers, making expansion even easier into the mainland as they already have a well-organised supply chain which needed little alteration to suit to Shanghai’s market. So where they compete on other than on product differences, it is often location. The location of the retail concept is very important. It is closely linked to how the retailer wants to position its brand in the market and what kind of consumers they want to attract. For instance, Zara chooses top locations in Asia with high-end brands promoting themselves as rivals of high-end brands. Chinese consumers want clothes that aspire them to buy more luxury and give them more status. And H&M looks for location with high foot-traffic in high-street locations or shopping malls.³⁴ (Kingsbury, Kathleen., 2007)

Shanghai has increased the amount of rental locations due to the expansion of the metro line system. The Shanghaiese commute to work with the metro or bus and when they wait they do some little shopping before going to work or home. Shop locations close to these metro stations have seen rental prices rise in these past few years. Hot rental properties now lie close to all the available metro stations. Also due to the Shanghai EXPO more retail-outlets have opened to house all the new foreign fashion market entrants. The most sought out locations are in: Nanjing East Road, Nanjing West Road, Lujiazui area in Pudong, HuaiHai Road, The bund, Yuyuan garden.

³⁴ http://www.time.com/time/magazine/article/0,9171,1617522,00.html
and Zhongshan Park. Beneath you can find a list of popular retail channels available in Shanghai.

**Specialty shops in shopping malls**

The average Chinese consumer prefers to spend their time in shopping malls, because it gives them all the facilities (food courts, restaurants and clean bathroom facilities) needed and it offers them a big variety of brand choices. The average customer is an active shopper; they will also shop in other stores. The foreign retailer should consider the extreme weather conditions in Shanghai. In the summer it can be very hot (40 degrees) and in the winter the temperatures can drop to minus 10 degrees. Therefore shopping malls can provide the consumers a comfortable shopping experience during these extreme weather conditions.

When choosing these shopping mall locations, the retailer should also think of the amount of independence they want. The foreign retailer should consider if they fit into the shopping mall image. The mall management will also look at this factor. Shopping malls always have rules concerning opening hours, window dressing and promotion activities. When one does not obey the rules, the tenant will be punished with penalties and the worst case is a forced eviction with no right of return on deposits. The management’s rules are there to enforce cleanliness and order in the malls. The management can also provide the retailer with security (often only mall security for the public spaces, own security needs to be contracted elsewhere) and they are obliged to keep foot-traffic high by advertising the mall in promotion activities. A main target of the management is to keep foot-traffic high by attracting anchor stores. The anchor stores’ customers will also shop at other smaller tenants stores. For example Zara and H&M are good anchor possibilities, but supermarkets and drugstores are also possible. The locations of these malls are always located in areas where the investor can find a combination of high-end residence buildings and office buildings.

The rent in these locations is always very high and room for negotiating is very small. To keep all the tenants happy, the management has a strict selection method for leasing out to any kind of retailer. Most malls are often hesitant to lease out to independent retailers, because they are not sure if it can generate enough customers. They do highly welcome foreign franchisers. In Shanghai there are several upmarket shopping malls. The Grand Gateway in Xujiahui, Plaza 66 in Jing’ An district and the newly-opened IFC mall in Pudong. These malls house famous foreign brands such as Louis Vuitton, Chanel, Gucci, Dior, Hermes and the multi-brand store I.T. from Hong Kong has set up their Asian Shanghai branches there. For instance, the IFC mall in Pudong is specially build to house the most famous retail brands who are asking for more high-end retail spaces. At the moment the most sought out mall locations by high-end foreign investors are in the Hong Kong Plaza, Lippo Plaza and IFC mall.

The mid-market malls, such as Image Mall, Cloud 9 and Super Brand Mall houses mid-market foreign brands like for instance, ZARA, H&M, Bershka, Mango, G2000 and mid-market domestic brands such as Kaja, Lazo and Pierre Garroudi.
The retailer should make sure that the location will still be popular in the future by gaining enough information before signing any lease. And he/she should read through the lease terms very carefully and see for what kind of costs they are responsible for. The mall management can offer a detailed description of the demographics of the area. So the retailer will have a good idea if the location matches their business concept.

**Department stores**

According to the Shanghai Merchandise Commercial Profession Trade Association, at the end of 2008 there were around 100 department stores with a floor space of 6000 sqm and above. 25 Department stores were under the Bailian Group, 30 were foreign-invested ones such as Printemps, Pacific, Parkson and Isetan, about 20 were government-owned, situated at the best locations, for example at Huangpu (The Bund) and Xuhui (Shanghai Stadium) districts. And 15 were situated in the suburbs.

The department stores are pre-dominated and operated by Chinese, Hong Kong and Japanese operators. The tenants offer mid-priced products and stores range from 8000 to 30,000 sqm. In Europe and in the US, department stores have not performed well in these last 3 decades and consumers have moved to other options. Shanghai is still a relative new market where department stores are still very popular. If the existing Shanghai department stores will not invest in re-positioning themselves for the future they will experience the same phenomenon which is happening in department stores across Europe and in the US. They need to compete more efficiently with other retail channels and create relationships with potential and older customers. The older Chinese department stores are involved in ‘promotion wars’ (selling their merchandise with high discounts over longer periods of time) to keep their foot-traffic high. They cannot stop giving out discounts because their customers are used to the low prices and the promotion offers. This led to lower sales profits and big discounts with suppliers.

Acquisitions and mergers led by foreign big investors (Harrods Ltd., Galleries Lafayette Group etc.) are occurring in former government properties. These department stores are going through a big transition, the foreign investors brings in marketing, management and organizational knowledge, by brightening and renovating the stores and by re-organizing and changing the management and re-positioning and specialising themselves differently with other merchandise.  

Independent small-to-middle sized foreign investors can rent space to visualise their brands. They call them concession deals. They should see it as their market-entry pilot and/or a stepping-stone for their research market-entry concept. Therefore when the concept is widely accepted by customers, they can make the choice of leaving the department stores and set up own retail shops.

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**Boutiques**

Boutiques are not registered and financial data is not present (all transactions are done in cash) to help the government find the statistics for this retail channel in Shanghai. Mostly they are around the old French Concession and other main downtown areas: Xinle road, Changle road, Anfu road, Julu Road and Nanchang road. The retailer has more independence to operate the shop. More unique boutiques are located in specialty store locations for highly specialized niche businesses for example Taikang road and in Xintiandi. These streets have a unique concept; the stores are located in the old renovated Shikumen areas. They have mixed trendy shops (foreign and local), restaurants, and bars in residential area. These locations are remote, but people are willing to go there for the atmosphere and the unique products. Foot-traffic is high in these places especially after work times for local and foreign workers and these places attract a lot of tourists. For instance Taikang road and the former French concessions are popular locations.

When walking through Shanghai each person will notice 4 different types of boutiques in Shanghai and it is divided by the owner and by the merchandise. Each of them specializes in different kinds of garments. There are local Chinese owners, Shanghainese owners, Foreign-born-Chinese owners and foreign owners. And merchandise options and price differences are very varied. The merchandise in department stores and chain stores carry national and global brands, the non-branded items and unique items are found in boutiques. Small retailers specialized in non-fashion will be phased out very quickly with the increase of hypermarkets which carry non-trendy basic clothing.

Also new areas have developed around the metro lines for small fashion retailers. These places are located underground for instance, around the metro station of Zhongshan Park and People’s Square. This location has high foot-traffic after work-time. Office ladies go shopping together before traveling back home with the metro.

The prospects of the small foreign retailers are very positive. As long as the retailer has an eye for detail and a good concept. Trendy small fashion boutiques will have a good chance in competing with the big global fashion retailers as their overhead costs are lower. The Shanghainese are gaining more knowledge and are developing their personal styles. Therefore market is open for unique and affordable clothing. The customers are often willing to travel to shop at the unique stores. It is very important for a foreign retailer to employ charismatic and nice local and foreign staff to serve the expat and local community.

**Chain stores**

Shanghai is home to all kinds of different foreign and domestic chain stores. The most famous European and American chain stores are ZARA, H&M, GAP, Marks & Spencer, Nike and Adidas. But Japanese chain stores for instance, Uniqlo are also very popular. To appeal to the Shanghai fashion market, chain stores have increased their prices. The foreign chain stores have positioned themselves as ‘imported’ brands to emanate a
more exclusive feeling. Domestic chain stores include Me & City, Metersbonwe and the famous Shanghai Tang. Also Hong Kong retailers, like Giordano, Bossini and Baleno enjoy business in Shanghai. Hong Kong retailers had an advantage over other foreign retailers. They had shifted their manufacturing bases to China in the 1990s because of lower production costs, so by the time China entered the WTO, they were the first ones to be allowed to distribute the locally-produced garments.

For a foreign small-to-medium segmented retailer market-entry with more stores than one is very difficult. They will lose control over their investment. Therefore it is very important to stay small and exclusive at the beginning to research if there is any interest in the brand.

**Online shopping**

This new way of retailing has been gaining sales volume in these last few years and retailers were very scared it would replace the conventional retail channels. But research has shown it is seen as a complementary channel to their normal way of doing business. The conventional shops give the customers a real-life experience of the buying the products.56 (Anon., 2011)

So how do the logistics look like in Shanghai? Major foreign logistics companies have seen the potential of China’s market and have plans expanding into those countries with help of local logistics companies.57 (Osawa, Juro., 2012) The infrastructure in and around Shanghai is a subject where the Shanghai government always finds ways to improve on. Foreign retailers often find the way logistics are organised very primitive in China but they do prove successful. For instance, congestion and the small roads are a big problem in and around Shanghai, so trying to deliver products on time is always a difficult undergoing. The inventive Shanghainese local logistics companies have come up with ‘quaidi’ services. When the merchandise (boxes) arrives at the main distribution centre, they split them into smaller batches. These smaller batches are then placed on smaller trucks (mini vans) or mopeds. They can manoeuvre much quicker around traffic and can unload very easily at the front door of the shops. Zara and H&M use these kind of services as they need to restock their products very quickly each day.

**4.3. Price**

Surprisingly prices set by the major foreign retailers are set as high as in the other countries or even more expensive. Everybody would think it would be cheaper as all the products are manufactured in the same country as it is sold but this proves us wrong. Due to the marketing decisions made at the head-offices, the major chain brands want to establish themselves as premium brands in China. Brands such as H&M and Zara mark-up their prices, by using the same prices as in Europe. For instance, a

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57 [http://online.wsj.com/article/SB10000872396390443686004577638631527227466.html](http://online.wsj.com/article/SB10000872396390443686004577638631527227466.html)
basic t-shirt costs 9 euros in the Netherlands, in China that would be 90RMB, which is reasonable expensive for the Chinese consumers.  

Discounting is often not advised as it can hurt the brand. The newly-rich shop at these foreign chain brands to have a feeling that they can have something foreign to show off in to the people around them. They want status and recognition of their newly found wealth.

The prices for import products from outside of China are often more expensive than in other countries. The reason is that the Chinese government puts taxes on consumption goods: At present, the heavy tax imposed on imported luxury goods comprises out of import duty (from 6.5% to 18%), value-added tax (17%) and consumption tax (30%), accounting for 60% of the final price.

4.4. Promotions

There are several ways to advertise for foreign fashion brands with more result than the conventional media sources as it proved inefficient all these years.

Word-of-mouth: All Chinese customers want the same as foreign customers; all they want is quality garments from reliable brands. All retailers who have tested the retail waters of the Shanghainese market for several years are more successful, as they already have built a strong identity and they have created awareness in the local and foreign market, often by word-of-mouth advertising. Word-of-mouth advertising still remains the most trusted marketing resource in Shanghai. And according to an expert strategist fashion companies are throwing away large amounts of money with advertising in mainstream advertising and media with little result.

Television: In this case we are not talking about advertisement through TV-ads as that is still under State government regulations and it is very expensive. The best way is through celebrity endorsements and through lifestyle programmes. The people in China are celebrity-crazed. So attaching your brand to a celebrity will bring instant brand-equity to the brand. That is why all high-end brands endorse European, American, Japanese, Korean and Chinese (mainland, Hong Kong and Taiwan) celebrities from movies, TV-series, sports industry and music industry. Shanghai has several Chinese speaking lifestyle programmes which focus on fashion and beauty. On these programmes they promote the latest fashion trend/craze to the young masses.

Fashion magazines: China has many magazines (local and foreign) which specialize in women’s fashion. Often when your merchandise is special enough, you will grab the attention of these magazines. They will be interested in doing a small spread (free

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58 [http://westiseast.co.uk/blog/foreign-company-china-business-model/](http://westiseast.co.uk/blog/foreign-company-china-business-model/)
59 [http://www.time.com/time/magazine/article/0,9171,1617522,00.html](http://www.time.com/time/magazine/article/0,9171,1617522,00.html)
advertising) on the owner, shop or merchandise. They also borrow merchandise to promote for example a spring/summer fashion spread, advertising the brand and price. China’s magazine world is very turbulent, China’s local domestic magazines are finding it very difficult to compete with the foreign fashion magazines or copyright shared Chinese and foreign co-operations, for instance, Vogue (best-selling in China), Elle and Cosmo. Shanghainese are also interested in Korean and Japanese fashion (Ruili), making them the runner up for popular Chinese fashion magazines.

Expat magazines: In Shanghai there are several expat magazines That’s Shanghai, City Weekend and Time Out. All of them contain fashion and lifestyle sections. Foreign small boutique holders with imported merchandise often contact these magazines for a free fashion spread on the owner, brand or merchandise. All expats and young Shanghainese read these magazines and they are freely distributed in expat hotspots, for instance, in foreign restaurants, clubs and shops.

Online: Online advertising is fairly new in China. Shanghai’s SAIC has given out licenses to companies that offer internet advertising. And rules and regulations are the same as the traditional advertising routes. Nowadays blogs are very popular. These blogs are written by young Shanghainese, Korean, Japanese, American inhabitants of Shanghai. They are often present at parties and make pictures on the street of young fashionable people. These blogs often show unique and individual styles and they do not promote chain store mass-made fashion. Also promoting the brand through Facebook or Twitter is not possible, as these websites are banned. Internet shopping is more popular now, so foreign retailers should be on the lookout to add an online internet shop and more advertising space on other websites.

Sales promotions: The amount of promotions that Chinese customers now receive from the major chain stores or the smaller boutiques is very small in Shanghai. Some smaller stores have a customer V.I.P. card. When the customer spends above an specific amount, he receives additional discounts, promotions and invitations to events. Often the bigger chain stores have ‘buy 2 get 1 free’ promotions to lure potential customers to buy more garments. Also consumers are lured with promotional giveaways. Often when consumers spend above an specific amount they get a promotional gift.

PR company promotions: Some brands have made the choice to work with local or foreign (Hong Kong) PR companies. These companies can do research for the brand and define the companies’ promotion mix better than a foreign marketer at the head office. These PR companies organise the launch of the brand and the openings with big events and they manage all negative and positive information around the companies brand image.

Relationship marketing: The owners of fashion boutiques cannot afford mass media advertisements or employ experienced marketing staff.

Instead they can create customer relations. The owners of these boutiques befriend the potential customers and treat them with coffee and a chat. Often the customers call the shop before coming to make sure if the owner is there to help them. These stores often have a big sofa, where the customers can sit and interact with the store employees, creating a good place to hang out when they have free-time and they like meeting new people with the same fashion interests. The customers will often come back to purchase another item. The boutique owners keep an updated contact book with personal contact details. When there is new merchandise or a new promotion activity, they will inform the customer personally. Boutique owners often chose merchandise which reflects their style and knowledge of the trends in the fashion industry. Although China has eased the rules of foreign trade, they still control mass-media. For the average Chinese it is difficult to gain information about world fashion. The Shanghainese often turn to magazines, television shows or websites from Hong Kong, Taiwan, Japan and South Korea. The serious Shanghainese trend-followers do not read the Chinese fashion magazines; they associate the magazines with pre-made marketing plans and/or sales strategies for the big brands. They think the information is censored by the government. The customers often turn to the owner for fashion advice.

**Store branding:** Store branding is for owners who have the ability (money and knowledge) to design their own-branded clothing or for owners who have the resources to source for clothing that they can re-brand as their own. This investment-heavy choice is not often made by the average boutique holders. They rather build brand-equity by selling ‘themselves’. The owner puts himself out in the fashion industry as a trendy, fashion knowledgeable and charismatic person to hang out with. Some customers are then attracted to come to the store and purchase items which can be sold for higher prices than anywhere else. The other way is using unique concepts in visual merchandising and interior design. Boutique holders have much more independence when it comes to visual merchandising and interior design. They have much more freedom to display their collection in creative ways and design the shop to their own tastes in accordance with the building permits and rental contract. They often ask the view of the customers or friends. For instance, boutique holders can mix and match different brands to dress up the shop and also they do not have to stick to standardization practices made by parent companies or compromise to mainstream tastes.

H&M spends 3% of their business gross revenue on their promotion budget worldwide. \(^{63}\) \(\text{[Lynn, Heather., et al, 2008]}\) And Zara spends only 0.3% of their gross revenue on specific targeted promotion budgets divided by country. This percentage is very low compared to other brands, because Zara has technological innovations to help them identify and manufacture clothes which customers want and thereby eliminating advertising costs. \(^{64}\) \(\text{[Jannoun, Roula., 2010]}\)


\(^{64}\) [http://www.slideshare.net/roula72/zara-presentation-1?src=related_normal&rel=3249223](http://www.slideshare.net/roula72/zara-presentation-1?src=related_normal&rel=3249223)
4.5. People

A lot of foreign brands were first attracted by the low labour cost in China when opening a retail concept, but were shocked to find out that there is not enough local management, sales and services staff. The Shanghai government has enforced increases in minimal wages and more regulations are made this year. Extra costs had to be made to train and employ good staff. Nowadays the foreign high-end and mid-segment brands employ staff through an extensive round of interviews. When employed the staff will go through a lot of training, before she is allowed to represent the brand. After the training and some working experience, the staff will go through evaluation rounds and additional training on weaker points.

It is always better to invest in better staff, so they can make free advertisement for the company. Good experiences with the sales staff is advertisement on its own, as the customer will tell all the people that he/she was helped very well in that particular store. When retailing in Shanghai it is necessary to hire staff who are native Shanghainese. The Shanghainese customers often will speak in their native tongue and other staff from other regions do not speak this dialect.

Some foreign retailers have given me some pointers to look out for when hiring local staff. In foreign businesses there is a big cultural difference between their local employees and between the foreign employers. There is big hierarchy between the employer and employees and the foreign employer often distrusts his/her employees. Hierarchy is advised, because the Chinese employees get confused when there is no hierarchy. They do not know who to report to.

Chinese employees are often accused of being lazy. They do have a different work ethic than foreign people but it is caused by the long indoctrination of the communist regime and by Confucianism teachings. It has been advised to Chinese to never outshine each other. Outshining each other can cause conflict and then harmony is in danger. The Chinese have learned that it is better to be standard and be the same as everyone else. Own individuality and ambitions are set aside for the common good. That is why they are perceived not to be ambitious enough.

Chinese employees and foreign employers do not understand each other. Therefore it is advised to set up a work manual, which is especially important in retailing. In the manual the employees need to find information on work ethics, work methods and processes. It has to be written and utilized in a direct and clear way, no grey areas are allowed. It is also advised to organize monthly inspections and when things are wrong, try to tell them in a ‘face-saving’ way. Also try making processes that will enforce the rules. For example, one retailer asked the employees to email the owner when the shop opens and closes. The employer can check back when the stores do not open on time.

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Also Chinese employees have a different approach to personal hygiene and style. It has happened to one retailer that she had to tell her employee that she could not accept the way she looked. The sales girl at that time had dirty nails, bad eyebrows, messy hair etc. Also in the summer when she wore sleeveless clothes, there was non-shaven body hair. The foreign retailer at that time had to bring her to the salon for a big make-over.

Foreign retailers should reach out to their local employees to create more understanding and familiarity between both. The foreign retailers should organise day outs and monthly meetings and trainings for team-building purposes.

4.6. Packaging
The packaging around the products is very important to a brand; it creates more brand awareness and is free advertisement. The Chinese people often re-use the bags for their own private use, for instance, to put their lunch/or paperwork in for the office. This creates more word-of-mouth advertising as office ladies always brag about their purchases when other office ladies ask her what she bought in that specific shop. Foreign retailers always have the paper bags with the name and logo on it. The smaller boutiques now even use cotton bags. The Chinese customers perceive the paper bags as something luxurious and expensive. And adding to the expensive feeling you can always pack the purchases in wrapping paper. The plastic bags are banned nationwide in China from June 2008 but with my experience a lot of smaller locally owned shops still give away plastic bags.67 (Zaleski. Olivia., 2008) Also offering business cards is a very good way of introducing a brand as Chinese and Foreign people keep the cards in their wallets for addresses. So design good and attention-grabbing business cards to attract customers.

4.7. Positioning
Foreign retail concepts should position themselves right at the first time when they enter the Chinese/Shanghainese market. When positioned itself wrongly it is a costly operation to undue this mistake. That is why there is a big demand for market-entry strategist. They design for all sorts of foreign companies market-entry strategies.

The major foreign retail brands position themselves as premium brands in Shanghai. This way they can charge higher prices on their products. The reason they did so is that the newly-rich look for another experience when buying foreign garments. They want the feeling of exclusivity and ways to show off their wealth. But how can small-to-medium segment small brands fight against these big chains? They found out that small-to-medium segment small brands need to promote their brands as a lifestyle brand and with this lifestyle image around the brand they will attract their niche target group who will eventually stay loyal to them.

The Chinese people have their attentions on hypes around products, spread through word-of-mouth advertising. The Chinese people will come to extraordinary measures

to purchase the hyped item. When they want a foreign hyped item and it is not yet available in China, they will ask a foreigner to purchase it in the country of origin, to get the item as soon as possible to show it off to the people around them. They will pay extra to get the item. These products bring the newly-rich the feeling of status and exclusivity. As an example I-phone 4 was a big hype. The gadgets were sold out in a minute of time and there is still a waiting list for the item. But there were already rich Shanghainese who owned the I-phone 4 before it was available in China. They have let other people buy it for them in the US. These items costs around 6000 RMB retail price in Shanghai. The rich have paid up to 8000 RMB to get it earlier. This phenomenon also happens with big fashion houses with their most sought-out and popular fashion item. For instance, the Balenciaga bags were sold out in China and people even travelled to Japan, Korea and Hong Kong to buy them.

The success of foreign brands is that they can create a positive feeling amongst their customers, which domestic brands cannot do at this time.

Chapter 5: So what does this mean in money terms?

5.1. Importance
After the explanation of all the factors which can influence any new entrant to the Shanghainese market, it is than for any new-entrant interesting what it means in financial terms. All these factors influence the start-up costs. It is foremost important that new-entrants cannot be undercapitalized in the most important introductory first years of business. Especially in China it is very troublesome to get more money into the business as banking options are very limited. To avoid problems, when money is needed some retailers have advised to triple or double the amount they actual need, to overcome sudden over-expenditure in the future.

5.2. Average start-up costs for small to medium sized retailers
The focus for the start-up costs in this chapter will be discussed per expenditure taking in account all the factors that influenced the prices.

Rent: The average rental price for prime locations is 48.5 RMB per square meter per day. Small boutiques have retail spaces of around 100-150 square meters and bigger. And medium sized foreign companies occupy retail spaces of around 400 to 600 square meter retail spaces. H&M and Zara locations have a retail space of 1250-2500 square meter shop space. Often these shops are flagship stores in Shanghai. Choosing a prime
location is very important at it is directly linked to the success of the shop.\footnote{http://www.beingfunchina.com/magazine/consumed-by-fashion/} Shops located at these locations are seen as status-enhancing brands and boost the egos of the shopping Shanghainese. It is custom to pay 2 months’ rent deposit to secure these locations.

**Insurance:** Is not required, but if wanted it needs to be quoted by an official insurance broker in China. But quotes of 5000 RMB to 10.000 RMB per month is not strange according to the retailers. It does cover all what a small to medium sized company needs, for instance personnel, equipment to cargo losses.

**Personnel:** According to several foreign retailers they have hired around 4-5 people to work in their retail stores. Most of the foreign retail stores have hired a full-time foreign manager to oversee the store. This has costs around 49000 RMB per month including their housing, insurance, benefits and travel costs. And 3 part-time Chinese employees. Their salaries are 2500 RMB a month and that excludes lunch and travel fees. Also around 37% of the personnel costs are for benefits. Need to be added on top of salary.

**Cost of products:** Mainly high-end quality garments have an average cost of 200 RMB per garment in China. This accounts for clothing including t-shirts, trousers, coats, dresses, shorts and skirts. With the lowest cost of 4 euros for a t-shirt to 40 euros for a coat. The only difference for the new retailer is that they pay less for logistical costs, considering the factories only have to distribute it into Shanghai.

**Sales and marketing:** H&M spends 3% of their total turnover into their annual sales and marketing budget in each country they operate.\footnote{http://www.chinadaily.com.cn/citylife/2007-04/10/content_847238.htm} The average budget lies between 1-10%. For new foreign entrants we would advise 7%, because traditional ways of advertising are not effective. PR-companies advise new-entrants to hold big promotional events and big openings. And do not disregard the internet as a powerful medium. Build a new and professional website for the new shop or re-build the original website with a professional around 5000 RMB - 7000 RMB.

**Phone, internet & utilities:** Average costs 0.03 RMB per kilowatt hour, so for opening hours from 10 am till 8 pm, the average retailer pays 300 RMB per month. Internet costs are around 100 RMB per month and phone connections costs to set up 150 RMB than 20 RMB per month.

**Store renovation:** The average store is renovated for around 1000 RMB-3000 RMB per square meter, according to the architect bureau Huge in Shanghai.

**Legal and accounting fees including licenses:** It is advised by other retailers when starting a business in China find a good foreign investment services company. These
companies smooth and speed up any legal issues. Fees for these companies cost around 8000 RMB to 80.000 RMB. Average is 40.000 RMB per business set-up for small to medium sized businesses, including all licenses needed. They also offer monthly services as pay-roll, accounting and legal support for around 6000 RMB per month if needed.

Capital injection: Capital is needed when registering any foreign company in China. For foreign retail businesses it is 300.000 RMB. This amount of money is money, which cannot be moved in the years of business operations in China.

Interest: This amount is often invested out of money from the home countries bank and not with money from a loan in China. These loans are risky for banks so they often ask for interest rates of around 8%.

Office supplies including cash register: Office supplies are very cheap in China. Average amount is 100 RMB for paper and pens and 100 RMB for a cash counting machine with fake money detector, but the cash register machine is more expensive. Around 5000 RMB for a very new one. New computer around 5000 RMB and phone around 250 RMB.

P.O.S. machine: This is the electronic payment system in China. This machine can process all mainland and foreign electronic payments made by customers. You can rent them for around 250 RMB per month at the bank where the retailer does business with.

Retail support solutions: This expenditure is for fixtures, fittings, racks, shelves, signage and displays. This amount is around 10.000-20.000 RMB. Alibaba, the online sourcing website provides cheap racks and displays for retail stores.

Hangers, paper bags, hangtags, wrapping paper, customer cards and business cards: Around 5000 RMB for the first batch of prints.

Here you can find an average calculation of the average start-up cost for a store of 400 square meter with 1 fulltime foreign manager and 4 part-time Chinese employees with a positive projected sales (175 sold pieces x average selling price of 750 RMB) of 131.250 RMB in the first season of 3 months. This example also serves as a good example for the Kiyuchi case study in the extra material.

Rent: \[ 48.5 \text{ RMB/m}^2 \text{ per day} \times 400 \text{ m}^2 = 19.400 \text{ RMB per day} \times 30 \text{ average day} = 582.000 \text{ p/month}. \text{Times 2 months for deposit} = 1.164.000 \text{ RMB} \]

Insurance: \[ 7000 \text{ RMB} \] (called insurance agent)

Personnel: \[ 49.000 \text{ RMB per month for fulltime foreign manager} \]
\[ 2500 \text{ RMB per month} \times 4 \text{ part-time employees} = 10.000 \text{ RMB per month} \]
500 RMB additional costs (lunch and travel expenses) 
49,000 + 10,000 + 500 = 59,500 RMB

37% benefits over total salary = 22,015 RMB per month
Total is 81,515 RMB per month. For the Kuyichi case study they should allocate 10,000 RMB extra per season for training and set up of an effective human resources programme.

Products: Around 200 pieces to fill store of average 200 RMB per piece. So that comes out to an total of 40,000 RMB for the first season.

Sales & marketing: If there turnover is around 131,250 RMB and 7% should be in the marketing and sales budget the amount comes to 9,197,50 RMB in the first season. Then add 6000 RMB for the new website = total 15,187,50 RMB

Phone: Electricity = 300 RMB, Internet = 100 RMB, Phone 150 RMB and 20 RMB per month. Total 570 RMB.

Store renovation: 3000 RMB highest renovation costs p/m2 x 400 m2 = 1,200,000 RMB

Legal and accounting fees including licenses: Average costs 40,000 RMB + monthly additional fees 6000 RMB = 46,000 RMB

Capital injection: 300,000 RMB

Office supplies including cash register: Average amount is 100 RMB for paper and pens and 100 RMB for a cash counting machine with fake money detector, but the cash register machine is more expensive. Around 5000 RMB for a very new one. New computer around 5000 RMB and phone around 250 RMB = 10,450 RMB

P.O.S. machine: 250 RMB

Retail support: 20,000 RMB

Hangers, paper bags, hangtags, wrapping paper, customer cards and business card: 5000 RMB

Total costs are 2,889,972,50 RMB and double the actual amount for possible over-expenditures = 5,779,945 RMB. Interest of 8% (462,395,60 RMB per month) needs to be added to it. Total start-up costs are around: 6,242,340,60 RMB (624,234 euros). For the Kiyuchi case study an extra of 10,000 RMB needs to be added up to this total amount of start-up costs for the training of personnel.
Chapter 6: Conclusion: Major factors for success rate of new small foreign retailers, recommendations and future expectations

This thesis’ main goal is to inform or ‘warn’ all interested new entrants about the Shanghainese market. Too often new entrants wander into China with no idea how the current market situation is at this time. They are lured with high revenues published by other successful companies and by the so-called low start-up costs. A lot of smaller foreign retailers have tried and have failed. Therefore underneath you can read a list of market factors and its influence on the marketing mix of any fashion company and some future expectations.

The DESTEP-analysis has showed the different market factors that can influence the Shanghainese fashion retail sector:

Demographic: The statistical indicators showed that Shanghai has a big market with potential: the middle-class women are growing strong and need more products to satisfy their needs. This information is foremost important for marketing plans for new entrants.

Economic: The indicators show that Shanghai’s economy proves to be very resilient in these difficult times. In the US and in Europe retail shops are closing as people are not spending money in these uncertain times. The Chinese government has already forecasted that growth will slow down in these 2 years as Europe and the US head into another year of recession which is slowing down the Chinese production facilities focused on export to the US and Europe. The Chinese state government will take more measures in these coming years to promote economic growth and stability in China. For new entrants this information is important because the Shanghainese people’s wealth standards will stay at the same level or will even increase if there is room for it. This means that the fashion market will stay stable and there is even room for growth.

Social-cultural: An age break-down of buying behaviour is given in this chapter, which shows different habits. It shows that there are many cultural factors and traditions to look out for when retailing in Shanghai. The most popular groups targeted by H&M, Zara and bestseller are in the age groups 18-34 and 35-59. This group also has the most income to spend on fashion.

Technological: Internet retailing will gain more popularity in the future as more people will have access to internet and credit cards. This means that the traditional way of ‘brick-and-mortar’ shops is not enough to sell to the Shanghainese population. Invest a decent amount of money to build the right website with possibilities to an internet shop. And advertising on Chinese social media sites proves to gain popularity amongst local and foreign retailers in Shanghai.

Ecological: The government is enforcing more rules to keep an eye on the quality of products sold to consumers. The Shanghai government is also promoting for a more ecological friendly city and the younger Shanghainese generations are catching up on this idea. The government prefers more eco-friendly foreign fashion companies and will ban environmental unfriendly companies more easily in the future.
**Political:** The government is still keeping a very tight control on the market. The amount of licenses and regulations is still climbing and will keep growing in these coming years to keep a control over the market developments.

These main market factors have influenced the major fashion companies for instance H&M, Zara and Bestseller how to survive in the Shanghainese market. These companies have successfully entered the market and expanding rapidly outside of Shanghai. This information can serve as good benchmarks for future entrants. Beneath you can find a list of how they sorted out their marketing mixes in short to survive in Shanghai’s over-crowded and fast-changing marketplace.

**Products:** The foreign companies use the common thought of every mainland Chinese person very extensive in China. They use the idea of what Chinese perceive over western quality, design and style that it is far more superior to the local quality. But the fact is that the quality is the same as in the US or in Europe, only thing is that they are produced in China with higher quality standards compared to the Chinese local brands.

A big problem threatening foreign companies is the products produced by local companies. The domestic companies specialise themselves in changing tiny details in the designs of foreign brands and then re-brand them as their own. Protecting intellectual property is still very difficult in China. Famous international brands are working closely with the local government to track down counterfeit products. But still every consumer can find the counterfeit products with much ease at the so-called fashion markets on Nanjing road and at the fashion market in Pudong Science & Technology museum station.

Branding is very important in Shanghai as the Shanghainese are very brand-driven consumers. H&M and Zara did not have problems with branding as they were famous and Chinese consumers were enthusiastic already before they arrived in Shanghai. The main point is that every beginning small retailer should choose a business name which creates a strong identity amongst your Chinese and foreign target groups. The store will become a recognizable strong brand with strong business values to the local Shanghainese market and the foreign expat market. Labelling will help partly with being successful in China, main rule is it has to follow Chinese regulations and offering a professional and kind service through training staff with the western standard of service will appeal to the Chinese consumers.

The foreign companies are trying to reach and appeal to more Chinese customers by stretching their product lines. High-end brands have introduced diffusion lines which are cheaper to reach the ever-expanding middle class. For instance Hermes has Shang Xia in China which is cheaper. H&M has introduced their H&M trend collection which is more expensive to appeal to the richer Shanghainese. And Bestseller famous for Vera Moda has introduced more expensive and cheaper lines in the same time to reach more income levels in Shanghai. Also all foreign fashion companies have altered their availability of certain bigger sizes. The Chinese population is much smaller and thinner
compared to the western population. Therefore the bigger women sizes above size 40 are less available than back home.

**Place:** The success and speed of the market-entry of H&M, Zara and Vero Moda was because they have sourced a big percentage of their garments in China for a long time. They already have strong relationships with their manufacturers, making expansion even easier into the mainland as they already have a well-organised supply chains which needed little alteration to suit to Shanghai’s market. So where they compete on other than on product differences, it is often location. The location of the retail concept is very important. It is closely linked to how the retailer wants to position its brand in the market and what kind of consumers they want to attract. For instance, Zara chooses top locations in Asia with high-end brands promoting themselves as rivals of high-end brands. Chinese consumers want clothes that aspire them to buy more luxury and give them more status. And H&M looks for locations with high foot-traffic in high-street locations or shopping malls.

**Price:** Prices at the 3 main benchmarks are relatively very high compared to the average income of the Shanghainese population. The companies maintain this strategy because they want to be perceived as a foreign high-end brand. Discount promotions are not advised. The brands want to be perceived as high-end so promotions are rarely given.

**Promotions:** H&M, Zara and Bestseller use conventional methods by promoting their brands in magazines for instance in the Chinese Vogue and Elle. But research has showed that conventional methods are ineffective in China. It is better for new entrants to open their new shops with a big opening and later organise fun events that can be remembered and recorded by the ‘cool’ fashion bloggers of Shanghai.

**People:** The workforce of China is very big but the availability of good staff is not that big as thought. A lot of training is needed and setting up manuals is needed to run the human resources side as smooth as possible and to keep the brand and concept unharmed. Set aside time and extra money to train staff.

**Packaging:** The luxurious feeling is very important. So pack the items very neatly (maybe use wrapping paper) in nicely designed paper carrying bags (plastic ones are not allowed) and design attention grabbing business cards for more future businesses.

**Positioning:** Small-to-medium segment brands need to promote their brands as a lifestyle brand and with this lifestyle image around the brand they will attract their niche target group who will eventually stay loyal to them. And watch out for hypes around products. The Chinese people have an attraction to them and they will do everything in their power to purchase a hyped product. By having that product they can safe ‘face’ and brag about it with proud to their friends and family about how well they are doing.

All these market factors and necessary adaptations to the marketing mix cost money and have influenced the start-up budget dramatically. For a new entrant it is foremost important to have an general idea how much it all will cost. The low start-up costs (foreigners thought it would cost less as in Europe or in the US but the fact is that it is the same as back there) attracted a lot of foreign companies but the ones that have failed have overlooked the importance of making the right start-up budget and often
have invested more money than planned. This makes the market-entry more expensive than planned and more risky as it will take much longer to break-even or to make a reasonable profit.

To survive through Shanghai’s intense competitive arena, businesses would have to adapt to the constantly changing business environment, finding new ways to create value, and making necessary improvements to products and services. And by investing a reasonable amount of time and capital into the company. Otherwise the intense competition will force the closure of similar stores selling identical or incompatible product mixes. These are a few key factors that will influence the success rate of new foreign retailers and these are the factors they will need to take into account when preparing their Chinese expansion plans:

1. Get to know the target market: The mistake that the earliest foreign retailers made when entering the Chinese market was to overgeneralise the target groups. The success rate depends highly on whether a new retailer has done extensive research on this matter. Details go beyond demographics and it takes years and a lot of research to improve and create a detailed impression of the different target groups per city. Also history, traditions and culture form important facts in defining the Chinese target groups. Major foreign brands (for instance, the high-end brands and the mid-segment chain brands) have already set an example for the smaller retailers by being good bench marks to research on. It is strongly advised to work closely with Chinese partners as they have more knowledge of the cultural backgrounds and tastes of different target groups. Even having knowledgeable Mainland Chinese managers will give each foreign retailer the needed advantage over other retailers.

2. Create efficient and smart marketing mixes: By creating strong marketing mixes and using it to create strong market-entry strategies it guarantees success. Also retailers should have a detailed eye for product demands and needs, pricing strategies, resources to good locations, create strong promotion activities, employ and train good staff, create unique and memorable and environmental-friendly packaging ideas and create strong positioning strategies in the market. And they should also be flexible and alert of market changes. The foreign retailers should also match the right locations with their merchandise and target group. They should inform themselves on what their competitors are doing. The Shanghainese are getting more sophisticated and have more attention for price-quality ratios. The Shanghainese market is famous for its short product cycles and quick changes in consumer preferences. Foreign companies are advised to try the market first and when they are fully integrated into the market then think of market expansion plans.

3. Strong branding: The key around the success of the major foreign brands is strong branding. With the growing amount of new retailers in the Shanghai market, smaller brands can get lost between all the other ones. The key is to create as much brand awareness with the possible media platforms mentioned earlier also by creating hypes around the brand. Also promoting the brand with a unique business concept, for instance, the case study example of Kuyichi (sustainable fashion) can create loyal followers.
4. **Unique retail concepts**: Above you can find a competitors grid. On it (grey area) you can see where small-to-middle sized retailers still have market opportunities in. The success rate depends on the retail concept, take for example the case study of Kuyichi, it is unique and fits in the grey area but when looking at the target group the brand needs to research if their concept is accepted by the majority of the Chinese consumers. To sustain business now and in the future, there is a need to understand the market completely and research the differences in each region. Companies should be very sensitive to marketing trends and market changes (demands and preferences of the customers) and translate all that information into new product introductions each season. At this moment all new retailers should create unique retail concepts to stay ahead of competition. By creating the right feelings (lifestyle) around the brand, it can distinct itself from other competitors. For instance, Zara and H&M are successful in China, because they sell affordable luxury to the middle class.

5. **The rise of well-known local brands**: Local brands are growing stronger by imitating the success of the foreign brands. The foreign brands used to have a competitive advantage by creating unique concepts and store formats. Now the local brands have been studying the success of foreign brands and have created their own success formulas which appeals to the Chinese market. The main advantage for them is that they know the market better than foreign retailers and they know how to manoeuvre in it. Foreign retailers are often slow and not alert enough, therefore working with local partners or experts in any field would help them compete more efficiently in the future. The Shanghai fashion market is growing and changing fast. The increasing amount of new foreign and domestic entrants forces the foreign and established brands to compete with their expertise. New store concepts and management techniques and new business strategies, for example cost leadership (creating value perception), product differentiation (better quality or unique products), building long-
term customer and supplier relationship and efficient logistics management will give them the initial competitive edge. Foreign retailer brands used to have the advantage over domestic brands, but domestic brands are increasing quickly and learning from their foreign competitors. They now know how to compete with modern store lay-outs, design and concepts. Foreign companies have also attracted the help of domestic upcoming designers and Chinese (foreign-educated) designers to help them mix the Chinese style with the Western style to appeal to the Chinese market. 70 (Graham, Mark., 2009)

6. The growth of E-commerce: The sales rate of internet sales has increased with double-digit numbers in these past few years. This amount will grow more as more people will have access to computers and internet. The biggest sales are made in fashion and appeal to the younger generations. Foreign and local retailers have seen the increase in internet sales and have added this retail channel to their existing retail shops. This way they can make more profit by selling to places where they have not opened up the traditional shops yet. But according to experts, internet will not overtake the traditional sales channels as consumers still want to experience real life shopping.

The future expectations of the Shanghainese retail market are still very optimistic, especially when the European and the US economies are still in a financial crisis. More and more smaller brands will enter the Shanghainese/Chinese market as they will look for profit elsewhere, in all the emerging economies.

The negative development of rising labour costs and retail rentals still pose a big danger for foreign and local retailers to create stable profit numbers. The government has announced slower economic growth next year and have announced to still focus their efforts on economic stability in the domestic market environment. The Shanghai local government is looking into the problems of pushing down rental prices in the retail and private sector.

The Shanghai fashion market is growing and changing fast. The increasing amount of new foreign and domestic entrants forces the foreign and established brands to compete with their expertise. New store concepts and management techniques and new business strategies, for example cost leadership (creating value perception), product differentiation (better quality or unique products), building long-term customer and supplier relationship and efficient logistics management will give them the initial competitive edge. Foreign retailer brands used to have the advantage over domestic brands, but domestic brands are increasing quickly and learning from their foreign competitors. They now know how to compete with modern store lay-outs, design and concepts. Foreign companies have also attracted the help of domestic upcoming designers and Chinese (foreign-educated) designers to help them mix the Chinese style with the Western style to appeal to the Chinese market.

E.1. Case study
Tuesday December 13th, 2011  
(Anon., 2011)

The first shop of the Dutch jeans brand Kuyichi opened her doors in August 2010. Now there are advanced plans to expand to Dubai, which will open their first shop in October. Also shops in China and Canada are planned: ‘But we are researching these markets first’.

Kuyichi wants to position them more as ‘industry leading lifestyle brand’. A new logo and a revised collection must make the brand popular in other countries. The brand now has up to 500 selling point in Europe and owns shops in the Netherlands, France, Ireland and the UK.

China, Canada and the Middle-East were on Kuyichi’s wish list. “They are the new developing economies,” says Kuyichi representative Rosemarie Hup. “And we have different contacts in these.”

In a press release they are speaking of a ‘re-launch’. “We are not really active in these markets, but last season showed the first expansion drift. Now we want to do that with a new logo, a ‘cotton bud’, and a revised collection.”

The revised collection-available for the autumn/winter collection 2012 and 2012- consists out of 8 deliveries per year. The concept - tinker, tailor, soldier, sailor, rich man, poor man, bagger man, thief – is based on a English 17th century children’s counting song. Each of the 8 deliveries will be about one profession. Therefore they will look how war, industries, and forgotten professions and crafts were created and what kind of garments people wore in those times.

The first 2 collections –tinker and sailor- consists out of colours like deep purple, Bordeaux red, pink-read and indigo. The collections have big chunky woollen knits. And to follow the brand Gsus, Kuyichi have also designed a pair of Aloe Vera Jeans, a

http://www.fashionunited.nl/Nieuws/Leads/Kuyichi%3A_Over_Europese_grens_met_herziene_collectie_2011121334739/
stretch model with hydrating properties.

In 2010 Kuyichi had a sales turnover of 14 million euros and this year Kuyichi expects to have a turnover of 18 million euros. Kuyichi is famous for introducing its first organic jeans brand to the fashion world in 2001. The name is derived from a Peruvian rainbow god. He took away colour when society was hurt with injustice, when the world became fairer he returned back the colours. Just like the god Kuyichi, the brand Kuyichi is transferring fairness to the fashion industry by paying fair wages to seamstresses on their manufacturing sites.

Next to sustainable clothing for men and women, the brand also has belts and bags in their collections.

**E.2. Recommendation**

Kuyichi is already present in small amounts and only with t-shirts in China. They would like to develop and expand their brand within China. The success rate of this brand depends on a lot of factors which can influence this retailer when making a choice how to enter the Shanghai market. I will use the DESTEP-analysis and then prepare a marketing mix to make:

**Demographics:** This brand will appeal to the people in the age group of 22-45, as they are the richest group in China and they have the capacity to grasp and be open to the concept of Kuyichi, because their education levels are much higher and they have more income to spend on fashionable clothing. The foreign expat groups are also a big group to consider as they have more experience with sustainability and environmentally friendly fashion concepts. Also this group has heard of more different brands outside of China. These both groups are seen as the most fashion-forward and trendsetting ‘population’ of Shanghai.

**Economic:** The economy of China is still growing and the incomes are increasing where in Europe and in the US jobs are lost and fashion retailers have a hard time keeping profits high. That is why China is very attractive to major western retailers as it can be their most profitable income source for these upcoming 5 years. Therefor it is now the best time to grab any entry opportunities. The market factors which can harm the brand Kuyichi with the Shanghai market entry is finding good locations at prime locations. Good retail spaces have been snapped up by the most foreign retailers as quickly as possible, pushing rental prices to an average high of 48.5 RMB per m2 per day. Also increases in minimum wages have set a tone for higher operational costs per month.

**Social-cultural:** The danger for Kuyichi is that the Chinese buying behaviour is still very primitive compared to the Western countries. The concepts of environmentally friendly and sustainable products are not routed into the mind-set of the majority of the consumers. They are still lured by luxury brands (for the really wealthy) and the chain brands (middle-class) and are looking for a more superficial way of showing of their new-found wealth and ways to improve their status. When Kuyichi really considers entering the Chinese market, they need to prepare themselves to educate the target market. The advantage of this concept is; that it is new and the more mature and richer fashion consumers are looking for ways to improve their personal
styles. The brand will appeal to consumers as it is still an imported western brand. This group of consumers can form the brands best target group, but needs a lot of unconventional ways of advertising to reach and educate them about the Kuyichi fashion concept.

**Technological:** The internet will not be a threat, but an opportunity to this company. They can use this media to educate, inform and promote the brand and concept. The focus will lay on sustainability and environmental friendly production capabilities of Kuyichi. Social media are common ways to promote brands in the rest of the world and it creates more brand awareness amongst consumers, but Kuyichi should also note that social media rules are different in China. For instance Facebook and Twitter are banned for the public, but China has their own kind of ‘Facebook and twitter’ media format. Promotion expenditures will be high to reach the right amount of consumers.

**Ecological:** Are the Chinese, who are at the point of looking for superficial luxury, accepting the ideas of recycled fabrics and organic fabrics? The Chinese have since the past looked for luxurious materials, for instance, silk is seen as highly luxurious and expensive. But are the Chinese willing to accept organic cotton, linen or hemp, which are seen as materials worn by the poor in the past? The new and younger generations can accept this, but the older generations who are just acquiring new-found wealth will not. They want fashion brands that will give them ‘face and status’.

**Political:** Kuyichi will be seen as a small player in the Chinese fashion market, but small players have a little more freedom than the bigger chain brand players. But when they get into trouble they have less capital and resources to get them out of trouble.

Kuyichi will be seen as a small player in the Chinese fashion market, but small players have a little more freedom than the bigger chain brand players. But when they get into trouble they have less capital and resources to get them out of trouble. Kuyichi still needs to obey the rules and regulations and try not to make too many brand concessions, which can influence the brands image and concept in China. This brand has the advantage of having a clear product concept, which is environmental friendly and it is different from fast fashion which the Shanghai local government prefers nowadays. It could be very successful as it targets a small niche group of customers, who will be loyal to the brand.

Beneath we will look at the marketing mix for Kuyichi in China:

**Product:**

**Quality:** In their designs Kuyichi uses honest, organic and recycled materials sourced from Peru, Tunisia, China and Turkey. This idea is accepted in the western countries in Europe as sustainability is a hot topic in that fashion industry, but it has not proved itself in China yet. There is not a lot of demand for it and customers are not thinking about it, except a small group of more mature and wealthy fashion consumers. The quality of this brand should be superior above the quality found at local brands, which is a good pointer when attracting Chinese consumers.

**Design and style:** Kuyichi is famous elsewhere for their famous, comfortable and trendsetting casual wear. Simple and clean designs with an explicit fashion detail. Kuyichi will not have to deal with copycats as much as all the other major high-end foreign fashion retailers in China. The brand still needs to be popular amongst the local people. When that is reached, than they should worry about
copycats. For instance Abercrombie and Fitch were unknown before, but after it has reached more popularity, people could find Abercrombie and Fitch t-shirts at the fake markets everywhere in Shanghai. The major advantage is that the Kuyichi brand has an unique concept and more elaborate designs, it makes it more difficult to copy. And the quality used in the garments, even though it is cotton, hemp or linen, it is still better than the quality used at the local companies.

**Branding:** The name Kuyichi can be hated or loved. It can go both ways, as it sounds very Japanese (although it is derived from a Peruvian god). The Chinese have a ‘bad’ history with the Japanese since it was occupied in the WOII by the Japanese. These memories have stirred up bad blood even now they are fighting about an uninhabited island with important resources. On the other side Japanese culture and fashion is followed closely by the young fashionistas, trendsetters and bloggers of Shanghai. The Kuyichi marketing staff has to prepare educational materials and platforms to reach the majority of the Chinese consumers into buying sustainable and honest products, as the majority of the Chinese are not thinking about this at all. Their main competitors will be Levis, Diesel and G-star. But also the Japanese label Evisu, still present and popular in Asia is a competitor.

**Labelling:** All the labels used in their products have to be re-labelled and attached together with a label in simplified mandarin. Even the quality labels, have to be translated to be allowed to be sold in China. The hang tags are a big part of the marketing strategy. The information on their hangtags should educate the customers about the organic materials used in each item.

**Product-support services:** To be successful in the Chinese market, Kuyichi needs to employ staff who share the same ideas on sustainable and honest products. They also need to be trained in selling effectively and professionally to consumers. Customers should be felt they are treated as good as possible with the best-mannered staff and get professional and up-to-date fashion information. The future staff will need to go through at least 2 levels of interviews, before making the choice to employ. The employee should be able eager to learn and promote the Kuyichi concept. Even after work the staff could act as sustainability ambassadors for the brand, creating a lifestyle to the brands concept and inducing more future consumers to shop the brand.

**Product lines:** Kuyichi can branch out successfully into China, when thinking of options in diffusion lines specifically targeting the Chinese consumers or even branch out into children’s clothing as Chinese parents will not deny their children of safe and expensive clothing.

**Product mixes:** To keep the customers happy the whole collection needs to be present in the stores, all women and men collections. Kuyichi stores should carry the smaller and shorter sizes to fit the Chinese sizes.

**Place:**

Kuyichi sources their materials from Peru and ships it to manufacturing factories in Tunisia, Turkey, Peru, China and India. Because some of the styles
are manufactured somewhere else, a lot has to be imported when they would like to retail in China. Government import duties will have to be paid additionally on the price, making the garments more expensive. That is why the brand should position them as a premium brand and choose a distribution channel in shopping malls or on premium shopping streets for instance Nanjing Xi Road. They can look for locations in the Hong Kong Plaza, Lippo Plaza and Xintiandi Style. All these are high-end malls attracting the more mature and fashion-conscious shoppers. Rents are very high in these malls, pushing profit lower than expected.

Some foreign boutiques, for instance, Dutch Items Shanghai (focuses on Dutch designs) and boutiques in the Xintiandi Style mall (focuses on new designs and foreign concepts with organic materials), could be approached as an alternative selling point with consignment deals to test the Chinese customers’ demands. These boutiques in this mall carry the most exclusive Japanese brands who often share the same concept as Kuyichi. The retailers in the Xintiandi Style mall often ask the new-entry brands for a small profit or they will offer a small spot in the shop and the new-entrant will have to pay a small fee for the ‘rented’ space.

Department stores are not advised, because the product concept behind Kuyichi can get lost, when fighting against other brands for survival. They will make concessions in product designs, materials used or concept to appeal to the majority of the public.

Eventually online shopping will need to be added to reach the customers outside of Shanghai or to reach more online shoppers as this will form a bigger shopping experience in China.

**Price:**

The prices of the garments will be higher than the chain brands, due to the expensive import taxes and operational costs. It will be one of the premium foreign brands in the Shanghainese market. Compared to the chain brands who charge customers premium prices, the quality and durability are much better than that of the chain brands. The main question remains: Are the Chinese willing to pay high prices for organic and recycled materials? I do think so, it will eventually catch on, because of the marketing strategies used to promote the brand.

**Promotions:**

**Word-of-mouth:** This way of advertising to gain more popularity is the best way for Kuyichi. By employing and training good staff, they can act as ambassadors for the Kuyichi brand even outside the working hours. Make them believe and support the concept.
Television: Kuyichi should endorse a celebrity, favourably an Asian celebrity from Japan, Korea, Taiwan or Hong Kong. This will add more credentials to the brand and create brand awareness amongst the Chinese consumers. The celebrity should share the love for sustainable, honest and edgy fashion and would like to educate his/her fans to become more environmentally friendly consumers.

Fashion magazines: To create more brand awareness Kuyichi needs to promote their brands in the mainstream fashion magazines, for instance, the Chinese Elle and Vogue would prove profitable. Conducting an interview with the owner would educate the readers about the brand and lending out items for photo-shoots prove to be very popular.

Expat magazines: Promoting the brand in Expat magazines proves to be profitable too. Especially informing the readers about the planned store launch, availability and a spread about the concept of the brand will create more brand awareness. These magazines are found at places (restaurants, hotels and shops) where foreign expats and richer Shanghainese are on a daily bases.

Online: Contact bloggers to promote the brand as they have a lot of readers. These readers are often people who are looking for ways to improve their styles and who do not follow the mass market fashion. With them you can create the brand’s niche market. Also create a Chinese website in Chinese to educate and inform the customers, but also to create more B2B business opportunities. An online sales website is not necessary in the first 2 years, as people will need to experience the brand itself in real life in the stores. Than when the brand is well-known in Shanghai, brand awareness will than spread outside of Shanghai. When that happens, brands are advised to operate an online shop. Do register and mention these business plans at the beginning of the business application process.

PR-companies: These companies will prove very useful when entering the Shanghainese market. Kuyichi will need help for the main launch of the brand (store opening) and will need them to organise events to promote the brand, concept and the lifestyle around it. A good and eventful opening with a big party is a successful way of introducing the shop and concept to future customers. Also pay a lot of attention to the invitations for that night and try to make it as exclusive as possible: send out invitations to fashion bloggers, it-girls, major fashion expats, foreigners, and trendsetters of Shanghai. Also potential business partners should get invitations. Later on Kuyichi can organise courses or events for customers on how to customise denim jeans. This event would be a popular event to attract fashion students and amongst them there are a lot of trendsetters and bloggers. They will promote the brands through the fashion blogs online or promote the brand through word-of-mouth advertising.

Company collaborations in the future with restaurants who serve organic food is also popular to work with, for instance the promotion can be spend above 2500 RMB at Kuyichi and win a chance to have a free meal at a popular foreign organic restaurant.
**Relationship building:** This promotion activity is to keep the customers loyal to the brand. By asking customers if they want to register their e-mail address, Kuyichi can keep them up to date with sales promotions or events. They can create hypes and events to inform the customers.

The promotion budget needs to be around (7%), to succeed in the Chinese market in the first years of market-entry. This is to create brand awareness for brands that are relatively unknown in the Chinese market. Than afterwards it can be lowered to still a high amount of 3-4%.

**People:**
Employ staff that is interested to stay long-term with the company. Offer incentives and organise training courses to make them ambassadors of the Kuyichi brand maybe extending it to outside working hours. Make them believe and support the idea of a sustainable and honest fashion industry through Kuyichi the brand. I advise to find local partners to invest together in the Chinese market. As they have the skills and knowledge to manoeuvre in that fast-changing environment. It is advised to employ a foreign shop manager, who is trained at the headquarters in Holland, to guard the concept, brand and business. It is more expensive to employ these managers, but it considerably reduces the chance of damaging the new business.

**Packaging:**
The brand already uses environmental friendly ways of packing and distributing their products to customers. Make the packaging as attention grabbing and maintainable as possible. Chinese customers always re-use their paper bags to put other items in. They often use them to carry lunch in them and office ladies always brag to each other where they have shopped in the weekend. These bags than serve as promotion material. Also do not forget to print fun and business cards which are unforgettable and will only induce positive feelings to the customer.

**Positioning:**
The major foreign players enter the market as premium brands. Kuyichi will have to do so too, but their target market will be smaller than the major foreign brands. Using the media platforms (Chinese versions of Facebook and twitter and fashion blogs) to create a hype around the brand creates more brand awareness, routing the Chinese mind-set into sustainable fashion. They should keep true to their concept and try to convince the main target groups of sustainable fashion. They will have to keep proving to the customers that they are right all along and that everybody who wants can also have this lifestyle. They will be the first ones to create these ideas with the Chinese consumers. And that is already an advantage for Kuyichi before other sustainable brands want to enter the Shanghai market in the future.
**Start-up budget**
The main operational costs will be the rent, personnel and marketing expenditures. The start-up costs are calculated in chapter 5 and is an amount of around 6,252,340.60 RMB (625,234 euros). These costs are already estimated for a new Kuyichi store on prime locations with 400 m² of floor space. It will not be interesting for Kuyichi to open a smaller sized shop as the other competitors Levis and Diesel have shop spaces of around the same size. The shop will maybe be too big at the beginning, but when business is going steady more shop space is needed. It is very important for foreign entrants to choose the right shop location as changes are nearly not possible. The lease is often already signed and the local government will not let you move around in conjunction with the turned-in business licenses. Personnel will form an expensive expenditure following the training needs of the staff. Also marketing expenditures will be high to introduce the brand to the consumers.

**E.3. Conclusion**
Kuyichi a Dutch brand wants to expand into China and these are a few pointers where they have to look out for when making expansion plans.

The chance of success to enter the Shanghainese market successfully is a very risky undergoing for Kuyichi as start-up costs are as high as in the Netherlands. Expansion to China has to be considered very well. The profits are present but squeezed small with high operational costs. A lot of money have to be allocated to high personnel costs, promotion costs and high rental prices.

If the brand choses to invest in China, it needs to consider the high labour costs for training and employing the right staff and promotion costs to educate the customers about sustainable and honest fashion. Also when setting-up their own stores they need to consider high rental prices for prime locations and business set-up regulations, cutting into their profits. And the target market is still very small as the majority of the consumers are not educated in sustainable fashion. They are still looking for affordable and fast fashion, which they can show off their new found wealth.

Therefore consignment deals are often much better to test the concept. If proven not successful the brand can still re-position or pull out any business activities without damaging the brand image or financial situation of the company. If successful the brand can start opening own retail flagship stores in Shanghai.
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(see appendix B)

• Government official
Name: Not allowed to publish name (he was not allowed to give an interview, it was a personal request as friends)
Job: official for the Shanghai local government. The State Administration of Industry and Commerce (SAIC)
Interview taken: October 2010

• Dutch consulate-general in Shanghai
Name: Christy Lam and Xiaoyi Liu
Job: Christy Lam is the office manager for Economic and commercial affairs.
    Xiaoyi Liu is the senior commercial officer
Interview taken: October 2010

• Fashion trend analyst and blogger
Name: Heejung Jun
Job: Creative director
Interview taken: October 2010

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• Fashion retailers
  Name: Connie Zhang
  Job: Chinese owner of fashion boutique Coreaholic
  Interview taken: October 2010

  Name: Not allowed to publish name (did not want her company published in this thesis as some information can damage the brand, very protective of brand)
  Job: Japanese owner of fashion boutique
  Interview taken: October 2010

  Name: Not allowed to publish name (did not want publish name as the information contains core business activities)
  Job: Chinese-born (Taiwanese descendant) foreign boutique owner
  Interview taken: October 2010

  Name: Not allowed to publish name (did not want publish name as the information contains core business activities)
  Job: American boutique owner
  Interview taken: October 2011
### Appendix A: The company list

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<tr>
<th>Retail channels</th>
<th>Names</th>
<th>Locations</th>
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Appendix B: The interviews
Qualitative research: a view on foreign businesses by stakeholders

Methodology
The qualitative research method is used in this thesis. The people interviewed for this research are people who are linked to the foreign fashion industry in Shanghai. Interviews are conducted with government officials (Dutch consulate and Chinese government official), foreign small to middle-segmented fashion retailers (foreign and Chinese) and a fashion trend analyst. The results of these interviews should lead to a confirmation that retailers indeed stumble on to problems.

Data collection
The qualitative research needs to prove whether foreign fashion retailers indeed have problems. To prove this I have used the qualitative research method, by conducting interviews with the stakeholders in the Shanghai foreign fashion industry. The stakeholders are government officials (government staff from the Dutch consulate and government officials from the Chinese government). The Chinese have the knowledge about what the Chinese government is planning with foreign investments. The staff from the Dutch consulate have experience in guiding and advising foreign investors in Shanghai. The next group are the foreign small to middle-segmented fashion retailers (foreign, foreign-born-Chinese, Shanghainese and Chinese) and a fashion trend analyst with her own blog recording the trends of the Shanghainese. The last interview was taken with a trend analyst and fashion blogger. She records all the trends of the people in Shanghai. The interview has been taken with open questions derived from the desk research to prove the existence of factors that could influence the success level of any foreign fashion retailer. Questions were thought out that could support the literature research and the factors. All people have participated anonymously in this thesis research. The main reason was that some information can bring troubles with the government and some information can leak to competitors.

Data analysis
The first step in analysing all the data from the interviews was to reduce the complexity out of the information of the interviews. All the information was summarised into a clear answer that should reflect the different views and answers of the interviewees, but also show the similarity in the views of the interviewees. The given answers should have some similarity with the desk research.
The research results
In this chapter the interview results will be discussed.

Summary of the interview with the government official
Note: the main problem with this interview was that the interviewee could not give me all the information he possessed. He gave me a general view of what the Communist Party is planning for FIEs and his personal view was not recorded in this interview.

What is the future of the FIEs in China, will there be any changes in the coming years?
The Chinese government welcomes the Foreign Investment companies and is not going to change the regulations or laws in these coming years. The only thing that they will do is to unify certain taxes. There will be no distinction made anymore between Foreign Investment companies and domestic companies. They are working closely with bigger companies to make the foreign investments grow within China. Also they are holding talks with big companies to simplify and clarify the regulations.

What regulations are there in force to make it easier to succeed in China?
The Chinese government is observing the market by enforcing the rules. They are making sure no foreign or Chinese retailers can come and harm the businesses which have already established themselves. The only way the Chinese government will help is to ensure the high quality of the new-entrants to establish a healthy domestic market.

The FIEs are complaining about the difficulty of the business application process, is the Chinese government going to change that?
The Chinese government will not change the business application process. The reason is that it enforces the law and the regulations and protects the consumers’ right. To make it easier the retailers should find the best foreign investment services companies. The government is also ensuring that the foreign investment services companies have the right licenses and that they do not participate in shady activities.

Summary of the interview with personnel from the Dutch consulate (department of economic and commercial affairs)
Two employers have been interviewed at the Dutch consulate, they have 6 years’ experience guiding and advising established Dutch fashion companies in Shanghai and newcomers to the market. They both work for the Department of Economic and Commercial Affairs.

What is the role of the Dutch Consulate in Shanghai?
The Dutch consulate is there to advise and guide the new foreign investors or investors that are interested in the Shanghai market. They are not there to help the investors with conflicts or arguments. They are there to advise the investor and to refer them to people that can help them with any issues. They also organize discussion platforms, network events, subsidies and exhibitions to help the Dutch investors in Shanghai.

Which issues are common with the Dutch investors?
Dutch investors are always asking them to advice with business partner issues. Often the business partners are not trustworthy enough. Not just business partners are a big issue. There are also problems with production manufacturers. Often products do not
arrive or the Dutch investors are deceived. The Dutch consulate can only refer them to good lawyers.

**What are the strong points of the Dutch entrepreneurs?**
They are often well-informed and well-connected. According to the Chinese people the Dutch people are good business associates. They also have a lot of experience and have the knowledge about the business. They also have a lot of guts to design something unique. And the Dutch people are very good in networking.

**What are the weak points?**
They are often too trustful towards the people they have to do business with. A lot of Dutch entrepreneurs get into partnership problems.

**What is the future of the Dutch fashion companies in Shanghai?**
There are a few Dutch fashion companies established in Shanghai. And new ones are coming to open Representative offices. And some are even signing concession contracts with department stores in Shanghai. The Shanghainese appreciate the simple designs from the Dutch designers and there is still a big market for the middle-segment. The Shanghainese are also fashion-forward people. They are interested in new and trendy garments.

**What tip would you like to give to new market-entrants?**
They should grab the chance, while they can.

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**Summary of the interview with the fashion trend analysis**
The fashion trend analysis/blogger specializes in street fashion and trends that young Shanghainese follow.

**What concepts work on the Shanghainese population?**
At the moment there is still a lot of variety in street wear. Street fashion at the moment is divided into two groups. You have the big group of OL’s (office ladies) who like to shop at H&M and Zara for fast and affordable fashion. This group also has money to spend on high-end fashion. The second group is the other group of young people, who go for the unique items. They follow fashion trends from Japan and Korea. And they distinguish themselves through unique pieces found at cheap and expensive clothing shops with small merchandise mostly imported from Korea or Japan.

**What is the future of fashion in Shanghai?**
The analysis shows that the Chinese young people will go for unique items. They are very focused on developing their own style and personality through clothing. This group will have more money to spend in the future and it means that boutiques selling unique expensive items are in their income reach. The young will mix Chinese influences with western influences. You will see some very unique mixtures in the future.

**Why do you think foreign fashion retailers become so successful?**
They often can provide the customer with unique and special items, but the prices are often very high. The younger generation still want to enjoy fashion for more affordable prices.

**Why do you think some foreign fashion retailers are still failing in Shanghai?**
Often they buy in garments that are not suitable for the Chinese people. I have seen garments with polyester linings inside it for summer wear. Chinese weather is too hot
for polyester. I have also seen garments that are to figure hugging or to low-cut. The Chinese girls are still shy showing to much nudity.

Summary of the interview with the retailers (local Shanghainese owners, Chinese owners, foreign owners and foreign-born Chinese owners.

In this piece I have interviewed several retailers with different backgrounds. Three of each background is interviewed: local Shanghainese retailers, Chinese owners, foreign owners and foreign-born Chinese owners have been interviewed. All the answers are summarized in this chapter. All interviewees have asked me to leave their personal information out as information can leak to competitors.

Why have they chosen to be retailers in Shanghai?
The foreign retailers were all spouses that came to Shanghai with their husbands. Because they were tired with the expat wives’ lifestyle, they created a job for themselves in Shanghai. All the Chinese retailers said they opened their stores, because they do not want to work for anybody else.

How long have you been in business?
The average was 5 years.

Why did they chose their business names and to what is their target group?
All the foreign retailers were targeting to the foreign expat community. And the Chinese were targeting the Chinese domestic market. All of them have chosen names that fit with the concept, origins and designers choices. One retailer has chosen a name that attracts foreign customers to shop for special sized clothes in Shanghai and one has grabbed the attention of trendy customers with a very unique business name.

Which business model have they chosen and what is their motivation for it? And did they use the services of the foreign investment services company?
The foreign retailers have chosen wholly-owned-foreign enterprises for their independence. There are some that have chosen the Joint Venture option where the local Chinese has invested into the location and paperwork and the foreigner has input in the designs and merchandise. But the majority of the Chinese retailers have not even registered their businesses. All the foreign companies have used the services of these companies. They still are using some services, for instance, for the re-application for permits and licenses and for accounting services.

Why chose their location and did you have problems leasing the location?
The location was chosen mainly on their target customers. The expat shops were nearly always located at hotspots for expats, for instance, the French Concession and Hongqiao area is very popular. Rent is also very high at those properties. The only difficulty they had was that the landlord was not really negotiable with. The landlords saw they were foreign and have asked more rent than when a Chinese retailer would ask for the rent prices. The Chinese retailers have chosen locations close to where Chinese customers go shopping, for instance, close to schools or supermarkets. They pay less rent, because they often are friends with the landlords. They also got a lot of things for free, for instance, down payment was less and they got big discounts with the referred renovation contractor. For instance, one retailer got into a lot of problems when she opened the store. The store next to hers was a restaurant and the smell kept
coming into the shop. Also water was leaking through the walls. The first contractor just painted over it. As advice asking too big of discounts is very dangerous. The contractor can deliver bad work. So at the end the retailer had to close the shop for one month to renovate the shop again and fix the major problems.

**Did they have problems applying for licenses?**
All of the licenses were already organized by the landlords.

**Are they aware of any sign/zoning permits?**
No, they have not even looked into this. When I explained what it was, they all rubbed their chest and said that they were lucky that they were still in business.

**Are they importing goods?**
The foreign investors were all importing their own garments from the country they come from. For instance, one Spanish retailer imports brands from Spain. The Chinese boutiques are importing garments from Japan or Korea. They do not import through the normal channels. They import it when they travel back into Shanghai by taking the merchandise themselves from home.

**How are they taxed?**
The foreign companies are taxed according to the law. The Chinese companies have not registered their businesses, so they only pay individual income tax.

**Are they having problems with their employees?**
All of them are having problems with employees. They need to be present at the retail locations to check on them. All of them have advised to write a shop manual before recruiting employees.

**Do they have E-commerce ambitions?**
They all have that, but it is to labour intensive and extra capital is needed. They need to hire extra staff for the IT-department. For instance, one company had to employ staff that dealt with the orders coming in (pack the goods and send it out) and one employee had to be hired to keep the website up-to-date.

**Are they aware of any product, packaging or labelling laws?**
The foreign retailers are all aware of them and everything is in order in these shops. But in the Chinese shops none of the owners know about the law and the garments shown in the store are all missing labels with care and specification information.

**Are they promoting their brands and how are they doing it?**
The foreign retailers are promoting their brands in expat magazines. They often have free spreads in these magazines. They also are represented at foreign network events (parties and fund raising events). The Chinese retailers are not promoting their brands. They rely on advertising through word-of-mouth.

**Do you think the regulations and laws are very clear to open a retail shop in Shanghai?**
All of them have said that the regulations and laws are very unclear. The foreigners have complained that everything is in Chinese, so they depend on experts, which they have to pay, for extra information. The Chinese say that there are so many rules and there are grey areas in these rules, making it very unclear when something is allowed and what is not allowed. Often the choice lies with the government official who has the last verdict over the case.