Business Innovation in China (Part 1):

Embracing New Opportunities by Adopting O2O Strategies & Building Business Ecosystem

November 2016
Key takeaways

More and more pure play online players and traditional offline retailers have a consensus that O2O commerce is the new avenue to reach customers.

O2O commerce is not simply selling goods online and offline. The critical success factors of running O2O business include knowing your customers, channels and system integrations, process standardization and logistics sophistication, on top of offering great products.

In China, certain internet giants and traditional incumbents decide to form O2O alliances through merger and acquisition and building business ecosystem.

When a user consumes various services provided within the same business ecosystem, the operators can have a better understanding of the user’s behaviour through data analytics. The more engagement in the ecosystem, the more data are gathered and analysed. And it is easier for the operators to create value by precision marketing.
This report

Observation: Changes in China

O2O commerce is the new avenue to reach customers

Internet giants are earnestly building their business ecosystem

Appendix
Observation: Changes in China

Retail

Go shopping

Shop online, Home delivery

Daily life

Hard

Easy

Why??

Picture source: Internet
1. Mobile. A powerful tool in changing the way of life
Mobile serves as a portable PC, connecting people anytime, anywhere. Mobile users can seamlessly share their views with peers and strangers online.
2. Due to technological breakthrough, the targeted consumers can be easily reached by mobile APP. The empowered consumers can impulsively press the two powerful buttons, Like and Buy, to show their preferences.

- **Like**: Indicates market reception
- **Buy**: Converts traffic to sale

*This feed was posted by a web celebrity* in China. Within 1 day, around 1.69 million followers view the post and almost 1,800 viewers like it.

*The largest web celebrity Taobao store in 2015 (In terms of sale value in lady fashion on Taobao platform) Source: Taobao, retrieved on 9th May, 2016, Compiled by Fung Business Intelligence For detail of web celebrity economy in China, view also “Cewebrity Economy in China” (2016) Series One and Two*
3. Buying decisions can be altered by social media
The internet changes the role of strangers

Travelers' forum

- I want to visit country A, and search for a nice accommodation via a booking platform
- “XX home” appears on the first row of the search result. The house looks great, with professional photos and descriptions. I almost confirm my booking.
- However, I search online again by using the name of “XX home”, and see if there are any comments from other forums
- Surprisingly, a comment is “AVOID AT ALL COSTS” without any explanation
- Should I take this comment or place an order?

Comments (18)

I wish I have never been there......

In the new era with technological advancement, people believes in **Digital Altruism**: The motivation of people leaving feedback online is helping others.

Nowadays, the reviews stated by strangers become valuable sources of information for people to make buying decisions.

Source: Internet
4. Welcome to the world of Gen Y and Gen Z
The buying behaviour of the new generations differs from that of their previous generations. These new shoppers grow up in the internet era. They rely on online shopping and occasionally visit physical stores with good reasons.
In the internet era, some Chinese retailers have responded to the changing market through business innovation:

- Quality, quality, quality
- Value for money
- Catering to individualistic
- Social marketing

Past vs. Now:

- Channel oriented vs. Product oriented
- Mass production vs. Mass customization
- Targeting customers vs. Nurturing fans

Source: Compiled by Fung Business Intelligence
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Appendix
What is O2O commerce in China?

- O2O commerce is a business strategy connecting the (potential) consumers between online channels and physical stores.
O2O commerce in China – Case 1

Marketing campaign (Offline to Online)

• In summer 2015, Unilever joined Alibaba’s Blue Star Program. Under the Program, each ice-cream was assigned an unique QR code
• From 1<sup>st</sup> May to 30<sup>th</sup> September, 2015, customers scanned the QR code on the packing of ice-cream by using the Taobao mobile APP and got 5Mb FREE mobile data allowance
• Over 1.6 million people in China participated in this campaign

Benefits of participating the O2O campaign

• For Unilever:
  • Directly connect to their consumers (majority are Gen Y and Gen Z, who have a good appetite for ice-cream and mobile data)
  • Secure an accurate data source, which contributes to the research and development of future products
• For Alibaba:
  • Secure an accurate data source, which contributes to the research and development of marketing campaigns
  • Increase the customers’ stickiness of Taobao mobile APP
• For consumers:
  • Easily check the product authenticity
  • Get promotion information from the brand in future

Picture source: Internet
O2O commerce in China – Case 2

**Online to Offline**
- **Shanghai Jiahua Herborist.** The online shopper can make reservation for skin test/skin care services, and collect sample products from the nearest physical store, after ordering products from the Tmall official store.
- **Formosa Optical and Chow Tai Fook.** The online shopper can pick up goods at the physical stores and request for customized services in store.

**Offline to Online**
- **Tmall and its offline partners.** When a customer visits a physical retail store, he/she would receive a Singles Day e-coupon. He/she can enjoy a privilege offer when shopping in that retailer’s Tmall official site by scanning the e-coupon on Singles Day.
O2O commerce in China remains at an initial stage

- Both online retailers and offline traditional players in China are willing to test the water by participating in short-term O2O campaign.
- However, it is not easy for the players to fully transform their business models to O2O commerce.
- O2O commerce is not simply selling goods to customers via online and offline channels.
- To fully implement an O2O strategy, the company should integrate their businesses and systems with the support of data analytics.
- The integrations should cover various aspects, such as pricing, products, channels, customer services, process standardization and logistics.
Business and system integrations with the supports of data analytics are the critical success factors for O2O commerce.

E-store/physical store integration
- Effective pricing strategy and product segmentation;
- Process standardization;
- Synchronizing data of all sale channels: sale, mobile payment, promotion campaign, product replenishment, store pick services and goods return services.

Warehouse integration
- Optimizing storage and inventory management: Same warehouse can handle the products of same brand selling through any channels.

Service integration
- Engaging the customers: The brand manages customer relationship through APP notifications and review; provides after sale services, delivery and maintenance services, no matter the products were sold via whatever channels.

Source: Compiled by Fung Business Intelligence
Some challenges facing the Chinese companies pursuing O2O commerce

• The customers tend to shop at the physical store may not be the targeted online shopper of the same brand. Aligned product segments at both e-store and physical stores may upset some customers, while segmented product categories sold in different channels may dilute the profit of particular channels

• It is generally accepted that the goods selling online should be cheaper than selling offline in China, even though the goods are same. Aligned pricing strategies may affect the profit and loss statement of certain offline stores, while differentiated price may confuse the customers

• Requirements for product handling, goods returns and logistics serving online and offline channels are different. Transport and warehouse management plans should be reviewed. Extra investment and new workflows are required

• There are conflict of interests among online and offline sale teams within same company, e.g. fighting for resources, hesitating for sharing customer databases, etc. No internal integration among various silos is the major obstacle for pursuing O2O commerce
Merger & acquisition in O2O commerce

- Both internet giants and traditional retail incumbents have realized that pure online or offline channel cannot fully satisfy the discerning customers in China
- Recently, they seek to perfect their retail networks by merger and acquisition with their online or offline counterparts

See also Appendix 1: Factsheet of Alibaba, Tencent and JD.com
Icon source: Internet
Source: Compiled by Fung Business Intelligence
M&A: Case 1
Strategic partnership of Alibaba and Intime since March 2014

Details:

• Alibaba becomes the largest shareholder of Intime (27.9%)
• Intime invests in Alibaba’s Cainiao Network
• Alibaba’s online products are sold in Intime’s stores, and vice versa
• Payment and membership systems of Intime and Alibaba are fully integrated in June 2015. Intime has rolled out O2O applications such as ‘Miaojia’, ‘Choice’, etc

Remark:

• Intime runs 46 stores in China, including 29 department stores and 17 shopping malls

Icon source: Internet; Source: Compiled by Fung Business Intelligence
M&A: Case 2
Strategic partnership of Alibaba and Suning since August 2015

Details:
• Alibaba becomes the second largest shareholder of Suning (19.9%)
• Suning owns around 1.09% of Alibaba’s share
• Suning’s national network will integrate with Alibaba’s online platform
• Suning logistics join force with Cainiao Network, serving 2,800 counties in China
• Suning and Alibaba jointly invest 1 billion for setting up an e-commerce company, which will explore O2O business
• The two companies will jointly provide one-stop-shop solutions to brand owners, retailers and customers

Remark:
• Suning runs 1600+ stores and 5000 after sale service points throughout the nation

Icon source: Internet;
Source: Compiled by Fung Business Intelligence
M&A: Case 3
Strategic partnership of JD.com and Tencent since March 2014

Details:

• Tencent owns 15% of JD.com’s shares, and further holds another 5% of JD.com’s stakes when JD.com listed

• JD.com acquires 100% of Tencent’s subsidiary Buy.QQ.com (B2C) and paipai.com (C2C), JD.com also owns minor stake at Yixun.com

• Tencent offers JD.com priority access to WeChat and Mobile QQ; JD.com is Tencent’s preferred e-commerce partner in selling consumer goods

• In October 2015, the two firms join force in creating the new platform named “Brand-Commerce”, which offers total solutions to brand owners, covering brand building, marketing strategy and customer experience
M&A: Case 4
Strategic partnership of JD.com and Yonghui Supermarket since August 2015

Details:
• JD.com owns 10% of Yonghui Supermarket’s shares
• More than 60 Yonghui Supermarkets set up online stores on JD.com platform and offer O2O services
• JD.com and Yonghui Supermarket will unify their sourcing operations

Remark:
• Yonghui Supermarket runs more than 350 stores in China
M&A: Case 5
Strategic partnership of JD.com and Walmart since June 2016

Details:

• Walmart owns 5% of JD.com’s share
• JD.com obtains 100% of Yihaodian’s brand, website and APP, but Walmart remains the operation rights of Yihaodian
• Walmart’s stores in China cooperate with JD.com’s crowd sourced delivery platform
• Walmart invests in New Dada, a delivery platform partly owned by JD.com
• Sam’s Club sets up an online flagship store on JD.com and uses the logistics services provided by JD.com
• Both parties join force in supply chain management, which may diversify the imported product categories of JD.com

Icon source: Internet;
Source: Compiled by Fung Business Intelligence
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Appendix
Internet giants are building their business ecosystem
Case – Alibaba

- Alibaba Group is today the largest e-business company in China
- It was founded by Jack Ma in 1999 as an online trading platform
- The group’s core businesses include:
  
  ![Diagram of Alibaba's business ecosystem](source)

- These businesses represent Alibaba’s dedication to establish a business ecosystem, which enables Alibaba to integrate its B2B, B2C and C2C businesses with sales and marketing, payment, financing, and logistics services

Icon source: Internet;
Source: Compiled by Fung Business Intelligence


To extend its market reach, Alibaba not only partnered with offline retailers, but also invested in a web of interdependent businesses.

- Take the domestic market as a case in point.
- Alibaba invested in quite a lot of businesses, which may not be directly related to their core businesses. For instances, health, sport, entertainment, social media, etc.
- Why?
- All the stakeholders create value and share data through their engagement within Alibaba’s ecosystem.

* This figure includes part of the business units and invested companies of Alibaba Group within China
* Icon source: Internet;
* Source: Compiled by Fung Business Intelligence
Alibaba’s business ecosystem in China

* This figure includes part of the business units and invested companies of Alibaba Group within China
Icon source: Internet
Source: Compiled by Fung Business Intelligence
How does the Alibaba ecosystem work?

1. Internet traffic is converted from various sources to sales via Alibaba’s commerce platforms or its offline partners.

2. Shoppers fulfill the bills via Alipay.

3. Data collected via platform tracking, location based services or Alipay are transmitted to Aliyun.

4. Aliyun provides big data analytics services to Alibaba’s business units and partners for precision marketing.

Icon source: Internet
Source: Compiled by Fung Business Intelligence
The internet giants (Baidu, Alibaba and Tencent) in China are doing the same thing – building their business ecosystem.

See also Appendices 2 and 3: Business ecosystems of Baidu and Tencent in China
Icon source: Internet
Source: Compiled by Fung Business Intelligence
This report

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Appendix
# Appendix 1: Factsheet of Alibaba, Tencent and JD.com

## Background

<table>
<thead>
<tr>
<th><strong>Alibaba</strong></th>
<th><strong>Tencent</strong></th>
<th><strong>JD.com</strong></th>
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</thead>
<tbody>
<tr>
<td>Founded by Jack Ma in April 1999, headquartered in Hangzhou, China</td>
<td>Founded by Ma Huateng and Zhang Zhidong in November 1998, headquartered in Shenzhen, China</td>
<td>Founded by Richard Qiangdong Liu in July 1998, headquartered in Beijing, China</td>
</tr>
</tbody>
</table>

## Core business

<table>
<thead>
<tr>
<th><strong>Alibaba</strong></th>
<th><strong>Tencent</strong></th>
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</tr>
</thead>
<tbody>
<tr>
<td>E-marketing services</td>
<td>Online/ mobile games</td>
<td>Financing</td>
</tr>
<tr>
<td>Cloud computing services</td>
<td>In-app lifestyle services</td>
<td>O2O services platform</td>
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<tr>
<td>Financing</td>
<td>Video and media</td>
<td>Logistics</td>
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</tbody>
</table>

## Other business

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>O2O services platforms</td>
<td>M-commerce</td>
<td>Financing</td>
</tr>
<tr>
<td>Video and media</td>
<td>O2O services platforms</td>
<td>O2O services platform</td>
</tr>
<tr>
<td>Social media</td>
<td>Travel and transport</td>
<td>Logistics</td>
</tr>
<tr>
<td>Travel and transport</td>
<td>Financing</td>
<td>Quality control</td>
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</tbody>
</table>

## Profit model

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<th><strong>Tencent</strong></th>
<th><strong>JD.com</strong></th>
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</thead>
<tbody>
<tr>
<td>Commission</td>
<td>Value-added services fee</td>
<td>Commission (marketplace)</td>
</tr>
<tr>
<td>Advertising fee</td>
<td>Sales of virtual goods</td>
<td>Markup (self-operated platform)</td>
</tr>
</tbody>
</table>

## Core competence

<table>
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<th><strong>Alibaba</strong></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Payment</td>
<td>Logistics infrastructure</td>
<td>Logistics infrastructure</td>
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<tr>
<td>Logistics infrastructure</td>
<td>Big data analytics</td>
<td>Quality control</td>
</tr>
<tr>
<td>Big data analytics</td>
<td>Financing</td>
<td>Quality control (self-operated platform)</td>
</tr>
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</table>

## Financial and operating performance*

<table>
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<th><strong>JD.com</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue: 15.7, +33%yoy</td>
<td>Revenue: 15.8, +30%yoy</td>
<td>Revenue: 28, +58%yoy</td>
</tr>
<tr>
<td>GMV**: 485, +27%yoy</td>
<td>Combined MAU** of Weixin and Wechat (Dec 2015): 697 million</td>
<td>GMV**: 71.4, +78%yoy</td>
</tr>
<tr>
<td>Mobile MAU** (Mar 2016): 410 million</td>
<td></td>
<td>213 warehouse in 50 cities (including 6 self-built “Asia No.1” warehouses)</td>
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<tr>
<td></td>
<td></td>
<td>5,367 delivery stations and pick up stations</td>
</tr>
</tbody>
</table>

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**GMV**: General merchandizing value; MAU: monthly active users

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*FY2015: Year ended at March 2016 for Alibaba; Year ended at December 2015 for Tencent and JD.com

** Source: Annual reports, company websites, compiled by Fung Business Intelligence
Appendix 2: Baidu’s business ecosystem in China

* This figure includes part of the business units and invested companies of Baidu Group within China

Icon source: Internet
Source: Compiled by Fung Business Intelligence
Appendix 3: Tencent’s business ecosystem in China

* This figure includes part of the business units and invested companies of Tencent Group within China
Icon source: Internet
Source: Compiled by Fung Business Intelligence
Forthcoming

Part 2: Internet-enabled boundaryless trade

Part 3: C2B/C2M models: A reality under Industry 4.0?

Part 4: Sharing economy: A disruption to the traditional market
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Management Theories and Business Models

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