



China's E-commerce Sector Online Retailing in Transition

October 2014

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Fung Business Intelligence Centre

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Introduction

Online retailing is at a tipping point, with the e-mobile Internet now behind the majority of its growth. Technological advances are also rapidly transforming China's e-commerce landscape. Both opportunities and challenges abound. Realising the importance of the online channel in luring customers – particularly the new generation of consumers – sees increasing numbers of retailers embarked on their own mobile and social media strategies. They have embraced new technologies that include analytic tools, location-based technologies, in-store mapping services, RFID and QR codes, all in a bid to make shopping more convenient and attractive to their customers. At the same time, more retailers in China have started implementing "O2O strategies" (aka omni-channels), hoping to create a seamless experience across multiple marketing and sales channels.

2014 marks a big year for Chinese e-commerce companies embarking upon initial public offerings (IPOs) on foreign exchanges. In particular, Alibaba's IPO on the New York Stock Exchange, the biggest in history, has taken the world's attention. Alibaba's IPO success is expected to entice its peers to follow suit.

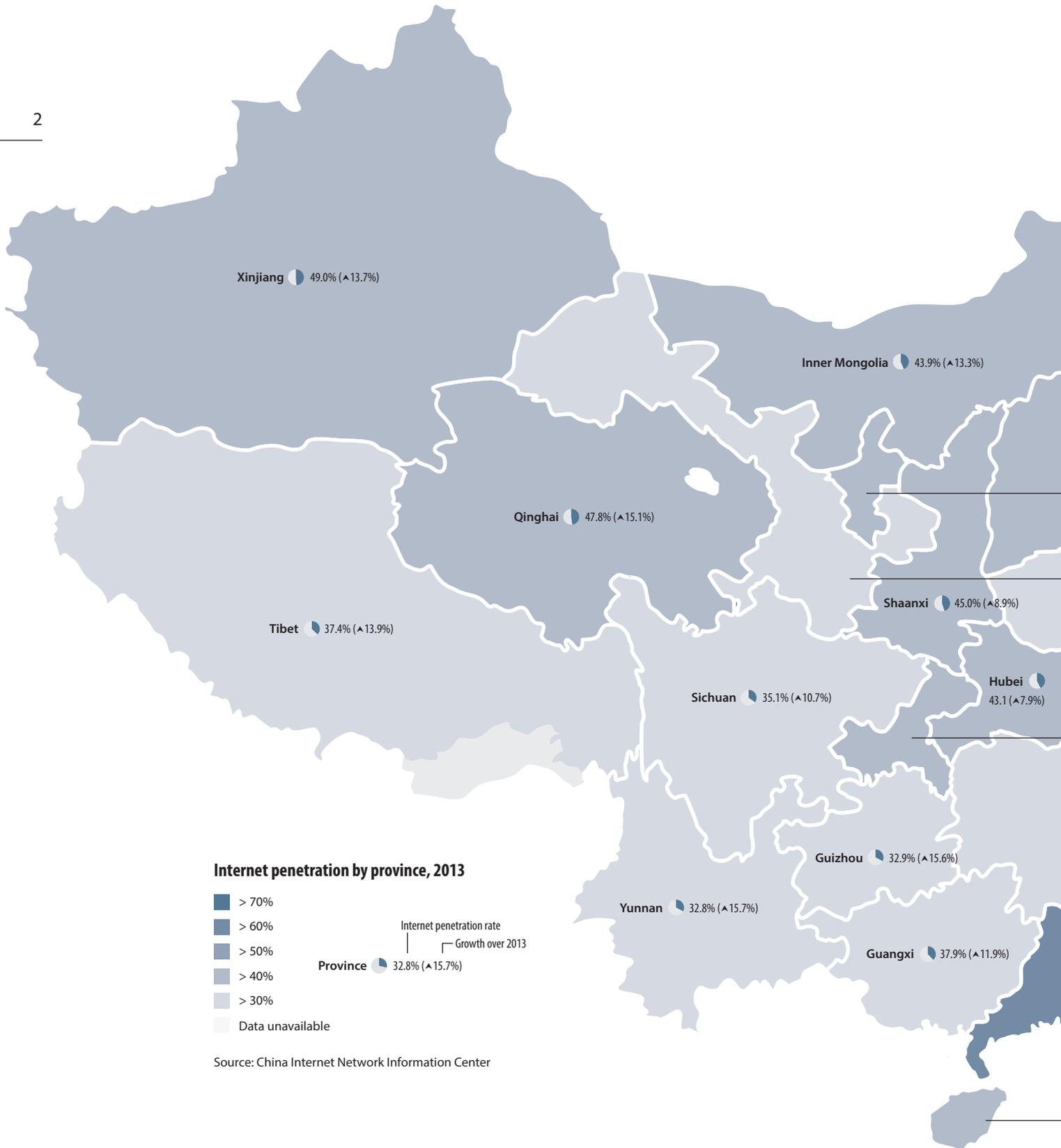
While China's e-commerce sector continues to grow, several new developments are taking place. Increasing numbers of Chinese shoppers are taking part in international cross-border shopping. Furthermore, they are buying from increasing numbers of product categories online, from apparel and shoes to bags and accessories and to fresh food produce.

As a result, the impact of e-commerce in China is becoming more significant than ever. Not only are many bricks-and-mortar retailers embracing e-commerce, but traditional industries such as the real estate, healthcare and automobile sectors, are also jumping on the online bandwagon. Last but not least, a growing number of small businesses in rural communities are leveraging e-commerce platforms to reach their customers. The rise of the so-called "Taobao village" is drawing increasing public awareness.

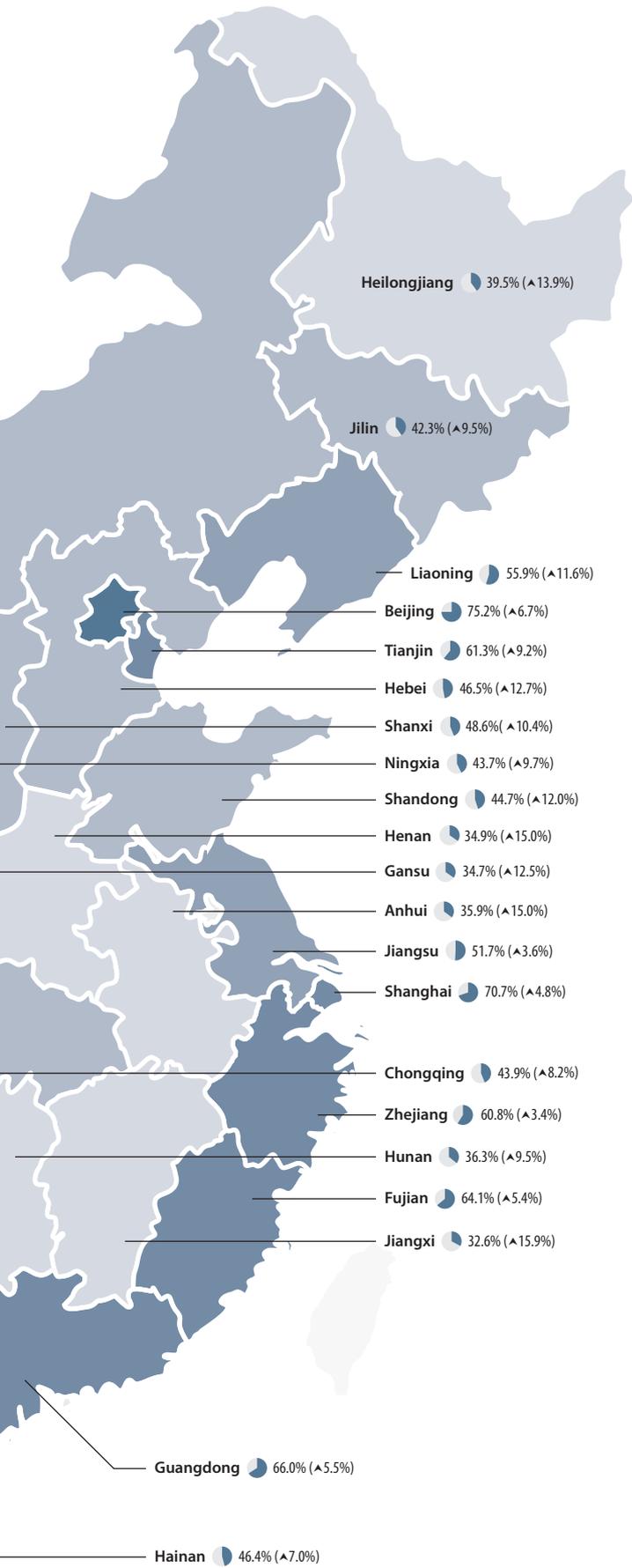
In this newsletter, we identify the top 10 key trends in China's e-commerce sector. We also address the implications for retailers hoping to gain a foothold in a vast—and growing—market. ■

At a glance

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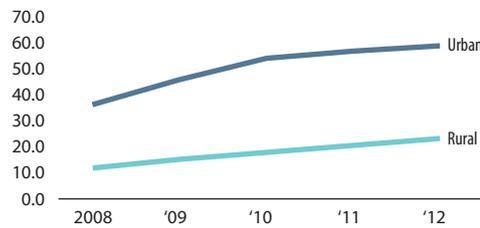


Source: China Internet Network Information Center



Chinese consumers are becoming increasingly connected, with Internet penetration reaching a high of 45.8% of the nation in 2013 (9.5% yoy growth), but a wide gap still exists between urban and rural populations:

Urban-rural internet penetration rates, 2008 - 2012



Source: China Internet Network Information Center

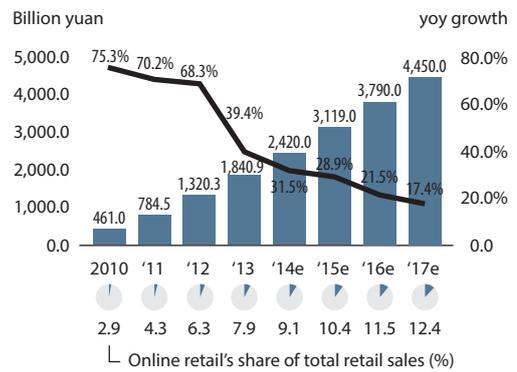
Key facts

Market

China's online market: the world's largest online market

The transaction value of China's online market increased by 39.4% yoy to reach 1.84 trillion yuan in 2013, accounting for 7.9% of the country's total retail sales¹. By 2017, total online sales are expected to reach 4.45 trillion yuan, accounting for 12.4% of the total retail sales.

Exhibit 1. Transaction value of online shopping in China, 2010-2017 (estimates)



Source: iResearch, March 2014

Mobile shopping is gaining traction

The mobile platform is now a highly popular sales and marketing channel. iResearch estimates the total transaction value of mobile shopping to exceed 3,207 billion yuan by the 2017, up from 274 billion yuan in 2013².

Exhibit 2. Transaction value of mobile shopping in China, 2011-2017 (estimates)

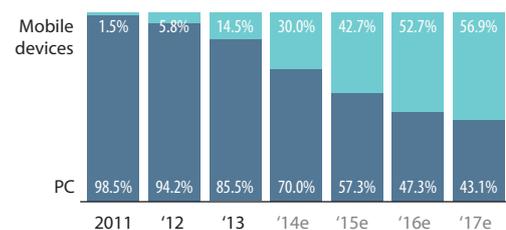


Source: iResearch, July 2014

Online transactions made via mobile devices on the rise

Currently, around 70% of the transactions are made via PC and 30% via mobile devices. It is expected that the share of transaction on mobile device will exceed PC by 2016 – 52.7% on mobile device and 47.3% on PC³.

Exhibit 3. Share of transactions made on PC and mobile devices, 2011-2017 (estimates)



Source: iResearch, July 2014

Growth drivers

Growing number of netizens drives e-commerce growth

An expanding Internet population is a major driving force for the robust growth of e-commerce in China. China’s Internet population amounted to 632 million in 1H14, with a penetration rate of 46.9%, while the number of China’s online shoppers reached 332 million in 1H14⁴.

Exhibit 4. Number of online shoppers and online shopping penetration, 2008–2013



Source: CNNIC, December 2013

Increasing number of m-commerce users

The number of m-commerce users reached 205 million in 1H14, up by 42% from 4Q13 and accounting for 32% of China’s total Internet population⁵.

Exhibit 5. Number of mobile shoppers and online shopping penetration, December 2013 – June 2014

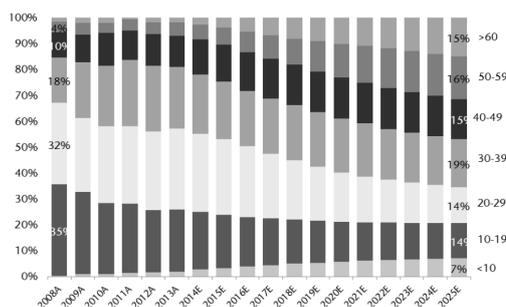


Source: CNNIC, July 2014

“Post-90s” are the main driver of online shopping

Younger consumers, particularly the “post-90s” generation show greater preference for mobile shopping⁶. In 2013, around 57% of the Internet population is under 30 years of age.

Exhibit 6. Chinese Internet users by age group, 2008-2025 (estimates)



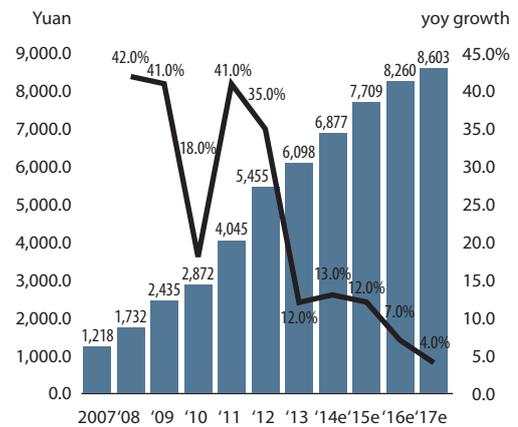
Source: US Census, CNNIC, Jefferies estimates, July 2014

Consumer behaviour and preferences

Average spending per online shopper has increased over the years, but growth rate is set to stabilise.

The average spending per online shopper amounted to 6,098 yuan in 2013, up by 12% yoy; and the growth rate is expected to stabilize over coming years⁷.

Exhibit 7. Average spending per online shopper, 2007 – 2017 (estimates)



Source: iResearch, CNCIC, Jefferies estimates. July 2014

Apparel, bags, and accessories remain the most popular category bought online

Apparel, shoes and hats constituted the most popular online retail category in 2013; 75.6% of the online shoppers have bought products in this category⁸.

Exhibit 8. Most popular categories online, 2013

Categories	People buying these items (%)
Apparel, shoes, and hats	75.6
Daily necessities	45.1
Digital products and accessories	43.3
Top-up cards	34.9
Bags	32.7
Cosmetics and skin-care products	30.6
Books, music, and videos	25.7
Consumer electronics	22.7
Food and health care products	22.4
Stationery	18.0

Source: CNNIC, April 2014

Price still the main reason for consumers to decide whether to buy online or via offline channels

Over 70.3% of China's online shoppers would consider "commodity price" when choosing whether to buy from a physical store or online store. "Vendor's credibility" and "commodity quality" are the next criteria that consumer looks into⁹.

Exhibit 9. Criteria for consumers to choose to buy online or via offline channels, 2013

Criteria	People who say they consider this criteria (%)
Commodity price	70.3
Vendor credibility	39.3
Commodity quality	38.0
Delivery fee	33.9
Comments of users or friends	32.4
Delivery speed	23.3
Goods in stock or not	20.7
Convenient return or exchange of goods	12.5
Flexible delivery time	6.0
Visiting familiar sites directly almost without price comparison	2.1

Source: iResearch, May 2014

Chinese shoppers engage actively on social media platforms

QQ, WeChat and Sina Weibo are some common social media platforms. They all have hundreds of millions of monthly active users.

Exhibit 10. Number of monthly active users of selected social media, as of 2Q14

Social Media	Active users
QQ	829.0 million ¹⁰
WeChat	438.0 million ¹¹
Sina Weibo	156.5 million ¹²
Renren	44 million ¹³

Source: Internet sources; compiled by Fung Business Intelligence Centre

Competitive landscape

C2C represents a dominant market share, yet B2C is expanding quickly

In 2013, the C2C and the B2C segment accounted for 59.6% and 40.4%, respectively, of the total transaction value of online retailing in China. It is expected that the transaction value for B2C segment will exceed C2C by 2015¹⁴.

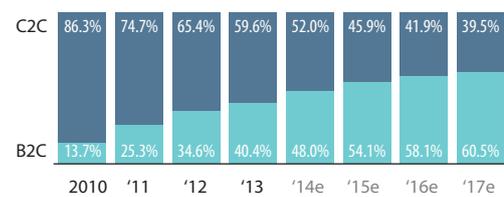
Taobao is the market leader in the C2C market

Taobao is the dominant market leader. As of December 2013, Taobao achieved 96.5% of the market share, while Paipai had 3.4% and Eachnet had 0.1% market share¹⁵.

Tmall and JD.com are the two largest B2C players

The two largest B2C players, Tmall and JD.com are both open platform operators—Tmall has a dominant share of 57.4%, while JD.com has a share of 21.0%¹⁶. The two leading platforms together accounted for 78.4% of the B2C market. ■

Exhibit 11. Share of online retailing in terms of transaction value, 2010–2017 (estimates)



Source: iResearch, July 2014

Exhibit 12. Market share of C2C market, as of December 2013

C2C competitors	Market share (%)
Taobao	96.5%
Paipai	3.4%
Eachnet	0.1%

Source: 100EC.CN, March 2014

Exhibit 13. Market share of B2C market, 2014

B2C competitors	Market share (%)
Tmall	57.4
JD.com	21.0
Suning	3.1
VIPshop	3.0
Gome	2.0
Amazon China	1.6
Dangdang	1.5
Yihaodian	1.4
Yixun	1.4
Others	7.6

Source: iResearch, July 2014

Comparison of e-commerce players, 2013

	Tmall	JD.com	Suning	VIPshop	Gome	Amazon China	Dang- dang	Yihao- dian	Jumei
Direct sale ¹⁷	×	○ 70%	○	○ 94%	○	○	○ 73%	○	○ 62%
Marketplace ¹⁸	○	○ 30%	○	○ 6%	○	○	○ 27%	○	○ 38%
Categories	All	All	3C/home appliance and others	Apparel and others	3C/home appliance and others	All	Books and others	Grocery and others	Cosmet- ics and others
In-house logistics	×	○	○	×	○	○	○	○	○
Third party logistics	○	○	○	○	○	○	○	○	○
Number of warehouses ¹⁹	n/a	86	12	5	5	108	21	5	2
Active users (million) ²⁰	231	47	n/a	9	n/a	n/a	21	n/a	11
Gross margin ²¹	n/a	9.9%	15.0%	23.5%	15.0%	27.2%	16.6%	n/a	41.3%

Source: Internet sources; compiled by Fung Business Intelligence Centre

Commission rates for different categories on different e-commerce platforms, 2013 (%)

	Tmall ²²	JD.com ²³	Amazon China ²⁴	Suning ²⁵	Yihaodian ²⁶	Dangdang (BoA data) ²⁷	Gome (BoA data)
Apparel	5	6-8	10	5	6	8-12	4
Shoes and bags	5	7-8	10	5	6	5-10	4
Outdoor and sports	5	5-9	10	2-5	2-6	5-10	4
Baby and maternity	2-5	2-8	8	2-5	2-6	8	2
Beauty and personal care	4	5	6	3-4	6	5-10	3
3C	2	n/a	4	0.5-4	2	1-2	1
Home appliance	2-5	n/a	4	4-6	2	2	2
Household and furniture	2-5	7-8	10	2-5	4-6	4-8	1-3
Jewellery	0.5-5	1-8	15	0.5-5	1-6	10-15	4
Food	1-2	3-5	7	1-3	2-5	n/a	2
Book and media	2	5	8	2	n/a	n/a	0
Healthcare and drug	3	5-8	6	3	5	n/a	3
Instruments	2	n/a	10	2	n/a	n/a	n/a
Services	0.5-2	n/a	10	n/a	n/a	n/a	n/a
Auto parts	2-3	3-6	7	2-3	n/a	n/a	2
Telecommunication	0.3-3	3-6	4	2	n/a	n/a	n/a
Travel	2	n/a	10	n/a	2	n/a	n/a

Source: Respective company websites; compiled by Fung Business Intelligence Centre

Top 10 trends

#1: M-commerce leaps in popularity, while s-commerce gradually emerges

The year 2014 marks an impressive jump for mobile commerce (m-commerce); the rising popularity of mobile devices across China has not only changed the way people communicate, but also the way they shop. The mobile platform is now a highly popular sales and marketing channel. According to China Internet Network Information Centre (CNNIC), the number of m-commerce users reached 205 million in 1H14, accounting for 32% of China's total Internet population²⁸. iResearch estimates the total transaction value of mobile shopping will exceed 3,207 billion yuan by 2017, up from 274 billion yuan in 2013²⁹. Consumers are able to use their mobile devices to search products online, scan quick response (QR) codes directing them to retailers' websites, and make purchases anywhere, at any time. To drive sales, retailers can also interact with consumers with targeted promotions.

The increasing sophistication of mobile payment particularly underpins m-commerce development. A large proportion of online shoppers still adopt cash-on-delivery when purchasing online, but they are becoming increasingly accustomed to mobile transactions. Mobile transaction values reached 1.38 trillion yuan in 2Q14, up from 0.1 trillion yuan in 2Q13³⁰. The top player in the mobile payment market, Alibaba's Alipay, accounted for 79.9% of market share in 2Q14³¹. Indeed, more retailers have partnered with leading e-commerce companies such as Alibaba and Tencent to offer mobile payment services. For instance, TeeMall, a shopping

mall operator based in Guangzhou, has allowed customers to use the Alipay mobile wallet to settle payments as from August 2014³². Wangfujing Department Store has partnered with Tencent's WeChat Payment to launch a mobile payment service in selected branches³³.

At the same time, social media is playing a larger role in supporting consumer purchase decisions. Chinese consumers, in particular, are used to voicing their opinions on social networking sites (SNS). iResearch estimates that over 60% of Chinese online shoppers wrote comments via SNS after purchasing online. So many retailers leverage the huge user databases of popular SNS such as Tencent's WeChat³⁴ and Weibo³⁵ to promote their products and services.

In tandem, the trend for selling on SNS (otherwise known as social commerce or s-commerce), is gaining traction. Mogujie, one of China's most popular fashion and beauty social shopping platforms, is a case in point. It started as a Pinterest-style shopping-guide website in 2011, and later transformed into a transactional website selling apparel and beauty products³⁶. As of August 2014, Mogujie's daily active users numbered 80 million, and around 6,000 retailers have set up stores on Mogujie³⁷. Mogujie places particular emphasis on its mobile strategy; it has built a well-devised mobile app, allowing buyers to exchange information and customers to easily find required products and settle payment at their fingertips. Some 65% of transactions on Mogujie are reportedly made via its mobile app³⁸.

Meilishuo, another popular fashion and

beauty SNS, built its own trading platform in 2013. Today, it reportedly has 10,000 retailers on its platform. To facilitate online transactions, Meilishuo partnered with WeChat in early 2014 to promote selected fashion products available to respective users via its mobile app³⁹. Shoppers can also use WeChat to settle payments when they buy online. Some 70% of Meilishuo's total sales revenue is reportedly generated via its mobile app⁴⁰.

#2: China's "diaosi" are set to become mainstream consumers

Rapidly changing consumer attitudes and purchasing behaviour are reshaping China's retail landscape. Recently, many retailers and brand owners have realised that an underclass of consumers may be where the real money is, and they are turning to target a vast market. This group of consumers, commonly known as "diaosi", is increasingly becoming the sector to watch. The term "diaosi" originally referred to young men with low incomes and limited prospects, and they spend much of their free time – and disposable income – on the Internet⁴¹. Especially with luxury sales growth slackening, this group is becoming a formidable sector in China's retail market.

The rise of "diaosi" has been driven by two major forces in Chinese consumption – rising consumer prices and an emerging virtual economy⁴². According to research by Sohu in March 2013, there were 526 million people labeled as "diaosi"⁴³. They opt for quality goods that represent value for money, and they like to shop online. Their individual spending may not be comparable

to the rich, but the large number of individuals involved plays a significant role in driving China's consumption growth.

Some of the country's most successful Internet companies, such as Tencent, have placed huge emphasis on this group of consumers. As well as providing instant messaging services, e-commerce platforms and mobile payment solutions, Tencent offers numerous online, multiplayer games through its game portal, games that are highly popular among the "diaosi". Another example is China-based, budget smartphone maker, Xiaomi. The company offers budget smartphones with functions comparable to famous brands. Its "hungry sales" online strategies (characterised by limited volumes sold only online over a short period of time) are particularly favoured by the "diaosi".

The rise of this major consumer group is set to continue. Retailers may need to rethink their strategies; they should be providing more products that show value-for-money, while increasing their focus towards online marketing initiatives.

#3: Leveraging Big Data and technologies for success

In today's digital world, the use of Big Data in e-commerce has become a competitive differentiator. Mining Big Data enables retailers to understand and anticipate the needs of their target customers, thus building consumer loyalty. As Chinese shoppers now demand a more personalised "shopping experience", some retailers are leveraging mobile technologies to explore consumer preferences and gather location-

based information; their intention is to launch tailor-made marketing campaigns.

For instance, in August 2014, Wangfujing Department Store announced a cooperative initiative with Baifendian Corporation, a domestic Big Data analytics solutions company, to collect and analyse consumer data⁴⁴. Similarly, Intime Department Store recently formed a partnership with Baidu, China's largest player in the search engine market, to use Baidu Eye (a Chinese version of Google's Glass) to provide a new shopping experience⁴⁵. Baidu Eye supports voice and gesture commands and sends information to customers' mobile devices. It can recognise all the department store's products and brands, and can track customers' movements so as to enable them to locate the products they are looking for. In another case, Alibaba recently acquired AutoNavi, a mapping and navigation company; this has enabled Alibaba to further expand its mapping services on its C2C platform, Taobao (as well as its Taobao mobile platform), so customers can more conveniently pinpoint location-based deals⁴⁶.

Other players are applying the latest technologies (such as RFID and augmented reality) to stimulate online shopping. For instance, fast fashion chain Uniqlo recently launched a "virtual dressing room" on its website, allowing customers to digitally try on clothes⁴⁷. Shoppers can choose a virtual model that has a similar body size, and place the clothes of their choice on the model to see how well they fit before making a purchase. JD.com, China's second largest B2C platform operator, has also added a similar feature on its mobile app⁴⁸. Users can

take "selfie"-style photos and apply these on virtual models; they can then "virtually" try on the clothes.

The Chinese government has been very supportive towards the use of Big Data in e-commerce. In November 2013, the National Bureau of Statistics (NBS) signed a strategic cooperation agreement with 11 domestic e-commerce and Internet companies to jointly develop an action plan for the further application of Big Data⁴⁹. The NBS will formulate statistical standards for Big Data application and complete and replenish government statistical data, using the information provided by partner enterprises. It is expected that the use of Big Data in e-commerce activities could further help businesses to improve their operational efficiencies.

#4: The rise of O2O

Advances in technology and increasing access to information through the Internet and mobile connectivity have provoked consumer buying habits and preferences across all channels. More bricks-and-mortar retailers are launching their online and mobile platforms, and using social media to reach their customers. Some pure-click companies are evolving from selling only online to setting up physical stores. In recent times, an increasing number of retailers are exploring "O2O" or "online and offline integration" (known as omni-channel strategies). They try to pull together multi- and cross-channel offerings, including physical stores, online and mobile platforms (as well as social media platforms) to create a closed loop for the whole purchasing

process. Major O2O initiatives by selected retailers are shown in Exhibit 14 (on the next page).

In short, the following are the most common ways retailers in China are trialing their O2O initiatives:

- **Launching mobile apps and offering location-based marketing.** Many retailers have launched their own mobile apps and leveraged popular social media platforms, such as Sina Weibo and WeChat, to launch personalised and location-based marketing. For instance, Intime Department Store and Rainbow Department Store provide free in-store WiFi services, and customers can receive personalised coupons and promotional deals via retailers' mobile apps⁵⁰.
- **Offering mobile payment services in-store.** An increasing number of retailers have partnered with leading e-commerce companies, such as Alibaba and Tencent, to offer mobile payment services. The most common mobile payment tools include Alibaba's mobile Alipay, together with Tencent's WeChat mobile payment and Weibo payment schemes.
- **Using QR codes to support online and offline integration.** A typical example is Metersbonwe, a domestic apparel chain. A unique QR code is printed on the product tag of each product available at Metersbonwe; when customers use their mobile devices to scan the QR code they will be directed to the product page on Banggo.com, Metersbonwe's online store. They can receive the product information and can shop online via their mobile devices.
- **Creating a shared customer database and loyalty programme.** Some leading retailers such as Intime Department Store⁵¹ and Suning⁵² have integrated their online and offline membership programmes. A single, integrated account allows retailers to capture purchasing data across different platforms.
- **Supporting "click and collect".** Some retailers have made it possible for customers to buy online while picking up the items in a physical store. For example, in addition to offering pick-up services at its physical outlets, Rainbow Department Store has expanded such services to allow customers to pick up their online purchases from one of its "O2O Store" locations, a convenience chain set up by the department store operator in Shenzhen in July 2014⁵³.
- **Integrating back-end operation.** To ensure smooth implementation of O2O, some retailers have integrated their back-end operations and systems such as inventory, warehouse and logistics management systems. For example, Shopin Discount Store has integrated its store inventory management system with those provide by suppliers⁵⁴.
- **Unifying online and offline pricing.** Suning, a leading home appliance retailer, is the forerunner in unifying prices for its online and offline offerings. The company offers the same price on its online and offline platforms at regional or city levels⁵⁵. It also adopts a dynamic pricing model by using web crawling tools to monitor and compare competitors' prices.

Exhibit 14. 020 initiatives for selected retailers, as of September 2014

Retailer	Major operating formats	Online/mobile initiatives						Online and offline integration
		Own transactional website	Third party platforms	Mobile portal	Social media: Sina Weibo	Social media: WeChat	In-store initiatives	
Rainbow Department Store	Department store, convenience store	○	×	○	○	○	<ul style="list-style-type: none"> • Free WiFi • Touch-screen device in some store branches • Displays QR codes on wall • Supports mobile payment 	<ul style="list-style-type: none"> • Integrates online and offline membership • Order online, collect in offline stores or in third party pick up points • Goods purchased online can be returned to stores or by post
Shopin Discount Store (Hangzhou branch)	Discount store	○	×	○	○	○	<ul style="list-style-type: none"> • Free WiFi • QR codes on tags for every product • Supports mobile payment 	<ul style="list-style-type: none"> • Integrates online and offline membership • Same products and same price for online and offline channels
Intime Department Store	Department store, shopping mall	○	○	○	○	○	<ul style="list-style-type: none"> • Free WiFi • Displays QR codes on wall • Supports mobile payment 	<ul style="list-style-type: none"> • Integrates online and offline membership • Same price for products which are common to online and offline channels
Guangzhou Friendship Department Store	Department store	○	×	○	○	○	<ul style="list-style-type: none"> • Free WiFi • Supports mobile payment 	<ul style="list-style-type: none"> • Integrates online and offline membership • Same price for products which are common to online and offline channels
Better-Life Chain Supermarket	Hypermarket, supermarket, department store	○	×	WIP †	○	○	<ul style="list-style-type: none"> • Free WiFi • Touch-screen devices available • Displays QR codes on wall • Supports mobile payment (soon) 	<ul style="list-style-type: none"> • Order online, collect in offline stores
Hongqi Convenience Store	Convenience store	○	×	×	○	○	<ul style="list-style-type: none"> • Touch-screen devices available • Supports mobile payment 	<ul style="list-style-type: none"> • Integrates online and offline membership • Order online, collect in offline stores

† Better-Life Chain Supermarket's mobile app is under development, and reportedly launches in October 2014⁶⁶.

Online/mobile initiatives

Specialty stores	Own trans- actional website				Third party platforms	Mobile portal	Social media:		Online and offline integration
			Sina Weibo	WeChat					
Metersbonwe	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Integrates online and offline membership Same products and same price for online and offline channels
Uniqlo	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Free WiFi Touch-screen device in the convenience store branches Displays QR codes on tags, directing to Banggo.com Supports mobile payment
Zara	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Displays QR codes in-store Supports mobile payment Displays QR codes on tags Integrates online and offline membership Same products and same price for online and offline channels Order online, collect in offline stores Goods purchased online can be returned to stores or by post
Suning	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Free WiFi Touch-screen devices available Displays QR codes in-store Supports mobile payment Integrates online and offline membership Same price for products which are common to online and offline channels Order online, collect in offline stores Goods purchased online can be returned to stores or by post 					
Gome	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<ul style="list-style-type: none"> Free WiFi Displays QR codes in-store Will support mobile payment Integrates online and offline membership Order online, collect in offline stores

Source: Internet sources; compiled by Fung Business Intelligence Centre

#5: Online players strengthen logistics services

To support their O2O initiatives, some online players have taken a variety of approaches to providing better logistics services. Some platform operators, such as JD.com⁵⁷ and Dangdang (since 2011)⁵⁸, have started to offer same-day delivery services. Others, such as JD.com⁵⁹, Amazon.cn⁶⁰ and Tmall⁶¹, have partnered with convenience store chains to provide customers with self pick up services. In July 2014, JD.com launched a pilot mobile pick up service in Beijing and Chengdu; consumers can pick up their online orders from mobile stations in certain metro stations and community centres, with the service rolling out to residential areas and key transportation hubs in tier 1 and 2 cities later in 2014.

Indeed, the Chinese government has been very supportive in the development of self-pick up points across the country. In September 2014, the Ministry of Commerce launched its *Opinions on Accelerating the Development of Commercial Logistics*, encouraging and supporting e-commerce companies to partner with convenience store chains to provide self pick up services, and supporting the establishment of pick up points in schools, communities and metro stations⁶².

Additionally, a growing number of e-commerce companies have invested heavily in warehousing and inventory management capabilities to gear up for future growth. Exhibit 15 shows the number of warehouses owned by selected online players. JD.com is among the first e-commerce companies to devote

substantial resources to building its own logistics infrastructure. As of June 2014, the company has established 86 warehouses with a total floor area of approximately 1.5 million sqm in 36 cities, with 1,620 delivery stations and 214 pick up stations in 495 cities across China⁶³. This has made same-day delivery available in 43 cities. The trend for investing in warehousing is expected to become increasingly important in supporting flexible inventory management, timely delivery and replenishments.

Exhibit 15. Number of warehouses of selected online players (as of June 2014)

	JD.com	Jumei	VIPShop	Dangdang
Number of warehouses	86	5	5	21
GFA (sqm)	1,500,000	<96,600	<317,105	390,000

Source: Company data, Nomura International (Hong Kong) Ltd

#6: Chinese e-commerce players seek overseas listings

Listing is amongst the most direct means to finance expansion, widen product categories and enhance logistics facilities. A number of large e-commerce players in China have sought public listings overseas over recent years (see Exhibit 16).

In particular, Alibaba has captured the world's attention with its initial public

offering (IPO) on the New York Stock Exchange in September 2014, raising a record US\$21.8 billion, the largest in history. Earlier, in May 2014, its rival JD.com listed on the NASDAQ, raising approximately US\$1.8 billion⁶⁴. Although the rationale for launching an IPO may differ between the two companies, their successful listings could encourage other large-scale players to follow suit. Exhibit 17 shows a comparison of Alibaba and JD.com.

Exhibit 16. Major IPOs of Chinese Internet companies, 2012-2014

Company	Year established	Major business	Listed Stock Exchange	Listed date	Capital raised
Alibaba	1999	B2B, B2C, C2C market platforms; payment platform, logistics network, cloud computing services	New York Stock Exchange	September 2014	US\$21.8 billion ⁶⁵
JD.com	1998	Integrated B2C market platform	NASDAQ	May 2014	US\$1.78 billion ⁶⁶
Jumei	2010	B2C market platform specialising in beauty products	New York Stock Exchange	May 2014	US\$245 million ⁶⁷
Sina Weibo	2009	Microblogging	NASDAQ	April 2014	US\$285 million ⁶⁸
LightInTheBox	2006	B2B market platform	New York Stock Exchange	June 2013	US\$79 million ⁶⁹
VIPshop	2008	B2C discount platform for brands	New York Stock Exchange	March 2012	US\$71.5 million ⁷⁰

Source: Internet sources; compiled by Fung Business Intelligence Centre

Exhibit 17. Comparison of Alibaba and JD.com

	Alibaba	JD.com
Year founded	1999	1998
IPO date	19 September, 2014	22 May, 2014
IPO placement	New York Stock Exchange	NASDAQ
Capital raised	US\$21.8 billion ⁷¹	US\$1.78 billion ⁷²
Major revenue source	Commission fees and advertising income	Commission fees
Revenue	15.8 billion yuan (For the three months ended June 30, 2014)	28.6 billion yuan (For the three months ended June 30, 2014)
Net income	7.3 billion yuan (For the three months ended June 30, 2014) ⁷³	-582 million yuan (For the three months ended June 30, 2014) ⁷⁴

	Alibaba	JD.com
Major businesses		
B2C	<ul style="list-style-type: none"> • Tmall (domestic online retail platform) • AliExpress (global online retail platform) • 11 Main (US online retail platform) 	<ul style="list-style-type: none"> • Integrated B2C platform with approximately 23,500 third party sellers
C2C	<ul style="list-style-type: none"> • Taobao 	<ul style="list-style-type: none"> • n/a
B2B	<ul style="list-style-type: none"> • Alibaba.com (global online wholesale platform) • 1688.com (domestic wholesale platform) 	<ul style="list-style-type: none"> • n/a
Group buying	<ul style="list-style-type: none"> • Juhuasuan 	<ul style="list-style-type: none"> • Tuan.jd.com (under JD.com)
Logistics	<ul style="list-style-type: none"> • Does not directly own any physical infrastructure or employs delivery personnel • Works with third party logistics service providers through a central logistics information system, the China Smart Logistics Network 	<ul style="list-style-type: none"> • Owns its own nationwide logistics infrastructure • JD.com has 86 warehouses in 36 cities, 1,620 delivery stations and 214 pickup stations in 495 cities⁷⁵ (as of 31 March, 2014)
Payment	<ul style="list-style-type: none"> • Alipay 	<ul style="list-style-type: none"> • n/a
Other businesses	<ul style="list-style-type: none"> • Online wealth management products (e.g. Yu Ebao) • Marketing services (Alimama marketing technology platform) • Computing services/Data platform (Alibaba Cloud Computing) 	<ul style="list-style-type: none"> • Online wealth management products (e.g. Xiaojinku) • Short-term loans to its suppliers (Jing Bao Bei)
Selected recent investments	<ul style="list-style-type: none"> • Mapping service: AutoNavi • Social media: Sina Weibo • Search engine: UCweb • Department store: Intime Commercial • Pharmaceutical: CITIC 21cn 	<ul style="list-style-type: none"> • Tencent bought a 15% stake in JD.com in March 2014. As part of the transaction, JD.com acquired Tencent's B2C platform QQ Wanggou and C2C platform Paipai, as well as a minority stake in its online shopping platform Yixun

Source: IPO Filings of Alibaba, JD.com, and Internet sources; compiled by Fung Business Intelligence Centre

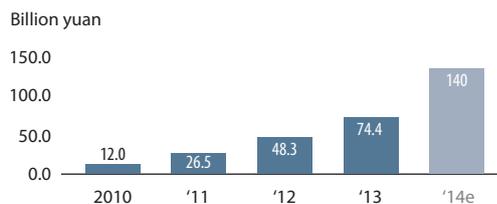
#7: Chinese shoppers increasingly favour “haitao”

While China's e-commerce sector continues to power ahead, increasing numbers of Chinese shoppers have been engaged in international cross-border transactions over recent years. Discerning Chinese consumers are now looking for authentic and high-quality imported products – ranging from high-end apparel and cosmetics to household products and food items – that

are either not available locally or are too costly. A popular approach is to buy these products via overseas online shopping platforms, an activity commonly referred to as “haitao”. According to China E-Commerce Research Centre⁷⁶, the transaction value of China's online shoppers buying on overseas online platforms reached 74.4 billion yuan in 2013, up from 12 billion yuan in 2010; the figure is estimated to reach 140 billion yuan by the end of 2014 (see Exhibit 18). According to Nielsen, 18 million people

used “haitao” in 2013⁷⁷. Most shoppers purchase from the U.S. (84%), followed by Hong Kong (58%), Japan (52%), the U.K. (43%) and Australia (39%); the most popular categories for purchases include skincare and cosmetics, women’s apparel, perfume, toys, health products, milk powder and food supplements.

Exhibit 18. Transaction value of China’s shoppers buying on overseas online platforms, 2010-2014 (estimated)



Source: China E-Commerce Research Centre

To facilitate Chinese purchases of imported goods, the country’s first pilot cross-border e-commerce platform, Kuajingtong, was launched in the Shanghai Free Trade Zone on 28 December, 2013. Kuajingtong targets the mid- to high-end market; major product categories available on the platform include shoes, luggage and handbags, imported foods, health products, baby products, skincare and cosmetics, apparel, accessories and household products. Online customers can buy cheaper products at Kuajingtong than on other online platforms, as all imported items are treated as personal goods, and are subject to the same tax rate as imposed on baggage and articles accompanying incoming travellers and on personal postal items. The rate is usually much lower than

that levied on commercial imports⁷⁸. Exhibit 19 shows the tariff on baggage and articles accompanying incoming travellers and on personal postal articles. International brands sold at kuajingtong.com are reportedly 30% cheaper than those sold in domestic offline stores⁷⁹.

Exhibit 19. Tariff on baggage and articles accompanying incoming passengers and on personal postal articles⁸⁰

Product category	Tax rate
Food, leader clothes and accessories, bags and shoes, gold, silver and jewellery, home medical supplies and equipment, kitchen equipment, furniture, cameras, books and periodicals, stationery and toys, instruments, sports equipment	10%
Apparel and accessories, textile, watches, home electronics, audio and video equipment, bicycles	20%
Luxury watches, golf and golf equipment	30%
Cosmetics, alcoholic beverages, tobacco	50%

Source: China Customs. March 2012

Witnessing the huge potential of China’s e-commerce market, some overseas online retailers such as Amazon have sought to accelerate their expansion in the country by setting up operations in the Shanghai Free Trade Zone. Amazon is to open its global platform to Chinese consumers, enabling them to order products previously available only for delivery in other countries. Furthermore, the U.S.-based firm is to build a warehouse to serve Chinese export companies. It will also offer new financial services, such as cross border online payment solutions⁸¹. In another case, Wal-Mart-owned Yihaodian has announced that it will partner with Kuajingtong to launch a “Yihaohaigou” project, selling imported

products via the Shanghai Free Trade Zone. This could lower the prices of imported goods and shorten delivery times⁸².

#8: E-commerce giants eye the fresh food market

In response to Chinese consumers' growing demand for healthy and safe foods, increasing numbers of online platforms selling fresh produce have emerged. Some Chinese e-commerce giants have also ventured into the online grocery market over recent years. For instance, Amazon China launched a seafood platform in June 2013, while the following month JD.com launched a fresh food platform in conjunction with China National Cereals, Oils and Foodstuffs Corporation. Other major online platforms specialising in selling fresh food produce include Caichongwang.com and Zhaixian.com (see Exhibit 20, on the next page).

An effective supply chain is a vital element for success in the fresh food business. Some Internet retailers have worked directly with farmers or upstream suppliers to shorten the supply chain and cut costs⁸³. Others have cooperated with overseas parties to expand product offerings for consumers. For example, Tmall partnered with New Zealand Trade and Enterprise to launch a six-day promotion in April 2014 to sell seafood, meat and wine to Chinese consumers at large discounts. Consumers can order online and receive the products within 72 hours⁸⁴. Then again, as O2O has grown out of the digital era, some platform operators such as Caichongwang.com have explored different aspects of their O2O initiatives,

expecting to accumulate more customers. As a case in point, Caichongwang.com is partially owned by Tianfu Group, which also owns Tianfu convenient stores, one of the country's large convenience chains; the platform operator can leverage Tianfu's extensive store network to promote its platform. Equally, Caichongwang's QR codes are displayed in Tianfu's 2,300 stores to help drive customers to the online platform⁸⁵.

Yet despite the growing popularity of fresh food e-commerce platforms, there are challenges ahead. High logistics and delivery costs, along with shortfalls in cold chain logistics facilities, pose major obstacles.

#9: Traditional industries jump on the online bandwagon

The impact of e-commerce in China is more significant than ever. Not only are many bricks-and-mortar retailers embracing e-commerce initiatives, but some traditional industries such as real estate, healthcare and automobile are also taking up the online challenge.

China Vanke Co. (Vanke), China's largest property developer, exemplifies the point. The company has teamed up with Taobao to launch a programme offering discounts to home buyers who also shop on Taobao. These home purchasers were able to receive discounts when buying apartments or villas in Vanke's 23 projects in 12 cities over the period 15 August to 30 September, 2014. The discount rates were calculated on the basis of the amount of money shoppers spent on Taobao, and could range up to 2 million yuan. More than 60,000 people

Exhibit 20. Selected major online platforms selling fresh food products

Platform selling fresh food produce	Launch year	Product categories
Miao.tmall.com (under Tmall)	2014	Imported fruit, imported seafood, imported meat
Channel.jd.com/chaoshi (under JD.com) ⁸⁶	2013	Vegetable, fruit, seafood, meat, imported food, regional food, healthcare products, wine and tea, oil
Yummy77 ⁸⁷	2013	Vegetable, fruit, seafood, dairy products, snacks, wine and tea
Zhaixian.com	2012	Vegetable, fruit, seafood, nuts, meat, eggs, wine, other grocery products
SF Best (under SF Express)	2012	Imported food, vegetable, fruit, seafood, wine, biscuits, other grocery products, baby food, healthcare products
Benlai.com	2012	Vegetable, fruit, seafood, baby food, other grocery products, organic food, imported food, bread, wine and tea
Caichongwang.com	2011	Vegetable, fruit, seafood, snacks, meat and eggs, rice, wine and tea, regional foods
Womai (under COFCO)	2009	Imported food, vegetable, fruit, seafood, wine, other grocery products, baby food, cosmetics, kitchenware

Source: Internet sources; compiled by Fung Business Intelligence Centre

reportedly received discount coupons on the campaign's first day⁸⁸. In another case, China's property giant Wanda Group recently formed a partnership with two of China's largest Internet companies, Tencent and Baidu, to set up an e-commerce joint venture (JV). Wanda Group holds 70% of the 5 billion yuan e-commerce company, and Baidu and Tencent each own a 15% stake. The three companies will cooperate in specific areas: Baidu provides Big Data services and integrates its group buying website, Nuomi.com within the JV, along with Baidu Map. Tencent is integrating its WeChat online payment service, QQ and other social networking services, while the JV is expected to facilitate Wanda Group's O2O development⁸⁹.

At the same time, online retailing opportunities abound in the healthcare sector. Of particular significance is the fact that the China Food and Drug Administration has officially approved three

e-commerce players to distribute medicines online; they are the pharmaceutical information platform operators 95095.com and Babaifang, as well as Wal-Mart's online retailing arm, Yihaodian⁹⁰. These players have each been granted a qualified third party medicine trading license, formally allowing them to distribute medical devices, nutritional supplements as well as over the counter (OTC) medicines online. It is also noteworthy that in January 2014 Alibaba invested 1 billion yuan in Citic 21 CN, the owner of 95095.com. The Internet giant has requested qualified medicine e-tailers on its B2C platform Tmall to set up their operations on 95095.com⁹¹. E-commerce is set to become the next major theme for pharmaceutical distribution.

Selling automobiles online is another trend to watch. SAIC Motor, one of China's biggest automakers, launched its online site, chexiang.com, in March 2014⁹². The online platform has pulled together its four

Exhibit 21. Selected “Taobao villages”, as of December 2013

Taobao Village	Location				Product categories	Population	No. of on-line stores
	Province	City	County	Town			
Shaji town	Jiangsu	Xuzhou	Suining	Shaji	Furniture	60,000	>2,000
Dazhong village	Jiangsu	Suqian	Sucheng	Gengche	Furniture	900 households	300
Yanji town	Jiangsu	Suqian	Shuyang	Yanji	Wood	48,000	>2,000
Donggaozhuang village	Hebei	Xingtai	Qinghe	Yang'er-zhuang	Wool	1,800	>600
Baigouxincheng	Hebei	Baoding	Gaobeidian	Baigouxincheng	Bags and suitcases	50,000	>3,000
Qingyanliu village	Zhejiang	Jinhua	Yiwu	Dongjiang Road	Commodities	8,000	2,200
Bainiu village	Zhejiang	Hangzhou	Lin'an	Changhua	Nuts	1,500	50
Xindu village	Zhejiang	Hangzhou	Lin'an	Qingliang-feng	Nuts	1,800	>20
Beishan village	Zhejiang	Lishui	Jinyun	Hu	Outdoor apparel	70 households	>100
Xishan village	Zhejiang	Lishui	Songyang	Dadongba	Furniture	980	32
Peixie village	Fujian	Longyan	Xinluo district	Xiaochi	Bamboo mats, decoration	700	>60
Zaomei village	Fujian	Quanzhou	Anxi	Xiangxing	Vine and metal decoration	1,650	>1,000
Wantou village	Shandong	Binzhou	Boxing	Jinqiu Road	Straw-plaited homeware	4,000	1,000
Gujia village	Shandong	Binzhou	Boxing	Boxing	Raw fabrics	n/a	>100
Dinglou village	Shandong	Heze	Cao	Daji	Stage costumes	1,100	>300
Zhangzhuang village	Shandong	Heze	Cao	Daji	Stage costumes	1,500	>240
Shuanglin town	Jiangxi	Xinyu	Fenyi	Shuanglin	Apparel, local specialties	n/a	>600
Junpu village	Guangdong	Jieyang	Jiedong district	Xichang	Food, apparel	2,700	>1,500
Lirendong village	Guangdong	Guangzhou	Panyu district	Nancun	Apparel	5,486	>200
Xi'ao village	Zhejiang	Wenzhou	Yongjia	Qiaoxia	Toys	230 households	>500

Source: Aliresearch, December 2013

passenger car businesses, eight passenger car brands, with over 2,000 distributors. Customers can buy automobiles online at a discount and collect them directly from the distributors.

#10: Online retailers go rural; “Taobao village” a unique feature

Rapid urbanisation and increased online spending by rural residents have made lower-tier cities and rural areas the new target markets for online retailers. According to a report by Aliresearch, the growth rate of online transactions in counties and villages outpaced that of cities by 13.6 percentage points in 2013⁹³. Some e-commerce giants such as Alibaba, JD.com and Dangdang (the latter being China’s largest online bookseller), have each expressed their intentions to further expand in the rural market.

In turn, an increasing number of rural residents are leveraging e-commerce platforms to make a living. As of November 2013, there were more than one million online retailers in the rural areas. In particular, Taobao has become increasingly important to rural communities across China. Groups of local residents or manufacturers in certain villages have set up online stores on Taobao; these are commonly known as “Taobao villages”⁹⁴. According to a report released in December 2013 by Aliresearch⁹⁵, there were 20 “Taobao villages” across the country, creating about 60,000 jobs in peripheral industries such as packaging, logistics, marketing and training. Most “Taobao villages” are located in Zhejiang, Guangdong, Jiangsu, Shandong,

Jiangxi, Fujian, and Hebei provinces⁹⁶ (see Exhibit 21, previous page).

It is noteworthy that many online shops in the same “Taobao village” sell similar products, forming an online industry cluster. For instance, Qingyanliu village in Yiwu city, Zhejiang Province, is the top “Taobao village” in terms of e-commerce sales, focusing mainly on small commodities and general merchandise; Baigao, another major “Taobao village” located in Hebei Province, specialises in selling luggage. Recently, some well-established online shops have shifted their operations from Taobao to Tmall, Alibaba’s B2C platform; others have built their own brands. Munuan Straw House, an online store on Tmall selling its own straw furniture brand “Munuan”, originated in Wantou, a “Taobao village” in Shandong⁹⁷.

The growth of “Taobao villages” has brought vitality to rural areas, and marked an important step in the process of rural modernisation. Specifically, it helps lift the incomes of rural residents and narrows the urban-rural income gap. Some “Taobao villages” such as Junpu village in Guangdong, with the support of local government, has taken a step further by opening a “Taobao university” to teach people how to sell online. The local government in Junpu village has provided support by offering free wireless Internet connections to residents, as well as tax credits⁹⁸. ■

Conclusions

The future of e-commerce looks promising for many businesses, underpinned by growing numbers of e-commerce and m-commerce users, the greater sophistication of mobile technologies and online payments and an extensive logistics and delivery system. That said, fierce competition is here to stay. Moreover, rapidly evolving consumer needs constantly reshapes both the online and offline space. To survive and prosper in this environment, businesses need to keep the following suggested imperatives in mind:

- Make full use of Big Data to better understand consumer needs and preferences
- Embark on a comprehensive mobile and social media strategy
- Leverage the latest technologies to improve in-store experiences
- Customer “experience” is the focus of O2O; but there is no one-size-fits-all strategy; players have to come up with their own O2O strategies to adapt to changing customer needs
- Leverage the vast web of businesses and huge traffic flows of China’s e-commerce giants; retailers can set up online stores on these e-commerce platforms, or partner with them, to roll out digital marketing campaigns, mobile payment solutions and other O2O initiatives
- Improve the quality of products and services; enrich product offerings, and refine tailored merchandise and assortments for different consumer segments. ■

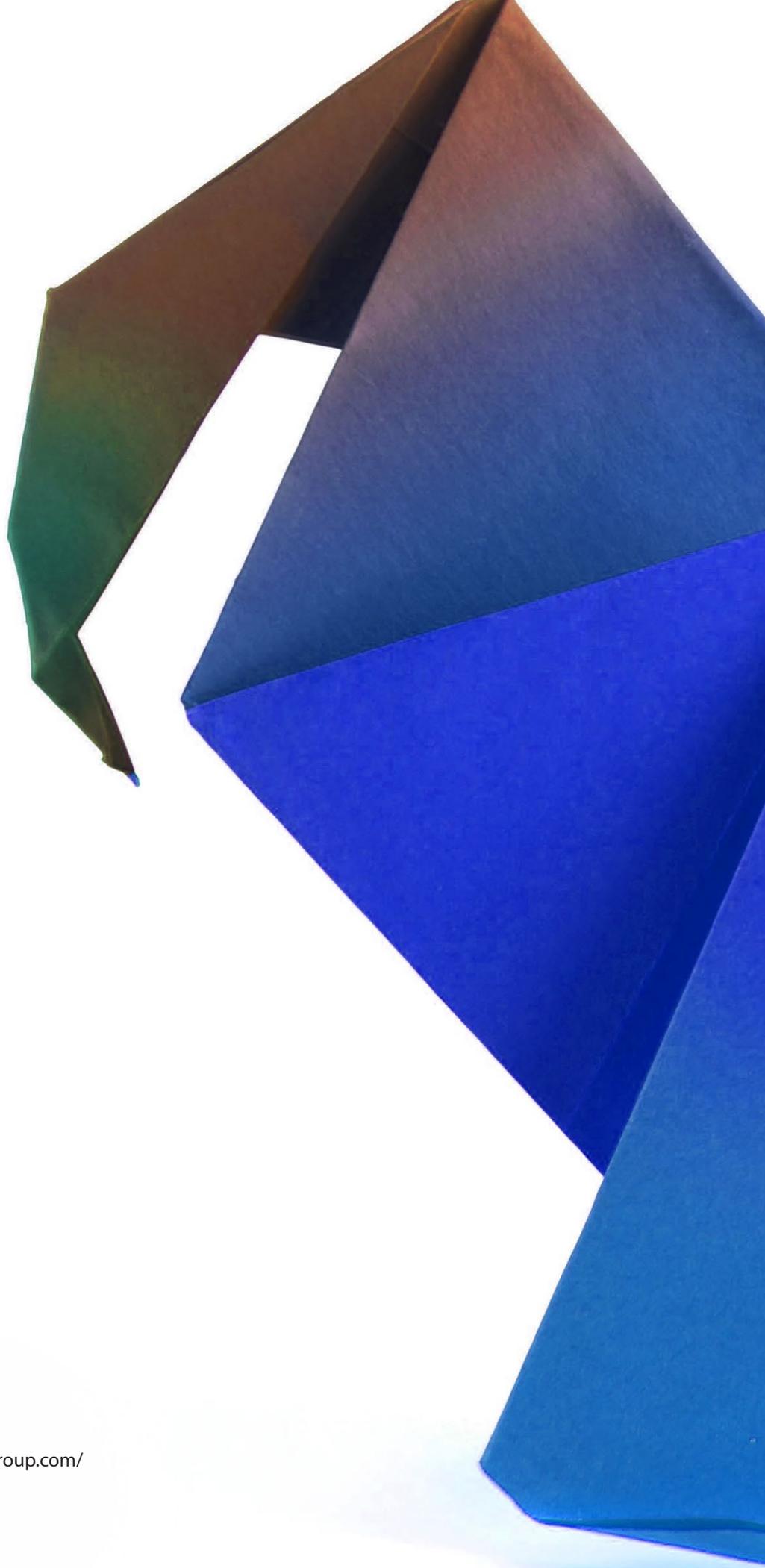
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