AN INTRODUCTION TO E-COMMERCE IN CHINA
ABOUT
SOVEREIGN
CHINA

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How Sovereign Can Help You?
With offices in more than 30 countries, The Sovereign Group is equipped to help you with your market entry and corporate services needs throughout the globe. In the Asia Pacific, Sovereign has the capabilities to assist you in a number of areas, including:

- Market research and market assessment
- Partner search and vetting
- Market entry strategy development
- Location analysis
- Corporate structuring
- Tax and accounting services
- Other consulting and corporate services

Enquiries
Should you have e-commerce related enquiries, or need information on other areas of the China market, please visit our website at Sovereigngroup.com/China or contact Mark Ray at Mray@sovereigngroup.com

With offices in Shanghai and Beijing, Sovereign China was created by the merger of Sovereign’s existing China operations and the JLJ Group in 2013. The JLJ Group was established in 2003 to accelerate international clients’ ability to understand and operate in the China market and has successfully assisted more than 600 companies from over 50 countries with their China market entry.

Sovereign China provides a suite of services designed to lead foreign investors through the market entry process and to support them to develop long-term success in China. We are with our clients from planning to execution – from assisting with understanding the market and developing a market entry strategy, through to establishing operations and providing back office and compliance support services.
Methodology And Information Sources

Generally speaking, conducting market research in China is different and significantly more challenging than it is in developed countries because of 1) the size and diversity of the country; 2) lack of fully reliable centralized/official information databases; 3) the change is constant and extremely rapid - the whole China economic system is far from being in equilibrium. Therefore solid market research work must be based on multiple resources and activities.

In the report, sources are mentioned for charts, tables and key data; secondary sources include dozens of Chinese and English sources, including news reports, magazines, publications, various websites, government statistics, and so on. Often we mention “Sovereign analysis” as one of the sources; this refers to our elaboration and analysis of qualitative and quantitative data collected. In addition to secondary sources, Sovereign conducted a number of interviews with industry insiders and experts. A key contributor is Kung Fu Data, which provided key marketplace data for analysis.

Kung Fu Data

Kung Fu Data offered key insights and contributed to the development of this report.

As a leading analytics and optimization partner for Tmall and JD, Kung Fu Data’s mission is to level the playing field. Experts in flagship optimization and brand control, KFD works with a select portfolio of Fortune 500 brands driving revenues to number 1 in their category as well as providing TMall key account activation, third party auditing, reseller oversight, and performance management.

Kung Fu Data offers complete transparency and accountability with full dedicated resources: +70 employees, 3 bi-lingual offices in Beijing, Shanghai, and San Francisco. Our clients enjoy the highest share of brand, average unit prices, and growth rates among like competitors in category.

Disclaimer

This report is intended to provide a general overview of e-commerce in China and act as a guide for companies with interest in the China market. It is not intended to provide exhaustive coverage of the topic and readers should be aware that policies, regulations and general market conditions related to e-commerce in China evolve rapidly.

The information herein is made available on the understanding that Sovereign China is not providing legal, financial, or any other form of professional advice. Therefore, while all care has been taken to ensure the accuracy of the information in this report, Sovereign China does not accept responsibility for any losses incurred through errors or omissions in this report. Any person relying on this report does so entirely at their own discretion and at their own risk. Sovereign China strongly recommends that readers obtain independent legal, financial and related forms of professional advice prior to acting upon information in this report. Sovereign China assumes no responsibility for any company, product or service mentioned in this report, nor for any act or omission of any business connected with such products and services.
EXECUTIVE SUMMARY

Now the world’s largest, China’s e-commerce market has grown by 50% per year since 2011 and is expected to be worth USD 1 trillion by 2019. Companies looking to sell to Chinese consumers should seriously consider e-commerce as a viable and cost-effective channel to market.

In a country where traditional channels of commerce are underdeveloped, e-commerce provides Chinese consumers with an abundance of choice, accessibility, and other advantages. Millions of Chinese now have access to a huge selection of foreign and domestic products that were previously unavailable. This is especially true in the country’s developing regions, which account for a majority of the country’s geographical area.

Chinese consumers, especially the emerging middle class, are spending more than ever before on online marketplaces, spending anywhere from 17 to 27 percent of their disposable income on online purchases. Sales are especially strong in the apparel and consumer electronics categories. Other key categories include cosmetics, food & beverage products, and baby & mother care products.

Selling online in China can be as simple as shipping direct to the consumer from overseas using an express or postal services, or through engaging 3rd party service providers that can manage and facilitate nearly every aspect. Partners and service providers can assist are completely manage the logistical process, including customs clearance, platform search optimization, payment, brand building, and other important areas required to successfully get your product to Chinese consumers. If deciding to work with 3rd party service providers and partners, it is important to work with reputable companies that have worked with foreign companies before and have a successful track record.

Although the size of the market is enticing, China’s e-commerce market is not without its challenges and risks. Government policies and regulations are usually opaque, complicated and prone to changes without notice, which can be extremely frustrating or even disruptive to business plans. Companies must recognize that the Chinese e-commerce market is extremely competitive (brutally so) and unforgiving. Changes in the market dynamics can be sudden and rapid. Merely having your products listed on a Chinese marketplace does not mean that you will be successful, or even profitable.

Successful market entry via any channel requires a well thought-out strategy and an ongoing commitment of resources, even when selling through e-commerce channels. All too often companies fail to commit the necessary time and resources to their China e-commerce business and then wonder why they are failing.
CHINA IS THE WORLD’S LARGEST E-COMMERCE MARKET

- Already more than US $650 Billion in Sales
- Expected to reach US $1 Trillion by 2019

460 MILLION ONLINE SHOPPERS

Shoppers are:

- 54% and buy:
  - Electronics
- 46% and buy:
  - Apparel
  - Cosmetics
  - Home Decor
  - Maternity
  - Baby

With a disposable income of:

USD 5,000

90% OF SALES THROUGH MARKET PLACES

POSITIVES ARE THAT:
- Underdeveloped traditional retail sector
- Ready consumers
- Infrastructure developed

NEGATIVES ARE THAT:
- Brand activation can be difficult
- Highly competitive market
- Sometimes competing with own distributors and partners

CHINA’S E-COMMERCE MARKET AT A GLANCE
Market Situation

Geographically, China is a very large country that is extremely diverse and experiencing an extended period of rapid economic and social development. In many ways, China is not a single market, but rather a set of multiple markets. Because of this, traditional retail channels in China are still regionalized and highly fragmented. This creates a number of challenges and difficulties for retail companies that are looking to scale up and develop national coverage, creating the perfect environment for e-commerce to thrive.

China has become the world’s largest e-commerce market with online retail sales growing from US $20 billion in 2008 to over US $646 billion in 2015; the market is expected to reach US 1 trillion by 2019. The chart below provides an illustration of this explosive growth.

Three factors have been the main growth drivers of e-commerce in China, which include:

1. **Demand readiness** – China’s middle class now exceeds 400 million people with a national average income of US $12,000 per year and spend on average 18 to 27 percent of their disposable income on online purchases;

2. **Technology infrastructure** – There are more than 632 million internet users in China with a penetration rate of nearly 47 percent. Mobile 3G and 4G networks continue to expand and the smartphone penetration rate is about 66 percent and growing;

3. **Support infrastructure** – Logistics and delivery services have expanded rapidly in recent years. Service standards often include same day delivery at minimal cost. Furthermore, online payment platforms such as Alipay and Wechat Pay have made online payments easier as has the expanded use of credit cards.
Cannibalization of Traditional Channels

Although e-commerce sales are growing rapidly, online sales are not all supplemental to the growth of China’s retail market. In many cases, consumers are eschewing traditional channels in favour of making purchases online. As such, online sales are, to some extent, cannibalizing sales from traditional retail channels.

For example, Unilever PLC’s sales in 2014 plunged as online sales increase. Swiss food company Nestlé SA faced a similar challenge as they could not sell the bulk of their instant coffee in physical stores. Malls such as Beijing’s Zhongguancun electronics market were once packed with sellers and buyers. However, they have now evacuated as E-commerce platforms cannibalize the market.

Source: Sovereign analysis on multiple sources, including The Wall Street Journal
Importance of Marketplaces in China

Unlike e-commerce markets in much of the rest of the world, China’s e-commerce market is dominated by marketplaces rather than stand-alone websites. An e-commerce marketplace is a platform where products are listed by multiple parties and the transactions are facilitated and processed by the marketplace operator. Amazon is a well-known example of a marketplace in North America and Europe. Taobao, the largest consumer-to-consumer (C2C) marketplace, and Tmall, the largest business-to-consumer (B2C) marketplace, both under Alibaba Group, dominate the overall e-commerce retail market accounting for about 80 percent of total transactions. Within the B2C segment, Tmall accounts for almost 60 percent of the market.

The chart below illustrates the leading B2C players in China’s e-commerce industry with their approximate market share:


Tmall and JD are the two dominant B2C marketplaces

Source: Sovereign analysis based on multiple sources; Note: figures have been rounded

Key Product Categories

Apparel and consumer electronics are the most popular product categories sold online accounting for nearly 50 percent of all sales. The chart below illustrates the key product categories for online sales. China’s e-commerce market is extremely vibrant and can potentially provide companies with an affordable way to access China’s consumers. It is still important however, to understand the intricacies and unique dynamics of the market and the consumers shopping online.

E-commerce Category Sales (2015)

<table>
<thead>
<tr>
<th>Category</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Apparel</td>
<td>27%</td>
</tr>
<tr>
<td>2. Consumer Electronics</td>
<td>20%</td>
</tr>
<tr>
<td>3. Cosmetics</td>
<td>5%</td>
</tr>
<tr>
<td>4. Infant &amp; Mother Care</td>
<td>5%</td>
</tr>
<tr>
<td>5. Publications</td>
<td>3%</td>
</tr>
<tr>
<td>6. F&amp;B</td>
<td>2%</td>
</tr>
</tbody>
</table>
Chinese Consumers

China has the world’s largest online population with more than 600 million internet users. The penetration rate, however, is only about 47 percent, leaving significant room for growth. The number of online shoppers has grown rapidly from 74 million in 2008, to more than 460 million in 2015, a compound annual growth rate (CAGR) of nearly 30 percent (see chart below).

Chart: Number of Online Shoppers

The number of online shoppers has grown rapidly from 74 million in 2008 to more than 460 million in 2015.

Source: Sovereign Analysis on multiple sources

In addition to the growing number of shoppers, incomes of shoppers have also increased. Urban disposable income levels have grown at a compound annual growth rate (CAGR) of 11 percent, rising from US $2,500 in 2008 to about US $4,700 in 2014.

Chart: Disposable Income

Since 2008, urban disposable incomes have nearly doubled, and rural disposable incomes have more than doubled.

Source: Sovereign Analysis on multiple sources

Important Note

Although China’s e-commerce market provides companies with an additional means to access an extremely large consumer market, it is important for companies to understand the intricacies and unique dynamics of the market and consumers. China’s e-commerce market has its unique set of hurdles and challenges, and companies need to fully understand and commit the necessary resources to the market.
Much of the wealth is concentrated along coastal provinces and in Tier 1 cities. E-commerce is providing consumers located in the inland provinces and lower tier cities, markets underserved by traditional brick and mortar retail channels, with access to an expanded selection of both foreign and domestic products.

Online shoppers in Tier 1 cities spend the most money buying products from e-commerce channels; however, online shoppers in lower Tier cities (i.e. Tier 3 and Tier 4 cities) spend a higher percentage of their disposable income shopping online. The charts below illustrates this.

**Online consumption per online shopper (RMB)**

<table>
<thead>
<tr>
<th>Tier</th>
<th>Online Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>6,819</td>
</tr>
<tr>
<td>Tier 2</td>
<td>4,922</td>
</tr>
<tr>
<td>Tier 3</td>
<td>4,624</td>
</tr>
<tr>
<td>Tier 4</td>
<td>4,467</td>
</tr>
</tbody>
</table>

**% of disposable income spent on online shopping**

<table>
<thead>
<tr>
<th>Tier</th>
<th>% of Disposable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>18</td>
</tr>
<tr>
<td>Tier 2</td>
<td>17</td>
</tr>
<tr>
<td>Tier 3</td>
<td>21</td>
</tr>
<tr>
<td>Tier 4</td>
<td>27</td>
</tr>
</tbody>
</table>

Source: McKinsey Global Institute and Sovereign Analysis

Fifty-four percent of online shoppers are male, while 46 percent are female. Male shoppers usually purchase electronic products while female shoppers tend to purchase apparel, cosmetics, home décor, maternity and baby products.

The majority of online shoppers are between the ages of 20 and 39 years old with incomes between RMB 1,000 to RMB 5,000 per month. The charts below provide an age and income snapshot of China’s online shoppers:

**Age of China’s Online Shoppers**

- 20-29: 56%
- 30-39: 23%
- 40-49: 8%
- >50: 3%
- <20: 10%

**Monthly Income of China’s Online Shoppers (RMB)**

- 1,001-3,000: 36%
- 3,001-5,000: 29%
- <=1,000: 12%
- >8,000: 11%
- 5,001-8,000: 12%

Source: Sovereign Analysis on multiple sources, including CNNIC

Note: Income figures are the actual estimated incomes of the individuals shopping. However, many individuals are subsidized by their parents in various ways and are able to spend most, if not more than, their reported incomes.
Aside from the general readiness of Chinese consumers discussed earlier, there are a number of reasons why there is a preference to purchase goods online. Four key reasons are:

**Choice** – The traditional brick and mortar retail sector is significantly underdeveloped. E-commerce provides consumers with greater choice of products.

**Convenience** – Delivery services have evolved rapidly in China. In most cases, online purchases are delivered within one or two days.

**Price** – Competition online is extreme with price often being a key factor. The prices offered through online channels tend to be more transparent and are many times the lowest global price for a product. Furthermore, full duties and VAT are usually not being paid. Online consumers tend to get a better price than they would at traditional brick and mortar stores.

**Trust** – When purchased on a marketplace, retailers are required to accept returns and exchanges, no questions asked, which is uncommon for small brick and mortar retail stores. Furthermore, a marketplace will usually attempt to ensure that goods sold are not counterfeit.

### E-Commerce Ecosystem

China’s e-commerce ecosystem consists of many stakeholders. In many ways, it differs significantly from the ecosystem in other markets, especially in the areas of product search, delivery, and operations. The ecosystem consists of marketplaces and many third party service providers that support companies with logistics, payment processing, online store management, and in other areas. A high-level ecosystem map broken down by function is illustrated below:

<table>
<thead>
<tr>
<th>Ecosystem Segment</th>
<th>Description</th>
<th>Examples</th>
</tr>
</thead>
</table>
| **Product Search** | • Brand Website  
• APP / Mobile markets  
• Marketplace Platforms | Online marketing channels such as search engine optimization, social media, and traffic optimization within domestic and cross-border marketplace platforms | Google  
Tmall  
JD |
| **Payment** | Third party service providers that facilitate payments through credit card or bank account | Paypal  
Alipay |
| **Warehousing / 3PL** | Companies providing 3rd party logistics services (3PL) including the physical storage of goods | USA Fulfillment  
Cainiao |
| **Domestic and international delivery** | Express companies providing delivery services to end customer | UPS  
FedEx  
SF Express  
SinoTrans |
| **Software & Infrastructure** | Software tools such as ERP, CRM, as well as the physical IT infrastructure to support online sales | Oracle  
Magento  
China Netcloud |
| **Integrated Partners and TP Partners** | Partners to whom brands can outsource complete or partial management and execution of their e-commerce operations | Digital River  
Kung Fu Data |

Source: Sovereign analysis on multiple sources including interviews with industry experts
Product Search

**Brand website**
In China, company websites are primarily used for brand building or consumer engagement. A brand’s website in China is not typically seen as a direct sales platform; sales transactions generally take place on marketplaces. Few consumers in China are bi-lingual. Companies targeting Chinese consumers should make their site available in Chinese characters.

**Search engines and search engine optimization**
The Chinese government’s Great Firewall of China blocks access to key websites and search engines, such as Google. Therefore, companies should focus Search Engine Optimization (SEO) investment on Chinese search engines like Baidu. However, as most transactions are conducted on marketplace, optimizing the in-platform SEO will be more beneficial assuming the company has a store on the marketplace.

**Social media**
Social media such as WeChat and Weibo are important to the overall marketing of a brand in China. WeChat currently has over 500 million subscribers in China and is extremely popular among the younger and affluent demographic. Social media is used by consumers to rate and discuss products, and can also be used by brands for marketing.

A legal entity in China may be required in order to establish a corporate account on some of China’s social media platforms.

**APP/mobile markets**
Mobile applications (APPs) are extremely popular in China due to the high penetration rate of smartphones. Many leading e-commerce marketplace platforms (e.g. Tmall, Jumei, Yhd, and JD) have launched mobile applications allowing consumers to shop conveniently on mobile phones and tablets. Additionally, JD cooperates with Wechat to sell some products on the Wechat APP, as illustrated in the graphic in the sidebar.

**Marketplaces**
The marketplace model dominates China’s e-commerce landscape, accounting for more than 90% of online retail transactions and is one of the most important aspects of the e-commerce ecosystem. There are several types of marketplaces in China, including Business-to-Business-to-Consumer (B2B2C), such as JD, Business-to-Consumer (B2C), such as Tmall, and Consumer-to-Consumer (C2C), such as Taobao. Business-to-Business (B2B) sites such as Alibaba also exist in the market.
In addition to large domestic marketplaces, there are also cross-border marketplaces such as Tmall Global, as well as smaller specialized marketplaces that focus on a handful of product categories such as Mei.com. Marketplaces will be discussed in more detail later.

Payment

Third-party payment platforms
Third-party payment platforms are an extremely popular method for purchasing goods online with more than 358 million users. The majority of payments are made through China’s two dominant platforms; Tencent’s WeChat payment and Alibaba’s Alipay. Apple Pay was launched in China in late February 2016. It is currently unclear how well Apple Pay will be received by Chinese consumers.

Credit cards
The use of credit cards has been expanding in recent years with penetration rates exceeding 45 percent, making online transactions much easier to complete. Chinese credit cards, such as Visa and MasterCard, are accepted by domestic and cross-border marketplaces and should work on websites hosted overseas; however the settlement currency will most likely need to be U.S. dollars.

Fulfilment

3rd party logistics providers (3PLs)
In some cases, fulfilment can be managed by the marketplace platform. However, some companies may want to use an independent Third Party Logistics (3PL) provider. These 3PLs can manage a retailer’s supply chain and usually offer warehousing services.

Delivery

International delivery
Shipping fees and timing will pose a major hurdle to companies if the products are shipped from overseas as consumers, who are used to receiving online orders from within China within just a few days, may be unwilling to wait several weeks for a delivery from outside the country. Product returns will also further exacerbate any challenges from shipping products from overseas into China.

Domestic delivery
If products are shipped from within China, delivery times can range from the same day to a few days. Many international delivery firms operate through partners for delivery within mainland China, but may be limited to a few key cities. Domestic delivery companies such as Shunfeng and EMS are very popular and have vast delivery networks throughout China.
Operations / Support

Third party management company / Tmall partners (TPs)
Third party management companies, also known as TPs or Tmall Partners, are one of the most important partners for a foreign company to consider for entry into China’s e-commerce market. TPs are third-party companies that manage the store page of a retailer in a marketplace platform such as Tmall. TPs also have relationships with the platform and can assist in driving traffic to a brand’s page. In some cases, they can act as turn-key solution providers and also manage logistics, in-platform media buys and promotional events. TPs can also utilize digital optimization information, usually from a data analytics company, to optimize marketing efforts.

The graphic below better illustrates some of the services a TP can provide.

E-commerce management software providers
E-commerce management software providers and content management systems, such as Magento, allow companies to actively manage their e-commerce activities, sales analysis and other tools to optimize activities. These types of support systems can be used by the retailer themselves or by a third party management company, also known as a TP.

IT infrastructure
China’s IT infrastructure is still developing and can pose problems with regard to internet speeds when sites are outside of China are accessed due to “The Great Firewall”, which can effectively throttle internet traffic. Unfortunately, there is little a foreign company can do to address this challenge if its servers are located outside China. Companies may choose to establish servers inside China or in one of China’s Free Trade Zones, which would require the assistance of partners providing infrastructure support.
Government

The Chinese government affects the e-commerce ecosystem through policy and trade measures, such as import regulations, tariffs and testing requirements. The GACC (General Administration of China Customs) and SAIC (State Administration for Industry and Commerce) are the two main bureaus foreign e-commerce companies should be aware of.

The Chinese Government, up to this point at least, has allowed e-commerce to develop without a great deal of intervention. Some cross-border e-commerce transactions however, are attracting the government’s attention due to the circumvention of import taxes and other regulations.

The Chinese government has introduced a number of policies to support and regulate e-commerce. Policies have been evolving rapidly in recent years and are expected to continue to do so.

Important Note

Although China’s e-commerce ecosystem is complicated, foreign companies should focus on understanding the marketplace platforms and identifying a strong TP partner to work with. These two areas are critical for success in the market. Identifying and vetting 3rd party logistics providers (3PLs) will also be important and could affect the company’s distribution strategy.
ENTERTING THE CHINA MARKET

Traditional Entry

There are several options available to companies looking to enter the China market. One such option is to establish a company (foreign invested enterprise, or FIE) in order to conduct commercial activities and to support partners in the market.

Establishing a legal entity in the form of a foreign invested enterprise (FIE) such as a Wholly Foreign Owned Entity (WFOE) or a Joint Venture (JV) in China is a front loaded process that can be quite arduous due to the amount of bureaucratic red tape. Typically, the registration process can take anywhere from three to nine months to complete, plus any time it takes to conduct due diligence on potential partners.

After establishing a legal entity in China, local foreign invested enterprises are able to conduct a range of commercial activities depending on the licenses they have, and are eligible to establish a store on one of China’s domestic e-commerce marketplaces. If the brand has set up an FIE in china, they are also able to setup a flagship store on one of China’s domestic e-commerce marketplaces. (The types of stores available on marketplaces are discussed in more detail below.)

Alternatively, foreign companies may identify a partner or partners to import and distribute their products in mainland China. Distribution can sell a company’s products through brick and mortar retail stores and/or through e-commerce channels. Distributors are able to setup stores on marketplaces. Depending on the licensing and IP arrangements, a distributor or partner can setup a single brand store on a market place or even a flagship store.¹

For more information on setting up a legal entity in China, please refer to Sovereign’s China Market Entry Handbook, which can be downloaded at:

https://www.sovereigngroup.com/china/china-additional-services/china-market-entry-handbook/

¹ VAT of most products in China is 17%; however, VAT of some products (e.g. seafood) is 13%
Setting Up On A Domestic E-commerce Marketplaces

Overview
China’s e-commerce market can be divided into two basic categories: marketplaces and independent websites. Unlike much of the rest of the world, e-commerce in China is dominated by the marketplace model, which accounts for more than 90 percent of total transaction volume. Websites established by independent merchants, even large retailers, account for little in the way of transaction volume and are primarily used as marketing tools. Independent online retailers suffer approximately a 4 percent EBITDA\(^2\) loss while merchants operating on marketplaces experience a 9 percent positive EBITDA\(^3\).

The marketplace model has taken root in China for two reasons; firstly, the underdeveloped off-line retail industry, and secondly, the difficulty in setting up an independent retail site, which requires a significant amount of time and investment. Marketplaces are especially advantageous to merchants lacking the volume of sales to justify such a large investment.

For individual and small scale sellers, the biggest advantage of selling through marketplaces is tapping into the huge aggregate traffic flow that the sites have developed. Furthermore, marketplaces assist businesses in quickly launching store fronts with minimal upfront costs, providing many of the tools the merchant needs.

For the consumer, marketplaces offer a convenient location to shop and often have some consumer protections in place. These may include return policies and assurances that the products are genuine, which is especially important as counterfeit products are relatively common in China.

There are a number of different marketplaces operating under various models, such as a hypermarket or online mall. Companies should make informed decisions on which marketplace is most suitable for their products.

<table>
<thead>
<tr>
<th>Model</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hypermarket</td>
<td>The platforms/marketplaces act as hypermarkets, buying products from producers/distributors and fulfilling orders to customers. JD.com and Amazon</td>
</tr>
<tr>
<td></td>
<td>(when Amazon is fulfilling the order) are examples of this model.</td>
</tr>
<tr>
<td>Online Mall</td>
<td>These platforms/marketplaces allow business to sell to consumers via store-fronts, also known as online malls. Tmall is an example of this. Amazon</td>
</tr>
<tr>
<td></td>
<td>also uses this model when products are not fulfilled by third party companies on the platform.</td>
</tr>
<tr>
<td>Bazaar</td>
<td>These platforms/marketplaces allow individuals to sell products to other consumers; effectively an online bazaar. Taobao and Ebay are examples of</td>
</tr>
<tr>
<td></td>
<td>this model.</td>
</tr>
</tbody>
</table>

Source: Sovereign analysis on multiple sources
Note: Various B2B models exist as well; however, these are not included in the above table as this report focuses on the consumer aspect of e-commerce. Furthermore, it is possible for marketplaces to incorporate multiple models. For example, JD.com operates both a B2B2C (hypermarket) and B2C (online mall) model in their marketplace.

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2 | EBITDA – Earnings before interest, taxes, depreciation and amortization  
3 | Source: multiple sources including McKinsey Global Institute
Hypermarket model

A hypermarket is a model in which the foreign company sells their product directly to an online platform. This is similar in many ways to selling to a distributor. In this case, the online platform manages all aspects of sales, distribution and marketing, making it a relatively simple transaction for the foreign company. With this model, the company is not directly involved in e-commerce in China, but rather selling to an e-commerce platform, making it a more straightforward and simple transaction.

Online mall model

The online mall model allows companies to setup “stores” on the marketplace which are operated by the company or a partner. In this case the marketplace acts as the platform in which the stores operate. There are typically three types of stores available on marketplaces using an online mall model, which are detailed below.

Flagship Store – Only the brand or the brand’s master license holder with full rights to IP can open a flagship store. For domestic platforms, a legal entity in China must exist. A flagship store has the highest priority for MXD (Ming Xing Dian) traffic (free live traffic from the platform) and has all media channels available to it. If run properly, the flagship store can manage resellers (exclusive shops), acting as a brand control tool, set brand standards, and capture revenue through the brand’s own channel.

Exclusive Shop – An exclusive shop is a single brand store front on a marketplace that is typically run by an authorized reseller of the brand. The reseller has rights to use some of the brand’s IP, for example the brand logo.

Boutique Store – A boutique store is a multi-brand store front. The store front may not have any relationship with the brand as it is just acting like a re-seller, usually with several different brands being sold.

Bazaar model

A bazaar is model in which individuals sell their products directly to consumers via an online platform. In this case, the online platform acts as the intermediary only. The platform may be integrated with other service providers such third party payment or logistics providers. A company or its partners can setup stores on bazaars in order to sell products if the requirements of the platform are met. However, trust is a concern among consumers shopping on bazaars and selling products on a bazaar may impact the company’s brand.
Key domestic marketplaces

Tmall, JD, and YiHaoDian are China’s leading marketplaces, and collectively have over 600 million registered users. These marketplaces operate through a hypermarket and/or online mall model. Some marketplaces sell general merchandise, such as JD.com, while others specialise in specific product categories, such as YiHaoDian. In June 2016, Walmart sold YiHaoDian to JD.com.

Tmall (www.tmall.com)
Launched by Alibaba Group in 2008, Tmall is China’s largest online marketplace for domestic and foreign brands and their partners. Tmall offers flagship store fronts for brands, exclusive shops for exclusive resellers, and boutique multi-brand stores.

JingDong (www.JD.com)
Jingdong is one of China’s key marketplaces and the largest online direct sales company. Based in Beijing and traded on Nasdaq, the company’s original B2C marketplace went online in 2004. In 2007, the domain name changed to 360buy.com and in 2013 it changed to JD.com.

YiHaoDian (YHD)
Launched in 2008, YiHaoDian is a Shanghai-based marketplace focused on selling premium groceries. Walmart began investing in the company in 2011 and eventually completed a full buyout in July 2015. The company is licensed to directly import and distribute goods from overseas. In June 2016, Walmart sold YiHaoDian to JD.com.
In addition to Tmall, JD and YiHaoDian, there are numerous specialized marketplaces in China. In recent years the number of new marketplaces has been growing rapidly. The chart below is a small sample.

<table>
<thead>
<tr>
<th>Name</th>
<th>Website</th>
<th>Key Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amazon</td>
<td><a href="http://www.amazon.cn">www.amazon.cn</a></td>
<td>General merchandise</td>
</tr>
<tr>
<td>Dangdang</td>
<td><a href="http://www.dangdang.com">www.dangdang.com</a></td>
<td>Books</td>
</tr>
<tr>
<td>Tmall Grocery</td>
<td><a href="http://www.chaoshi.tmall.com">www.chaoshi.tmall.com</a></td>
<td>F&amp;B</td>
</tr>
<tr>
<td>SF Best</td>
<td><a href="http://www.sfbest.com">www.sfbest.com</a></td>
<td>F&amp;B</td>
</tr>
<tr>
<td>Fields</td>
<td><a href="http://www.fieldschina.com">www.fieldschina.com</a></td>
<td>F&amp;B</td>
</tr>
<tr>
<td>Epermarket</td>
<td><a href="http://www.epermarket.com">www.epermarket.com</a></td>
<td>F&amp;B</td>
</tr>
<tr>
<td>51Shuichan</td>
<td><a href="http://www.51shuichan.com">www.51shuichan.com</a></td>
<td>Seafood</td>
</tr>
<tr>
<td>Fruit Day</td>
<td><a href="http://www.fruitday.com">www.fruitday.com</a></td>
<td>Fruit</td>
</tr>
<tr>
<td>Maijiuwang</td>
<td><a href="http://www.maijiuwang.com">www.maijiuwang.com</a></td>
<td>Alcohol &amp; spirits</td>
</tr>
<tr>
<td>Yes My Wine</td>
<td><a href="http://www.yesmywine.com">www.yesmywine.com</a></td>
<td>Wine</td>
</tr>
<tr>
<td>Winekee</td>
<td><a href="http://www.winekee.com">www.winekee.com</a></td>
<td>Wine</td>
</tr>
<tr>
<td>VIPSHOP</td>
<td><a href="http://www.vip.com">www.vip.com</a></td>
<td>Fashion / luxury</td>
</tr>
<tr>
<td>Mei</td>
<td><a href="http://www.mei.com">www.mei.com</a></td>
<td>Fashion / luxury</td>
</tr>
<tr>
<td>Vancl</td>
<td><a href="http://www.vancl.com">www.vancl.com</a></td>
<td>Apparel</td>
</tr>
<tr>
<td>Gome</td>
<td><a href="http://www.gome.com.cn">www.gome.com.cn</a></td>
<td>Electronics / appliances</td>
</tr>
<tr>
<td>Suning</td>
<td><a href="http://www.suning.com">www.suning.com</a></td>
<td>Electronics / appliances</td>
</tr>
<tr>
<td>LAMALL</td>
<td><a href="http://www.LAMALL.com">www.LAMALL.com</a></td>
<td>Baby products</td>
</tr>
<tr>
<td>Muyingzhijia</td>
<td><a href="http://www.muyingzhijia.com">www.muyingzhijia.com</a></td>
<td>Maternity and baby products</td>
</tr>
</tbody>
</table>

Source: Sovereign analysis
Marketplace restrictions and requirements

If your company intends to sell products directly on a domestic marketplace such as Tmall or JD’s online mall, a legal entity such as a Joint Venture (JV) or a Wholly Foreign Owned Enterprise (WFOE) is required in China. Furthermore, the specific marketplace may have other requirements, including trademark seasoning, registered capital requirements and years in operation.

Alternatively, companies can work with platforms that act as a hypermarket, or a local partner that can import and distribute goods. Your local partner may be able to setup an e-commerce store front or use their existing store front on various marketplaces.

“Double 11” – Singles Day

November 11th is “Singles Day” in China, which is a promotional sales day launched in 2009 by Alibaba Group, the operator of Tmall and Taobao, China’s two largest marketplace platforms. Singles Day, tantamount to an online version of Black Friday, caught on rapidly and sales grew from RMB 1.9 billion (US $ 300 Million) in 2010 to RMB 91.22 billion (US $ 14.33 billion) in 2015. The success of Single’s Day has prompted other platforms to also run their own Single’s Day style promotions. Double 11 is now an entrenched sales event for all major e-commerce players and has become a major bonanza with huge turnover.

However, the sales numbers represent a blitz in buying for a 24 hour period. The weeks leading up to November 11 and the weeks following tend to be relatively slow periods. Furthermore, merchandise is heavily discounted, resulting in virtually zero margins and the official figures do not account for returned merchandise.

Retailers participating in Double 11 are required to provide deep discounts, virtually eliminating any margins. However, sales generated during Double 11 affect the retailer’s overall traffic and can boost search traffic in the future.
Entering Through Cross-Border E-commerce

Selling products in China through cross-border e-commerce channels is a lower risk approach to the market as it requires relatively little investment from the company. Cross-border e-commerce has expanded significantly over recent years and the growth is expected to continue in the coming years.

Since 2012, the Chinese government has done little to restrict the development of cross-border e-commerce, allowing it to expand and grow in a relatively unregulated environment. This has recently been changing, however, with the introduction of The Positive List (discussed later) and a reduced VAT that is now being collected on cross-border goods. Still, this model offers foreign retailers a means to reach Chinese consumers without establishing a legal entity in China. Many foreign retailers have used this business model to test the market in China before actually establishing businesses in China.

Cross-border models

There are two models to approach the market via cross-border e-commerce:

1. **Company’s existing foreign (non-Chinese) website**
   It is the easiest way to approach the market and if the brand is already activated in the market can be a relatively simple way to sell to the market. However, if the brand awareness is not extremely high, this method is unlikely to yield results as Chinese consumers typically shop on marketplaces.

2. **Cross-border marketplace**
   Cross-border marketplaces such as Tmall Global and JD Worldwide offer companies access to the aggregate traffic of the marketplace without having to establish a legal entity in China, or sell through partners that list on domestic marketplaces. Cross-border marketplaces operate in a similar manner to domestic marketplaces as discussed earlier; there are hypermarkets and online malls.

There are currently two typical models for logistics: 1) Direct Mail and 2) Bonded Warehouse (Forward Deployed Inventory). For the Direct Mail model, a customer places an order, either on a registered cross-border e-commerce platform or through the company’s website and then the product(s) will then be shipped by direct mail to customers directly from overseas locations. In the Bonded Warehouse model, which is often used when utilizing a cross-border marketplace, products are shipped in bulk and stored in a bonded warehouse in a cross-border e-commerce free trade zone. When a customer places an order the product(s) will be shipped to the customer from the

A recent Nielson study found that 38% of shoppers in tier 1 cities and 27% of shoppers in Tier 2 cities make cross-border purchases online. Cross-border e-commerce transactions are expected to continue growing. However, it is important to note that cross-border transactions are still only a fraction of overall e-commerce transactions.

In addition to standard cross-border marketplaces, there are also marketplaces for “Daigou” shoppers, which connect individual shoppers overseas with customers in China. Daigou marketplaces act as a peer-to-peer platform. They are not necessarily useful for brands to sell products, but can be instrumental in brand activation.
bonded warehouse. As individual parcels, customs clearance is usually a non-issue. However, new restrictions are being put in place with the introduction of the Positive List (discussed later).

The following three are prominent cross-border e-commerce marketplaces.

**Tmall (www.tmall.hk)**
Launched by Alibaba Group in 2014, Tmall Global is China’s largest online marketplace for foreign brands and retailers selling directly to China. Tmall Global has over 5,400 brands from 53 countries and regions, and over 80% of them entered China for the first time.

Ciaoniao, an affiliate of Tmall, can also assist companies listing on Tmall.hk.

**JingDong (www.JD.hk)**
Launched by Jingdong in April 2015, JD Worldwide has over 1,200 foreign brands and 450 stores. It cooperates with eBay on promoting foreign brands on the marketplace.

The company cooperates with international third-party logistics companies and warehouses in three FTZs in China (Ningbo, Hangzhou, and Guangzhou) to assist foreign brands from 50+ countries / regions with fulfillment and delivery.
Cross-border e-commerce restrictions and requirements

There are no special licensing or business registration requirements for companies selling products from an overseas website or on a cross-border marketplace. However, there are restrictions with regard to product categories. Some products are restricted or forbidden from being imported into China without specific licenses. For example, seafood of any kind is not legally allowed to be sold cross-border and imported through cross-border channels. Products like this must come through normal import channels. You should check with the relevant agencies to understand if your product is restricted.

Listing products and selling them on one of China’s cross-border e-commerce marketplaces is not significantly different from listing and selling on a domestic marketplace, except that the company does not need a legal entity in China. You will still need to go through the platform registration process and provide the required documentation.

Recent changes to cross-border e-commerce policy

In April, 2016, the Chinese Ministry of Finance announced new taxation policies targeting cross-border e-commerce. The new policy replaces the previously implemented postal articles tax applied to pilot zones for cross-border e-commerce. Under the new policy, retail goods purchased online through registered cross-border e-commerce platforms are treated as imported goods and are subject to tariff, VAT and consumption tax.

The new policy stipulates that products within a transaction limit (RMB2,000 per single transaction and RMB20,000 every year for one person) are subject to 70% of the VAT and a consumption tax, if any. Tariffs are not applicable within the exemption limit. A number of products sold through cross-border marketplaces are now subject to an 11.9% (i.e. 17% x 70%) VAT, instead of the personal postal article tax, which used to be classified at four different rates (i.e. 10%, 20%, 30%, 50%) depending on the product category. The new policies eliminated the duty-free exemption for goods whose tax payable did not exceed RMB 50.

The Chinese government also released in April, 2016 a “List of Imported Commodities for Retail in Cross-border E-commerce” - often referred to as the Positive List. Only products on the Positive List are now allowed to be imported through cross-border e-commerce zones (i.e., utilize the forward deployed inventory logistics method, which is discussed below) and the Positive List is said to be reviewed on a regular basis. Fortunately, the implementation of the Positive List has been delayed for one year, giving companies a chance to prepare and adjust their strategy.
Product categories affected by this include cosmetics, nutraceuticals, health foods and supplements, infant formula, and other products which require a CFDA (China Food and Drug Administration) certificate.

As e-commerce evolves, changes in government policy and regulation are inevitable. Companies are advised to keep abreast of changing government policies in regards to e-commerce.

There are advantages and disadvantages to each of the different methods of approaching the China market. Thought and effort should be into your market entry decision regardless of the entry model chosen. The China market, with more than 1.3 billion consumers and an ever increasing middle class, is too big and too important to approach half-heartedly. Significant opportunities exist but it is also a significantly challenging market. Proper care should be given to strategy development and the selection of partners. That being said, the China market isn’t right for everyone.
LOGISTICS

Import Tariffs

Products entering China are categorized as either personal parcels or commercial cargo. Both require declaration at customs by filing ‘Article Lists’ or ‘Cargo Lists’ for customs clearance before entering China’s customs border. For product distribution and logistics from overseas to mainland China, companies will need to hire a licensed international 3PL or freight company. China’s regulations on importing personal parcels and commercial cargo are substantially different regarding import taxes, documentation, CIQ inspection and quarantine requirements, and labelling and testing requirements.

Personal parcels

China has defined personal parcels in the GACC Announcement No.56, 2014 on Cross-Border E-commerce Trade Supervision, which has been in effect since August 1, 2014. There are two important criteria for personal parcels, which are:

1. The value of the parcel must be lower than US $154 except when from Hong Kong, Macao, or Taiwan, where the maximum value is US $123;
2. The goods in the parcel are for personal use (meaning the quantity is reasonable).

The customs officer has the authority to determine if the parcel is for personal use or not.

Import tax

For personal parcels, import taxes are only levied on goods if applicable, and the goods are not required to go through the CIQ inspection and quarantine process. There are no requirements on labelling and testing; however, goods forbidden to be imported are not allowed. If taxes are levied, they vary depending on the product category.

A personal parcel with a value exceeding US $154 is subject to full import tax without exemption. If import taxes payable are not paid at customs, personal parcels will be returned by the individuals/end customers or the 3PL/Courier. Exceptions to the above are personal parcels containing food & beverages and cosmetics. The tax exemption value for personal parcels containing F&B products is US $77, and the tax exemption value for cosmetics is US $15.

Commercial cargo

Goods for commercial use and/or not categorized as personal parcels are usually categorized as commercial cargo and must go through customs and CIQ inspection and quarantine procedures.

Import tax

Commercial cargo is subject to various types of import duties and taxes, such as an import tariff, VAT, and consumption tax. The rate and type of applicable duties depends on the products’ HS Code classification (Harmonized Commodity Description and Coding System) as well as any free trade agreements, most favoured nations agreements, or other trade agreements/disputes that may affect the import duties. The table below provides an example of the import tax rate, VAT, and consumption tax for several products.
Table: Import Tax Rates on Different Products

<table>
<thead>
<tr>
<th>Product Categories</th>
<th>Import Tariff (MFN)</th>
<th>VAT</th>
<th>Consumption Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baby care products and baby formula</td>
<td>10%</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Alcohol and wine</td>
<td>50%</td>
<td>0</td>
<td>10-20%</td>
</tr>
<tr>
<td>Dietary supplements</td>
<td>10%</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Sovereign analysis based on multiple sources including GACC
Note: MFN – Most Favoured Nation

Import process

It can take several months for exporters and Chinese importers to prepare all of the necessary documents required for the pre-import process. For example, frozen seafood products will require Sanitary Administrative Approval, original labels and the Chinese translation, as well as registration and filing with the local CIQ office in China. During the import process, the inspection declaration, CIQ inspection and quarantine, and customs inspection might take another 1-2 weeks. If any issues occur - for example, wrong labels or missing documents - the goods may take longer to clear customs.

A large number of importers regularly experience challenges with the importation process and it is important to be aware of the specific requirements for your product categories.
Cross-Border Shipments

There are two principal methods available to foreign companies engaged in cross border e-commerce in China to ship to the end customer. To ship directly to the end-consumer via an international / domestic express company, or to ship in bulk to a 3PL who can warehouse the products in one of China’s pilot e-commerce zones, and then ship the product individually to end-consumers as orders are fulfilled.

**Directly ship to customer**

The simplest way for a company to ship to customers who purchase from them overseas (individual parcels) is to use international express companies such as UPS, FedEx, or DHL. These companies can manage the customs process and transfer the parcel to their domestic partner for final delivery.

Although simple, the downside of this method is that transportation costs are high and delivery time is lengthy.

Depending on the product and the value of the parcel, it may be subject to tariffs and other import regulations.

**Product Shipped Directly from Overseas to End-Customer / Consumer**

Source: Sovereign analysis on multiple sources

![Diagram showing cross-border marketplace ecosystem](image)

- **Brand**
  - Shipped from overseas and clears customs as a personal parcel post
  - Manages exclusive shops or flagship store on marketplace (Optional)

- **Partner**
  - Listing and Marketplace management activities

- **Online transaction**
  - Payment remittance

- **Consumers**
Warehouse products in e-commerce pilot zone for forward deployment

Companies can engage a 3PL with warehousing facilities inside one of China’s pilot e-commerce zones or bonded areas. When Chinese consumers order products on the company’s website or cross border marketplace, the products can be delivered directly from the warehouse inside the pilot e-commerce zone as personal parcels shipped to end consumers. This cuts delivery time significantly and also bypasses some of the restrictive regulations affecting imported products. Furthermore, if a single transaction is under 2,000 RMB or within a yearly customer limit of 20,000 RMB, VAT is decreased by 30% (making applicable VAT 11.9% as opposed to 17%). There are also no tariffs applied to purchases within these limits. The graphic below provides an illustration of the delivery process.

Product Shipped Via 3PL and Stored in Bonded Warehouse

Source: Sovereign analysis on multiple sources

If your product is not on the newly published “Positive List” the only cross border shipping option reliably available is to ship via individual parcel post originating from outside a bonded cross-border logistics area (FTZ).
PAYMENTS

Within China

A number of payment options are available for companies with a legal entity in China, including online payment platforms such as Alipay, WeChat Pay, JD Pay, and recently Apple Pay. Credit cards and other forms of payment are also available. However, some platforms commonly used in the West, such as PayPal, are not generally available in China. Below is a brief description of the common payment platforms available in China.

Alipay (Alipay.com)
Launched by Alibaba Group in 2004 as an affiliate company, Alipay has the largest market share (nearly 50 percent) of China’s online payment platforms, with over 300 million users as of 2014. Alipay works with Visa and MasterCard and supports transactions in dozens of major foreign currencies.

WeChat Pay - Tencent
WeChat is the most popular instant messaging App in China. WeChat Pay, which has been integrated into the WeChat platform, is one of the principal Mobile Payment systems in China. WeChat pay offers QR Code payment, In-App Web-based payments, and In-App payment when vendors integrate WeChat Pay SDK into their Apps.

Apple Pay - Apple
Partnering with China Union Pay, Apply Pay began rolling out in China in early 2016. Although a relatively new entrant, Apple’s partner, Union Pay, controls all card payments in the country; however, Alipay and Wechat Pay have a nearly 100 percent penetration rate, and it will be difficult for Apple Pay to carve out market share.

Cross-border payments
For overseas registered companies, payment platforms such as Alipay and WeChat Pay provide cross border e-payment services, which allow buyers to pay in RMB and sellers to settle in major foreign currencies. For sellers, there is also no need to open a bank account in China, as once the payment is converted it will be remitted into the seller’s international bank account.
Opportunities

Many of the opportunities China’s e-commerce market represents are quite obvious with the sheer size of the market and access to Chinese consumers. Three key opportunities for overseas merchants include:

Consumer readiness – China’s middle class has been growing rapidly over the last thirty years, with disposable income levels exceeding US $ 5,000 a year, which is similar to that of the middle class in developed countries. Furthermore, consumers in China enjoy the convenience, selection, and rapid delivery e-commerce provides. Furthermore, because of the underdevelopment of traditional retail channels, Chinese consumers are far more likely to turn to e-commerce to fulfil their shopping needs.

Developed marketplace ecosystem – marketplaces developed rapidly in China as did the support system surrounding them, creating a highly complicated but developed e-commerce ecosystem. The ecosystem provides a relatively straightforward and uncomplicated way for foreign brands to approach the market.

There is a cost to selling on marketplaces, such as transaction fees and not being artistically free to manage your marketplace page, but the benefits are quite obvious. There are partners to manage logistics and the marketplace already works with the main domestic payment processing companies. The marketplace itself is also familiar to Chinese consumers with a substantial amount of aggregate traffic, especially during special events. Companies or their partners can focus on activating the brand and on managing other distributors operating within the marketplace.

Cross-border marketplaces – A relatively recent development in China, cross-border marketplaces provide foreign retailers access to Chinese consumers without having the risk exposure or costs associated with establishing a legal entity in China. Although the traffic to cross-border marketplaces is not as high as it is on domestic Chinese marketplaces, cross-border marketplaces can provide retailers with a cost-effective way to test the market.

Key Challenges

Unlike the opportunities in the market, the challenges foreign companies face are not so apparent. Two of the most significant challenges foreign brands face when selling to Chinese consumers are difficulties in brand activation and the brand competing with itself in the form of its distributors and resellers. Both are discussed in more detail below.

Brand activation

China is not a magical market where consumers are fighting to own the next foreign product to hit the market. Chinese consumers are sophisticated and are aware of many of the top global brands in most product categories. However, this does not mean they know every brand and just having your brand in China does not mean it will immediately be recognized or be successful. Brands need to be activated, which means that your brand engages directly with consumers and has some form of brand loyalty – i.e., your brand needs to have sufficient demand amongst Chinese consumers.
Brands are essentially activated in one of two ways: 1) targeted marketing and brand building activities, which can be expensive, especially for small or medium sized companies; or 2) on by accident.

Brands are activated on accident primarily when tourists or consumers living abroad are exposed to and like particular brands. Through word of mouth, the brands become activated in the China market, even though some may not necessarily officially be selling in the market.

Three examples of brands activated on accident are:

<table>
<thead>
<tr>
<th>Kirkland</th>
<th>Burt’s Bees</th>
<th>Nu-Lax Fruit Laxative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private label products sold at Costco for more than 20 years, Kirkland Signature products have a strong brand reputation in China.</td>
<td>An American personal care product, now a subsidiary of Clorox, Burt’s Bees has nearly 200 natural personal care products. It is distributed in more than 30,000 outlets in more than 7 countries (not mainland China)</td>
<td>An Australian natural products brand first launched in 1937. The company’s products are sold in a number of countries, and are sold in China through a distributor.</td>
</tr>
</tbody>
</table>

14,000+ daily searches in China 15,000+ daily searches in China 20,000+ daily searches in China

Brand awareness and activation for consumer goods is an important part of succeeding in the China market. Apple iPhone is another great example of a brand and product that had extremely high brand awareness before their China launch. Companies should take the time and spend the resources necessary to understand how well their brand is known in the market and determine how much brand building will be required. If the brand is lucky, there will already be sufficient demand in China. Furthermore, investment should be made in understanding competitors, distribution options, and in developing a solid strategy for China. Too often companies try to enter China “on the cheap” and end up failing.

If demand for the brand is too low the company will want to consider all of its options before market entry. This could range from utilizing a distributor first, hiring a firm to assist in brand building and activation, or finding alternative ways to activate the brand.
Competing with yourself

Marketplaces, especially Tmall, are a fundamental part of China’s e-commerce ecosystem and companies should consider having a presence on one or multiple platforms if serious about exploiting opportunities in China’s e-commerce market.

However, operating on a marketplace effectively can be extremely challenging. Many brands do not have a professional team dedicated to managing their marketplace stores well and end up being event dependent and rely on price cutting to drive sales volumes. This results in a low volume of sales at MSRP. Because of this, around 85% of brands do not make money on Tmall.

Below is an example of typical brand’s Tmall store.

As illustrated on the previous page, when prices are set at or near MSRP, volumes are flat. However, when prices drop, sales spike.

An additional challenge facing brands on Chinese marketplaces is that they will usually find themselves in competition with their own authorized distributors. Nike for example has nearly one thousands stores selling legitimate products on Tmall, all of which are authorized to do so as they are distributors or resellers. The competitors can potentially sell at discounted prices, below MSRP, making it extremely difficult for the brands own store.

Foreign brands opening their own store on a marketplace must spend the necessary resources. China’s e-commerce market is extremely dynamic, rapidly changing, and full with competition that knows how to exploit the intricacies within the platforms. If the company itself does not have the necessary expertise, it is highly suggested that they outsource the management of the store to a qualified TP.
Practical Advice For Approaching The Market

Approaching any new market, especially a developing one like China, is a challenge that requires careful planning as well as commitment from all levels of management. E-commerce in China is no different from approaching the market by more traditional means.

Although the e-commerce marketplace model in China addresses many of the common challenges companies normally face when selling to the China market, the company still needs to consider the following:

Facing – Develop a web page and/or storefront on a marketplace with the appropriate “look, touch, and feel” that is in line with your overall brand.

Pricing strategy – Develop a pricing strategy that is aligned across all channels. Competing on price is not always the appropriate solution, especially as you may find that the brand is competing with itself. Invest in finding the right price point for your products and work with distributors to create consistent pricing.

Service – Offer during and after sales service, either directly or utilizing a 3rd party partner.

Marketing/traffic generation – It is important for companies to invest in activities that generate traffic to their page or marketplace shop. If internal capabilities are lacking, consider outsourcing this to a 3rd party service provider.

Fulfilment and supply chain – Chinese consumers are used to receiving goods within days or hours of purchasing them. Fast and efficient fulfilment is critical to success in the market. You also need to be able to manage returns in an efficient manner. If you are unable to develop your own supply chain, then consider working with an integrated 3rd party logistics provider (3PL).

Choosing the correct model – Understanding which model you should be using to exploit the market is critical to success. It is important to spend time assessing the different options available. Use a third party consulting firm if necessary.