

China's Online Retail Market 2012–2013

An outlook over a market with high potential

Zhang Yao Yao
Daniel Ekström
Matilde Eng

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Swedish Agency for Growth Policy Analysis
Studentplan 3, SE-831 40 Östersund
Telephone: +86 (0)10 6532 6480
Fax: +86 (0)10 65327273
E-mail: info@tillvaxtanalys.se
www.growthanalysis.se

For further information, please contact Zhang Yao Yao
Telefon +86-10-65326480
E-post yaoyao.zhang@growthanalysis.se

Introduction

The 11th of November has been named the singles day in China. The holiday has been picked up by Chinas online retail giants as the time for the biggest sales promotion of the year. This year the Alibaba group alone sold for over 35 billion yuan, more than the total amount of Sweden's e-commerce for a whole year. This is a remarkable example of how the Chinese E-commerce has grown in recent years.

The rapid development of the online retail industry is one of the most remarkable results from China's rapidly improving ICT infrastructure. From being almost unheard of a decade ago online retail is now making more and more consumers abandon their traditional ways in favor of the new and convenient way of shopping. The industry is yet not fully developed and the market is characterized by fierce competition between competitors and rapid development of services and supporting functions.

Online retail is one kind of e-commerce and refers to the sales of physical goods to consumers over the internet. This report focus of the development of online retail in particular but also provide a general view of the development of the e-commerce industry as they are growing hand in hand.

The growth of online retail is reshaping the structure of many industries and has the potential to dramatically change the way business is done. The new technology can effectively integrate existing resources and be used to reduce costs of development and radically increase the market access for companies. This can in the long run improve the productivity of the whole society. From the Swedish companies' perspective, the Chinese platforms provide new ways of entering the Chinese market that may well prove to be more effective than the traditional ways. This creates more opportunities as we see great potential for further growth in e-commerce.

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1 China's online retail market

The Chinese E-commerce market has grown fast in the last decade and the total volume of trade reached 8.0163 trillion yuan in 2012.¹ With an average annual growth rate well above 20 percent in terms of Gross Merchandise Volume (GMV), a measurement of the total value of total sales over a specific time, the most rapidly growing segment has been online retail. Online retail has increased its share of total e-commerce from 2.1 to 6.2 percent between 2009 and 2012 and by the end of 2012 China's online retail transactions reached 1.3 trillion yuan (Figure 1).



Figure 1. China online shopping GMV (Gross Merchandise Volume) 2009-2016.

Source: iResearch

This was an increase by 66.1 percent compared with the previous year and China is expected to pass the US as the largest online retail market in 2013.²

Until recently China's e-commerce market has been dominated by so called consumer-to-consumer (C2C) retail like Taobao in the Alibaba group. However this has started to change. During the past few years we have seen strong development of business-to-consumers (B2C) platforms. B2C platforms could be described as open platforms or online malls where companies set up online stores using the infrastructure provided by the website owner. The largest B2C platforms are Tmall (Alibaba group) and JingDong (former 360buy). In Figure 2 we can see the impressive growth of the Chinese online retail market from 2006 and its estimated growth.

¹ Mofcom <http://english.mofcom.gov.cn/article/newsrelease/press/201310/20131000353941.shtml>

² iResearch Consulting Group <http://www.iresearchchina.com/views/5206.html>

The market volume share of B2C platforms has grown from less than one tenth to some 33,8 percent in 2013 and is expected to make up half of the market in 2016.

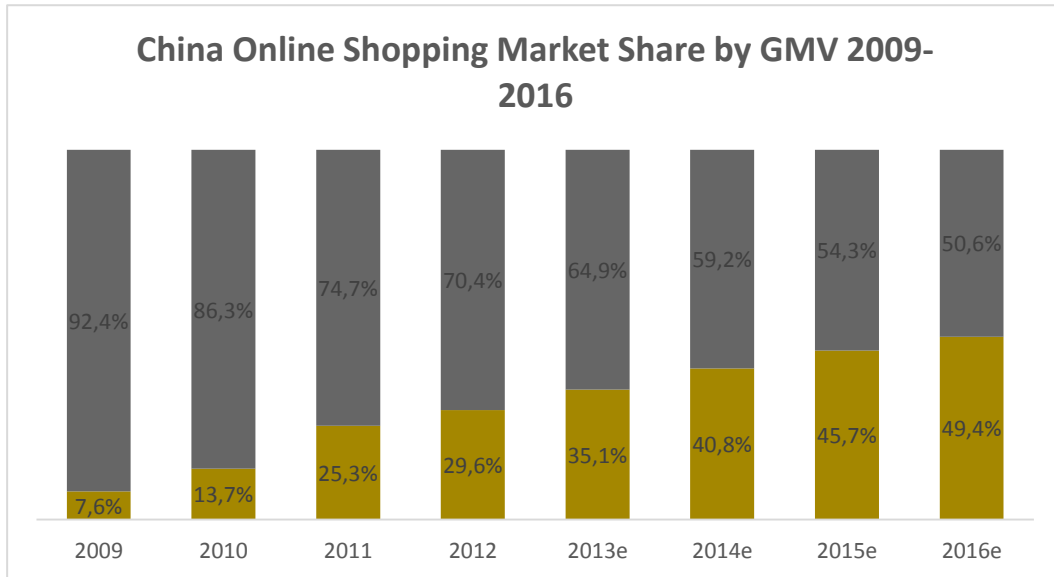


Figure 2. GMV structure of China online shopping 2009-2016.

Source: iResearch

The fast increase of B2C platforms has resulted in fierce competition between websites to attract new customers. It has also forced traditional retailers such as Suning and Gome to enter the e-commerce market and has through strategies like merges with competitors and the launching of open platforms developed fast. Over a short period their market share even surpassed small and medium sized e/commerce enterprises, see Figure 3.

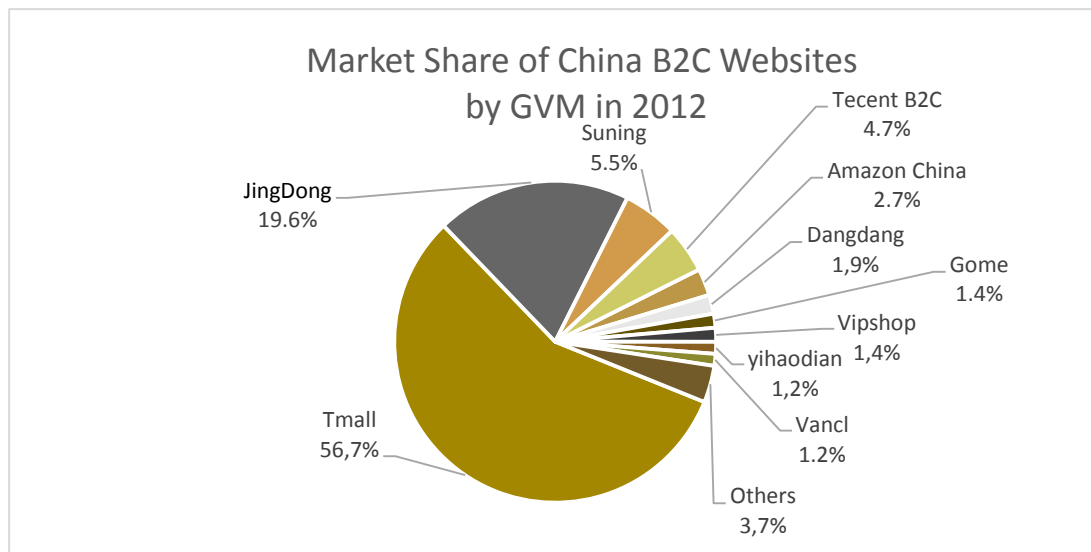


Figure 3. Market Share of China B2C Websites by GMV in 2012.

Source: iResearch

2 Policy drivers

In the 12th five year plan reaching between 2011 -2015 “new-generation IT industry” is pointed out as one out of seven strategically important industries. In a more detailed plan released by the Ministry of Industry and Information Technology, e-commerce is listed as a key area and the government has set up the target to grow e-commerce sales in China to 18 trillion yuan by 2015. One of the main focuses mentioned in the plan is to strengthen e-commerce laws and to create industry standards and practices for e-commerce operations. The plan identifies three areas for which new laws must be introduced: online sales promotion, electronic contracting and payment settlement and collection. The plan also encourages PRC authorities to step up their effort to stamp out commercial fraud, intellectual property rights infringement, false advertising, anti-competitive behavior committed online and illegal use of personal data.

Since last year the Ministry of Commerce has been leading efforts on a draft version of the new "Online Retail Management Regulations," which is expected to be released soon. Several ministries including The Ministry of Public Security, State Administration for Industry & Commerce, State Administration of Taxation, Ministry of Industry and Information Technology are participating in the drafting work. The regulations will establish mechanisms for third-party transaction platforms to enter and exit the market, and will clarify the rights, responsibilities, and duties of all participants in the online retail market. Ministry of Commerce clarified recently that the government would not directly intervene in the problems that can be solved through market mechanism.

A big problem is the large tax avoidance among companies engaging in e-commerce. According to a representative at the National People's Congress online shopping platforms evaded taxes of more than 100 billion yuan in 2012. China's State Administration for Industry and Commerce recently launched a system of granting specialized business licenses, called "identification certificates," to online stores and websites engaged in e-commerce. This is one way that the authorities can strengthen the control and management of e-commerce sites.

The Ministry of Commerce released a policy recently that will take measures to improve China's cross-border e-commerce retail and export. The new policy took effect on October 1 and aims to promote growth in cross-border e-commerce at a time when e-commerce in the nation has outgrown existing regulations. The policy defines outbound e-commerce governing bodies, requests a new method of supervising customs and specific statistics, supports regular earnings announcements by companies and encourages banks and other payment institutions to provide payment services and tax policies. It also asks for a credit system in e-commerce exports. The cross-border e-commerce has become a new engine propelling China's foreign trade growth and helps expand overseas sales channels for Chinese enterprises.

3 Trends of China's online retail market

There is a clear trend of traditional enterprises entering the e-commerce industry leading to bigger potential for e-commerce in western China and in third and fourth tier cities in middle and eastern China. Meanwhile, other methods such as mobile shopping are becoming more and more convenient with the development of mobile Internet.

i. Fast development of mobile e-commerce

By the end of 2012 China's mobile e-commerce transaction volume reached 96.5 billion yuan, this is an increase by 135% compared with 2011. The growth of mobile shopping has several reasons. Along with the popularization of new ICT technologies like smart phones; the application of mobile short-range communication technology (including NFC, RFID, etc.); the increase in the number of mobile internet users and the active promotion of various e-commerce players, the habits of the Chinese costumers towards mobile shopping has clearly changed. With the expansion of mobile internet, mobile e-commerce is becoming an increasingly important part of the online shopping ecosystem.

ii. Online retail initiated reconstruction of the industrial chain

The expansion of internet and mobile internet is reshaping the traditional view of how business is conducted. This development is particularly strong in the case of e-commerce, changing the way we think about production, logistics and consumption. A new modern service industrial chain based on online retail is demanding new solutions in fields such as internet branding and online retail related services amongst others. Take clothing circulation as an example; traditional clothing circulation is accomplished by a general agent, regional agent, regional retailer (or direct-sale store), big scale shopping mall and marketing in traditional media. However the modern online chain is formed by an operator, online retail platform service provider (who provides the online retail platform where stores can be opened), online shopping guide service provider or internet new media. A similar business model is so called drop shipping, when the retailer does not keep goods in stock, but instead transfers customer orders and shipment details to either the manufacturer or a wholesaler. This new industrial chain solves problems such as region restrictions and inventory bottlenecks as well as achieves higher efficiency with reduced circulation and higher technological content.

Introduction of open platforms creates revenue

The importance of open commerce platform has increased rapidly in recent years and in 2012 all big scale online retail enterprises like Taobao, Tmall, JingDong, Dangdang, Amazon and Suning had launched open commerce platforms. An open commerce platform is open for a third party to sell their products using the platform in contrast to isolated retail business. This kind of platform often include other services such as online store technology service, advertisement and marketing service, storage and logistics outsourcing. Such open platform services are bringing high added value revenue to big online retail enterprises.

Further development of services is expected and the financial services are currently under joint exploration between enterprises and banks.

iii. More participants

With the emergence of B2C enterprises many traditional retailers have had a hard time trying to compete with the low costs of online retailing. This has developed a strong integration trend, big retail brands were forced to expand their business and join the B2C market while others laid off staff or even closed down. According to a survey from McKinsey done on online shopping in 266 Chinese cities traditional retailers lose around 60 cents of business per dollar spend on online shopping³. In coming years more actors from the traditional retail sector is expected to extend their business to the internet by building their own online platform or by purchasing one. This has already been the case for a few companies, for example Suning's acquisition of online platform Honghaizi in 2012. Up until now almost all famous Chinese retail brands are present online, either based on big platforms, by themselves or both.

iv. Growth rate about to slow down in 2013?

The Chinese online retail market scale is over one trillion. It is a remarkable development from almost nothing just a decade ago. At the same time more actors are fighting for a share of the market, especially traditional retailers are realizing the importance of e-commerce. However the market cannot continue to grow in the same rate as has been the case for the last years. In figure 4 we can see both the rapid growth and the decline in growth rate. In absolute terms however the industry is still expected to triple in size over the coming five years.

³ http://www.mckinsey.com/insights/asia-pacific/china_e-tailing

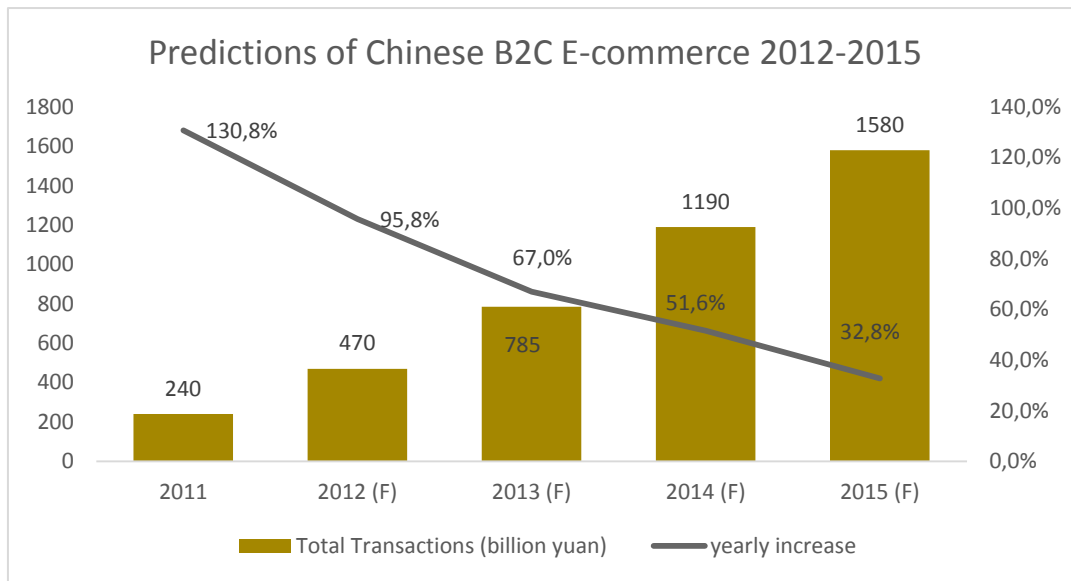


Figure .4 China online retail B2C transaction scale prediction 2012-2015 (Unit: 0.1 Billion yuan)

Source: EnfoDesk Analysys International

v. Platform competition

The declining growth of the e-commerce market will lead to increased competition among e-commerce platform companies. As smaller players aim to increase their market share new actors are entering the market. Companies will need to put in more effort to keep their current customers and work on in depth operation since obtaining new customers is getting more and more difficult. This also means that small and medium sized companies in this area will face tougher market conditions.

An example of tougher competition is JingDong's first big sales promotion of the year offering big discounts to their customers at prices the competitors could not compete with. This caused a short-term financial loss but they also gained many new customers moving over from the competitors. We can expect to see many of these price-wars in the future as competition is growing.

Some companies also managed to generate bigger sales at lower prices for the consumers by offering group purchases and producing goods to demand. This method can lower the prices for consumers by up to 40 percent.

4 The future

After about 10 years of development, consumption concept of online shopping is changing and customers have started to pay more attention to the quality of goods. Compared to C2C, B2C gains more trust from online shoppers in both reputation and quality assurance. Some B2C websites, such as Tmall, JingDong and Suning now put more effort into attracting retailers of high quality and opening more stores so that they can satisfy the new needs of consumers. However, this also means that they are facing some new challenges:

In 2012, major online retailers carried out full year price wars, this has continued in 2013. We have witnessed group-buy websites' rapid ascents and sharp falls, in the meantime, integration between online retail platforms and logistics, financial entities etc. need to be improved. The business model is still in a developing phase which results in a situation with high-risks as well as great opportunities.

i. Stronger need to improve conditions for multinational online retail

More companies – both domestic and oversea ones – are working internationally, which brings new challenges in terms of logistics as well as financial and payment. An even larger challenge is purchasing terms, conditions and regulation which varies greatly between countries. Take one of the most discussed topics in recent years as an example. After the milk powder scandal in 2008 - when melamine-tainted baby formula caused the deaths of at least six infants and sickened 300,000 others - more and more Chinese parents started to buy products for their children online from abroad. However there are so many online dealers and shops with very limited supervision that parents might find themselves in the same situation as they tried to avoid.

ii. Moving down the value chain

An online platform's entire shopping experience which include far more than just the products offered, is being constantly reviewed by the consumers. To meet the demand from the customers and stay competitive the firms engaged in online retail is driving the development of many supporting functions such as payment, financing and logistics. In many cases these services are now the most developed services on the market, attracting third part costumers from other industries. The Swedish firm Oriflame is as an example using Alibabas logistic network when selling cosmetics across China. During a discussion with Oriflames China CEO Pierre Mårtenson explained that they previously had contracts with more than 20 logistics firms across China, but that they now only need to have one contract with Alibaba.

The list of new services that Alibaba has come up with is impressive. Alibabas third-party payment processor Alipay (that now occupies 40 percent of the market) announced on April 18th that it would start to provide insurance against stolen items purchased through Alipay's Express Checkout service. Alibaba group has also launched a service called Yu'e Bao that allows customers to invest unused credits on their Alipay account. At the end of

the first month Yu'e Bao reached 2.5 users with 5.7 billion yuan of investments.⁴ However the China Securities Regulatory Commission has said that the service violates fund management rules because part of it had not been registered with regulators. In many ways Alibaba is using the new technology to offer similar products as those traditionally offered by a postal and bank. This is just a few examples of how online retailers are using the new technology to develop new solutions that has the potential of effecting areas far away from e-commerce.

iii. Customer management and big data

As the growth rate is expected to slow down in coming years customer management will become increasingly important. Especially the ability to process and use the gigantic amount of data that is generated every day will be a factor to success. Already the major websites has started this development and E-commerce is probably the most developed area for big data in China today. An industry source revealed in April that TMall has begun developing its own customer relations management (CRM) systems for TMall merchants⁵. TMall's self-developed CRM systems is aiming at offering accurate and timely data and incorporate business intelligence in classifying and tagging users via a number of metrics based on their activity on Taobao's platforms. This included the creation of a data-platform division with about 800 employees, as reported in the Chinese financial magazine, Caixin. The Alibaba Group has just begun to scratch the surface of analyzing the reams of user data generated through its business-to-business e-commerce site and its massive consumer-to-consumer platform, Taobao.com.⁶

⁴The Financial Times <http://www.ft.com/intl/cms/s/0/f956b004-ffe-11e2-9c40-00144feab7de.html#axzz2kKjvzg2>

⁵ "Rumor: TMall Develops CRM System", Marbridge Daily, 2013

⁶ <http://www.cgap.org/blog/microfinance-e-commerce-big-data-and-china-alibaba-story>

5 Concluding discussion

In recent years, China's online retail industry has moved towards a more mature phase of growth. However the landscape is still shifting, with the development of B2C platform as the most notable trend. We can expect fierce competition in the coming years before the market settles more permanently. Specialized service providers are developing progressively and the operating capability of e-commerce in terms of information, capitals, products and services are being improved step by step, resulting in gradual improvement in the ecosystem of online retail. All major players reached a new high in the market last year, but some weaknesses are disclosed and the business environment in general needs to be improved both from the government and enterprises' perspective.

In the development of the system surrounding the online retail platform we can expect big changes ahead. Not the least because many of the companies are developing their own solutions of customer management and payment services. This system with parallel functions is inefficient and it is likely that we will see development towards a more unified system in the future.

From the Swedish company's perspective, Chinese online platforms provide a new method of entering into China's market, compared to the traditional process. E-commerce can be an efficient way of reaching a bigger audience and reaching outside the big cities. As Chinese online retailers are looking abroad there is also opportunity in integrating Swedish and Chinese value chains. An international approach to logistics has the potential to increase the flexibility and efficiency of the supply chain. If it is something we can learn from the development of the Chinese e commerce it is the great potential that the new technology holds.