

China Online Retail Sector

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Australian Government
Australian Trade Commission



The World's Biggest Market

China's online retail spending reached US\$190 billion in 2012 – ten times greater than 2007 – or 5 per cent of China's total retail sales volume. There's no sign of a slow-down. So what's behind this growth and how do Australian companies tap into China's online market?

Online retailing in China, dubbed 'e-tailing', has doubled every year since 2003. By 2020 the size of China's online retail market is predicted to reach up to US\$650 billion, exceeding the combined value of online markets in the USA, UK, Japan, German and France. With over 590 million internet users, China boasts the world's largest online population - more than the US and Japan combined – and still growing at almost 10 per cent per annum.

The boom in online retail is a key element of the government's drive to re-balance China's economy in a way that positions consumption to make a far more significant contribution to GDP growth. China's new leadership team - Premier Li Keqiang in particular - is actively encouraging the expansion of so-called 'digital consumption' - *xinxi xiaofei* 信息消费.

The spread of high-speed internet and smartphone technology are key factors. The combination of over 130 million residential broadband accounts and 460 million mobile internet users means that millions of Chinese consumers now enjoy ready access to online shopping.

In the first six months of 2013, e-commerce revenue in China reached almost RMB 5 trillion, a 45 per cent increase year on year. Payments through mobile devices reflect triple digit growth – transaction volumes have increased by over 270 per cent year on year, and the RMB value of e-commerce transactions has increased by over 360 per cent.

China's middle class is set to grow from 200 million to as many as 800 million over the next 20 years and will be dominated by internet-savvy consumers. Not confined to the biggest cities, approximately 75 per cent of wealth creation is expected to come from over 200 second and third tier cities across China. A recent McKinsey study indicated that shoppers in some Tier 4 cities spend up to 27 per cent of their disposable income through online retail channels.

The rise of an affluent and aspirational middle class, lower prices and simple convenience will continue to drive China's online retail revolution. So too will the Chinese consumer's appetite for quality products in which they can trust. Already a quarter of shoppers buy online because they can't get what they want at bricks-and-mortar stores – these traditional retail outlets simply don't exist in many parts of China. Online shopping offers competitive pricing, the convenience of easy delivery and payment systems, and a welcome relief from the chaos of traffic congestion in China.

Online Marketplaces

90 per cent of online shopping in China runs through online marketplaces. Marketplaces provide a website for merchants to list their products or set up individual shopfronts. Some companies with marketplace platforms also act as an importer, but most simply provide the sales platform. The major advantage for e-merchants is the value of a large, aggregated customer base, plus a far lower upfront investment. Larger companies often supplement this approach with their own branded website.

C2C sites (with mostly small B2B merchants) currently dominate but B2C sites (for larger merchants) are expected to account for over half of China's online market by 2014.

Key benefits of online selling:

- › significantly lower start-up costs
- › ability to test the market
- › flexibility to modify product & price
- › easy access to consumers
- › ability to scale-up quickly

Leading Online Platforms - Taobao and Tmall

About 80 per cent of China's e-tailing transactions pass through Alibaba's Taobao and Tmall sites. On 11 November 2012 (known in China as 'Singles Day' – a Chinese variation on Valentine's Day) their combined sales exceeded US\$4bn, generating 2.4 per cent of China's annual online retail sales in just one day.

Taobao is China's biggest e-commerce company. It has over 6 million e-merchants and handles around RMB10 trillion worth of transactions annually. In 2011, 48,000 products per minute were sold on Taobao, surpassing China's top five bricks-and-mortar retailers combined. Like eBay, Taobao users can sell goods at fixed or negotiated prices, as well as through auction-style listings. However, unlike eBay, most goods are new, and there are no listing or transaction fees (though merchants do pay set-up and maintenance fees). Merchants are generally small businesses, and the majority of Taobao's revenue comes from advertising.

Tmall was launched by Alibaba in 2008 to diversify from its fee-free model and expand into the B2C market. It targets medium to large businesses and is used by over 50 per cent of online shoppers in China. With over 70,000 brands and 50,000 flagship stores, Tmall is China's dominant online platform. The principal store formats include:

- › Flagship Stores only sell trademark products for which the store owner holds an exclusive authorisation. Blackmores is an example of an Australian company with a Flagship Store on Tmall.
- › Speciality Stores are used by sellers with exclusive distribution rights to sell in China
- › Virtual Stores reduce costs and cut risk by allowing sellers to test the market before committing to a Flagship Store

Tmall's revenue model includes:

- › A deposit which is used to reimburse buyers who receive counterfeit goods. The deposit amount varies based on store format and trademark status
- › An annual technical service fee which varies according to product category and is redeemable subject to sellers reaching pre-defined sales targets
- › Sales commission of between 1 and 5 per cent

For example, Tmall fees and charges for a fashion brand with a trademark might include:

- › A deposit of RMB 100,000
- › A technical service fee of RMB 60,000
 - of which 50 per cent could be reimbursed if sales reach RMB 360,000
 - of which 100 per cent could be reimbursed if sales reach RMB 1.2 million
- › Sales commission of 5 per cent per transaction

Other Online Platforms

Despite Alibaba's dominance, competitor B2C sites have emerged (see table below). Jingdong (formerly 360Buy) and Tencent's QQBuy are widely considered the second and third largest B2C e-commerce platforms in China, both for PC and mobile-based shopping.

Fierce competition will continue to drive innovation in payment systems, delivery and after-sales service. Some companies are drawing customers away from Taobao/Tmall with the promise of faster delivery and improved after-sales service. Many of these newer e-vendors have invested significantly to build delivery networks or aggregate smaller logistics providers into a broad network. Jingdong, for example, now offer 3-hour and same day delivery services in selected major cities, utilising their own network of bike couriers.

Alibaba founder, Jack Ma, has announced ambitious plans to invest around US\$16 billion in an eight year project to build a nationwide logistics network capable of delivering online purchases to almost all parts of China within 24 hours.

| Platform | Products |
|---|---|
| Jingdong (formerly 360Buy) | Computers, communications, electronics, books and clothing, plus luxury mall 360TOP.com |
| Tencent – including QQ Buy and reseller 51.buy | Consumer products (QQ), home appliances (51.buy), and gaming (Tencent) |
| Suning – also owns Redbaby | Electronics and home appliances (Suning), baby goods and clothing (Redbaby) |
| Dangdang | Books, baby products, personal care products, clothing |
| Yihaodian | Food and beverage and consumer goods |
| Amazon China | Books |
| Vancl | Own-brand clothing |
| Coo8 | Home appliances, electronic gadgets |

Opportunities for Australian Businesses

Although e-commerce may not replace traditional retail channels, it delivers greater and lower cost reach into China's second, third and fourth tier cities. With careful planning, established businesses and young start-ups alike can succeed in leveraging the enormous potential of China's online retail environment. Opportunities exist across a range of product categories and related services including:

Consumer Products

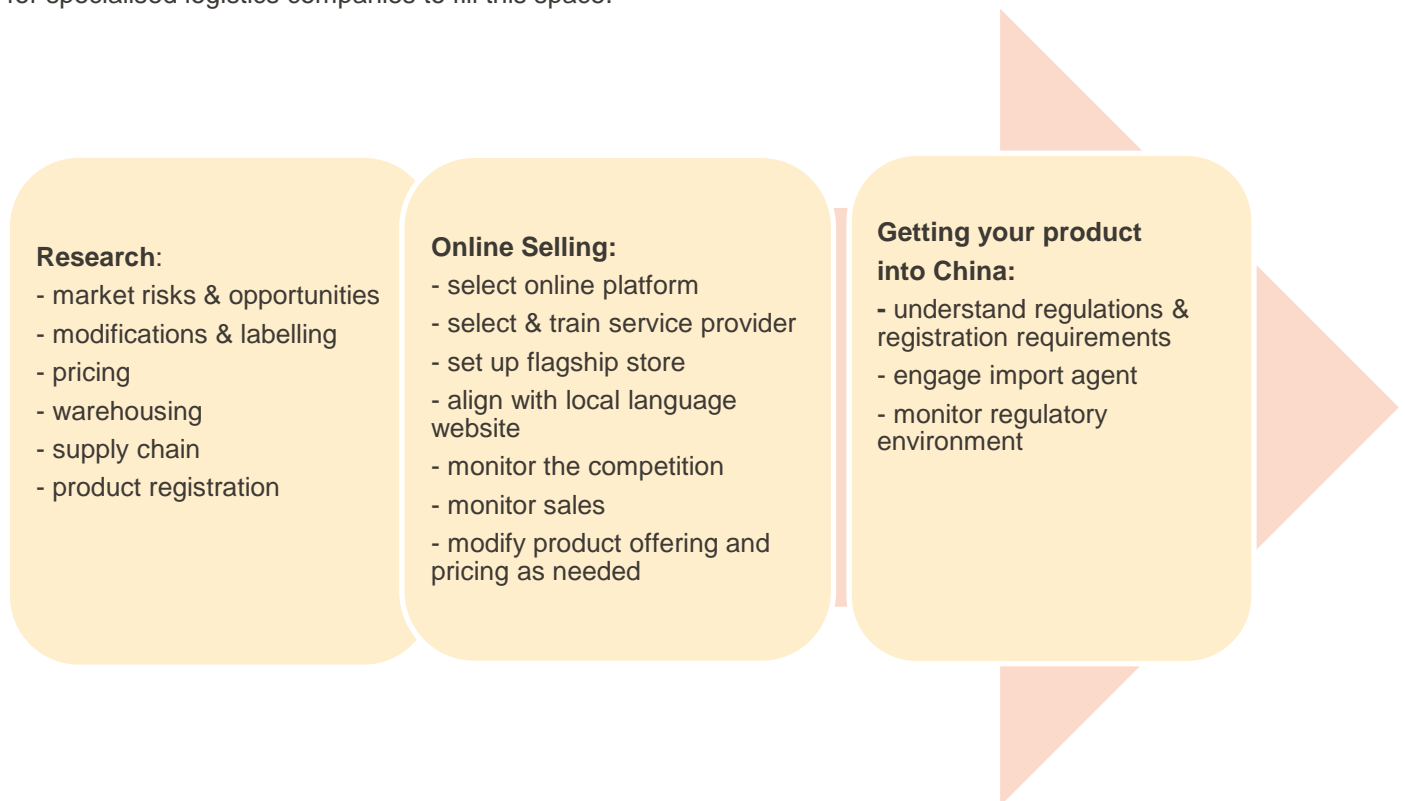
The top three online product categories (collectively accounting for 70 per cent) are apparel, recreation and education, and household products. These are followed by transportation/communications and healthcare/personal. New product categories such as fresh food are gaining in popularity. A large online platform recently ran a promotion of products from the U.S. including wine, seafood, pork and freshly-picked cherries.

Associated Services

E-tailing has spurred the development of a US\$13 billion service provider industry that encompasses online advertising and marketing, payment systems, warehousing, express delivery and IT services.

Logistics

In China, delivery staff not only deliver orders, they collect cash payment, handle return requests, or even act in a sales role while a customer tries on a piece of clothing. Traditional logistics companies do not offer this range of after-sale service and smaller operators are struggling to forge significant economies of scale. This opens up the potential for specialised logistics companies to fill this space.



Key Considerations

Strategy

- › Take time to conduct thorough research
- › Consider engaging a service provider to set up and manage your online store. The quality of service providers, local partners and allies is critical
- › Consider the alignment between your own unique website and your online marketplace
- › Chinese language website is essential, preferably optimised for mobile platforms
- › Understand the process - logistics and distribution are critical success factors
- › Understand your financial obligations

Platform

- › You can set up your own online 'shopfront', or engage a local service provider. Details of accredited service providers are available from online platforms such as Taobao (<http://tp.taobao.com/taopartners/taoPartners.htm>)
- › Research your options and understand the upfront and ongoing fees

Technology

- › A China-hosted website will deliver optimum internet speed and accessibility
- › Websites should be optimised for mobile platforms
- › Invest in website optimisation via local sites to help drive traffic to your website
- › Consider China-specific software to facilitate payment in RMB. Much like eBay's PayPal system, many online platforms feature an inbuilt payment system

Customer Expectations

- › Products should be cheaper online than in traditional retail stores - but a strong value proposition is critical to avoid competing on price alone
- › Know your customer and aim to deliver an experience unmatched by your competitors
- › Next day delivery is often expected in 1st and 2nd cities such as Beijing and Shanghai, and within 2-3 days in 3rd and 4th cities
- › Payment systems should be simple and generally limited to contact, address and payment details

Tips and Insights of a Leading Online Entrepreneur

- › A leading online retailer with annual revenue in excess of \$2 billion is continuing to experience triple digit sales growth. In Shanghai alone, the company has a delivery team of 3000 personnel, each of whom average 50 deliveries per day.
- › In the past 18 months, China's appetite for imported dairy products has seen the company's sales grow from one container per month to five containers per day
- › Competition in China is tough, it's fierce, and no market is as brutal as China.
- › China's economic growth may be moderating, but China will remain the world's most exciting market for a long time to come.
- › Networks and *guanxi* are important to building a business in China, but nothing is as important as value.
- › Value is the key – know your customer and aim to deliver an experience unmatched by the competition.
- › A clear understanding of your value proposition is critical, but so too is the quality of local partners and allies.
- › Success in China depends on a combination of intellect, initiative, innovation - and above all else - passion.

Service Providers

Quality service providers are critical to success in China's online retail market. China's online boom has sparked a plethora of service provider companies which offer services including customs clearance, setting up online stores, marketing and branding, sales rep support, packaging and labelling, payment processing and delivery. Taobao and Tmall are typical of online platforms which recognise the importance of quality service providers and offer an

established network of registered providers. See the Taobao Partner website for details (Chinese-only)
<http://tp.taobao.com/taopartners/taoPartners.htm>

It is important to note that many of these registered service provider partners do not provide import/export customs clearance. Sellers without a Wholly Owned Foreign Enterprise will need an import agent to manage customs clearance and, where applicable, provide in-market warehouse storage.

Typical fees for a Taobao Partner service provider include:

- › Initial store set up costs – eg. needs analysis, marketing and branding (RMB 100,000 to 500,000)
- › Monthly maintenance – based on the number of sales reps, warehousing and delivery services (RMB 40,000)
- › Commission – between 10 and 40 per cent based on unit price and sales volume

How Can Austrade Help?

The Australian Trade Commission – Austrade – is the Australian Government’s trade, investment and education promotion agency.

Through a global network of offices, including 11 across China, Austrade assists Australian companies reduce the time, cost and risk of exporting. We provide a range of services to Australian exporters looking to expand their business in China, including:

- › information and advice on doing business
- › assistance with market entry and regional market selection
- › identification of relevant overseas contacts including service providers assisting with online retailing
- › assistance with business expansion including online retailing and other strategies
- › identification and follow-up of specific business opportunities

For more information visit www.austrade.gov.au or call 132878 (within Australia).

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