



Selling Online in China

The year 2013 will be remembered as the year in which China surpassed the US as the world's largest digital retail market. Despite a relatively lower retail and internet penetration, China has become the world's number one e-commerce market. Last year, Chinese e-commerce shoppers spent CNY 1.3 trillion, a sum that has increased by more than 70% annually since 2009 and is expected to continue on this astonishing trajectory.

The rapid growth of e-commerce in China presents an attractive opportunity for EU SMEs to access a vast market spread across a large geographic area, for relatively little cost.

This report provides information about the Chinese e-commerce market and describes the main models that EU SMEs can utilise to sell online in China.

Table of Contents

1	Background	3
1.1	Figures	3
1.2	Search engines	6
1.3	Key portals and players	7
1.4	Consumer behaviour	9
1.5	Chinese online shoppers buying overseas goods	13
1.6	Luxury goods	14
2	E-commerce market forecast	16
3	Advantages of e-commerce in China	17
3.1	E-business models for EU SMEs selling goods in China	17
3.2	Delivery company competition in China	17
4.	Recommendations	19
5.	Resources	21

1 Background

1.1 Figures

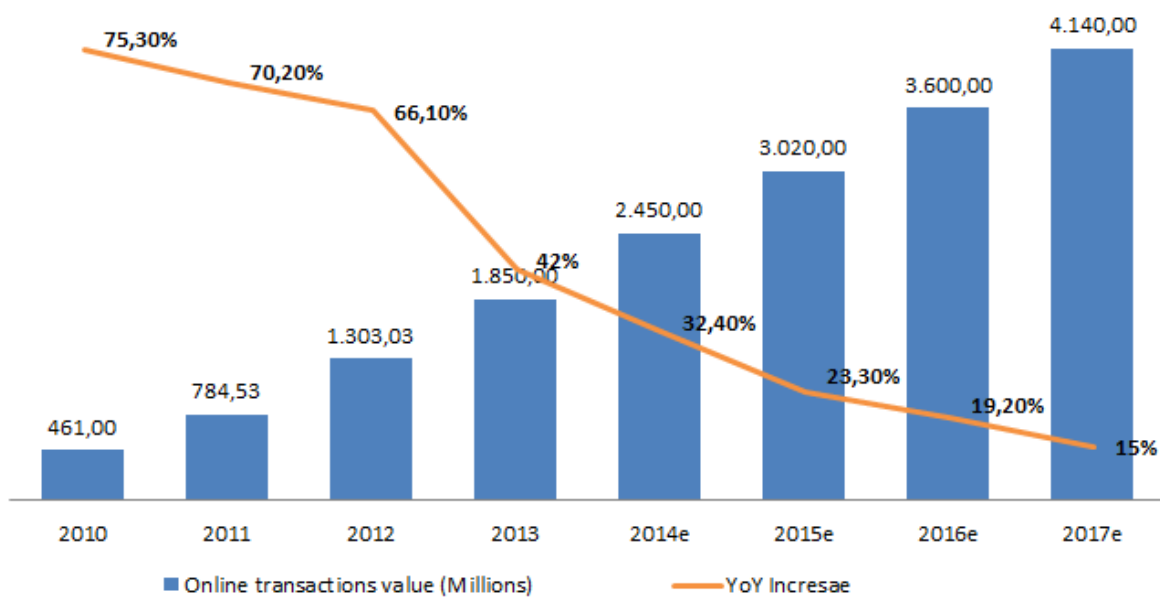
In recent years, e-commerce has seen tremendous growth in China due to favourable market conditions including a growing number of internet users, the size of the country, an extraordinary delivery system, increasing consumer acceptance of and comfort with shopping online, as well as all the advantages e-commerce brings to the Chinese retail sector.

China is the largest retail market in the world, as shown by these figures from January 2014:

Total population 1,349,585,838 (51% rural – 49% urban)	Internet users 590,560,000 (44% internet penetration)	Mobile subscriptions 1,206,553,000 (80% are pre-paid subscriptions)
Average time that internet users spend using the internet each day 4H 31M	Mobile internet penetration as a percentage of total population 43%	Average time that mobile internet users spend using mobile internet each day 1H 55M

China leads the world in terms of the percentage of time its population spends using the internet. However, market penetration is still behind that of many other countries. Currently, internet penetration stands at less than 50%, although this figure is on the rise.

2010-2017 Chinese online shopping transaction values



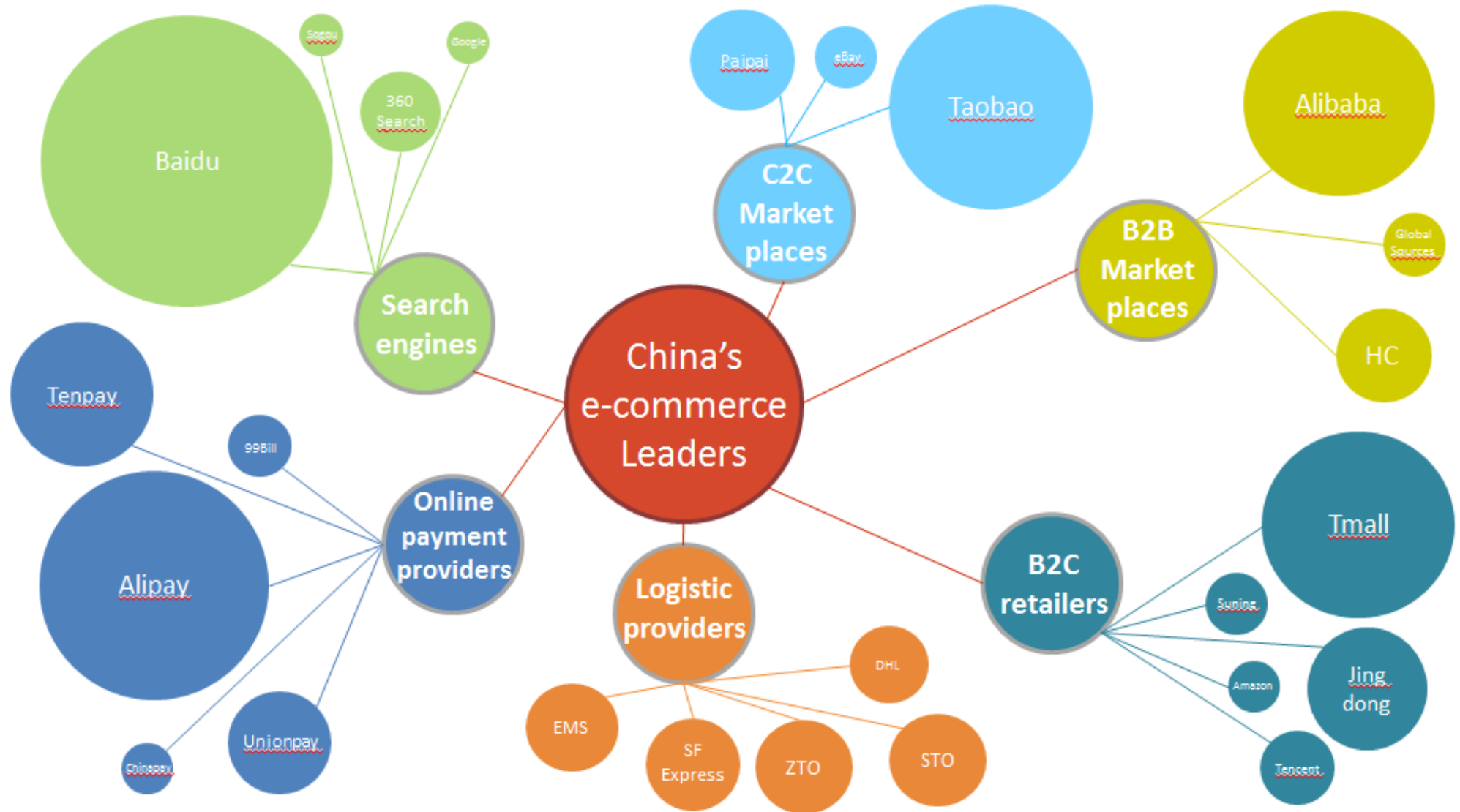
Source: *iResearch*

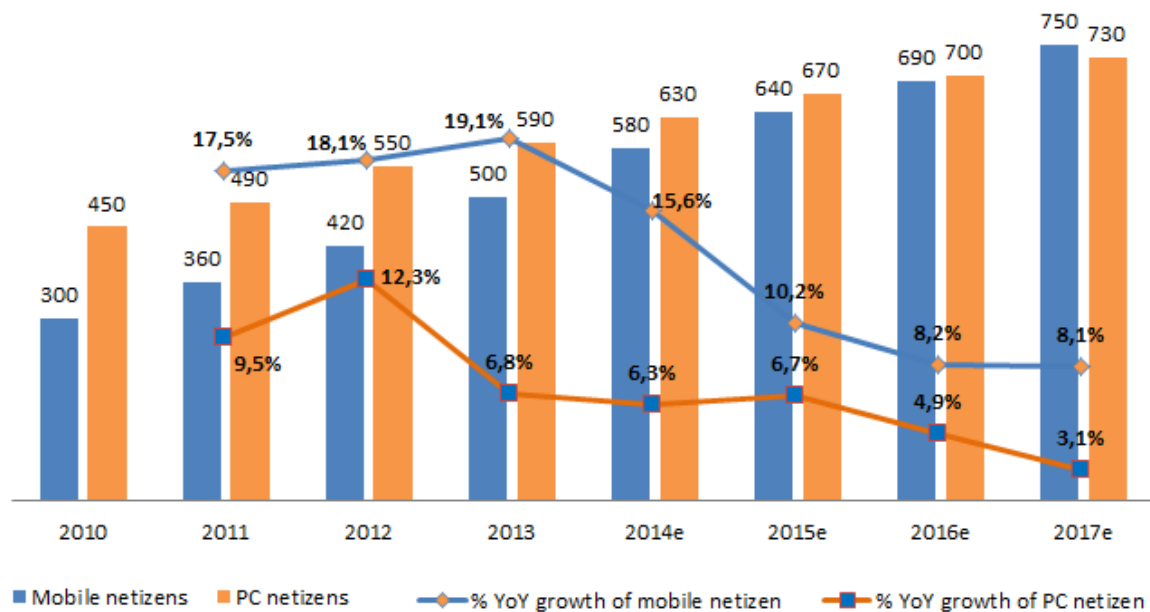
In 2013, the total value of online transactions in China reached CNY 1.85 billion, with 42.0% year-on-year growth, according to data obtained from iResearch.

With the growth in online shopping and the gradual establishment of rules and regulations, the Chinese online market is now coming of age, and will continue to grow steadily for the foreseeable future. At the same time, traditional businesses will see a wide-scale move towards e-commerce. Most western provinces and the third- and fourth-tier cities in eastern China will also move en masse to online shopping. Furthermore, the convenience of mobile e-commerce (m-commerce) represents the future of online shopping. It is estimated that by 2016-2017, the value of e-commerce in China will reach CNY 400 billion.

Cross-border transactions constitute an important aspect of the e-commerce economy. According to the “2012 China cross-border e-commerce report” by iResearch, e-commerce transactions between China and foreign countries increased by 32% in 2012. The main reasons for shopping on a foreign website are to save money and find products which are unavailable in local stores.

Given the huge worldwide developments in this area, cross-border e-commerce in China – with the help and support of Chinese government policy and contributions from the business world – should be well placed to make significant, sustainable progress.



Number of Chinese netizens 2010-2017

Source: iResearch

In late December 2013, the number of internet users in China had reached 500 million, with an annual growth rate of 19.1%. China continues to be the country with the highest number of online devices in the world. Since late 2012, the proportion of mobile users has grown from 74.5% to 81.0%. A much higher proportion of users currently access the internet in this way than via other devices. The mobile phone is expected to continue to be the main driver for the growth in internet usage. It is estimated that mobile users will exceed PC users in 2017. With flat rates for mobile phones, falling prices for calls and rising sales, adapting e-commerce for m-commerce is a must for any company wishing to succeed in China.

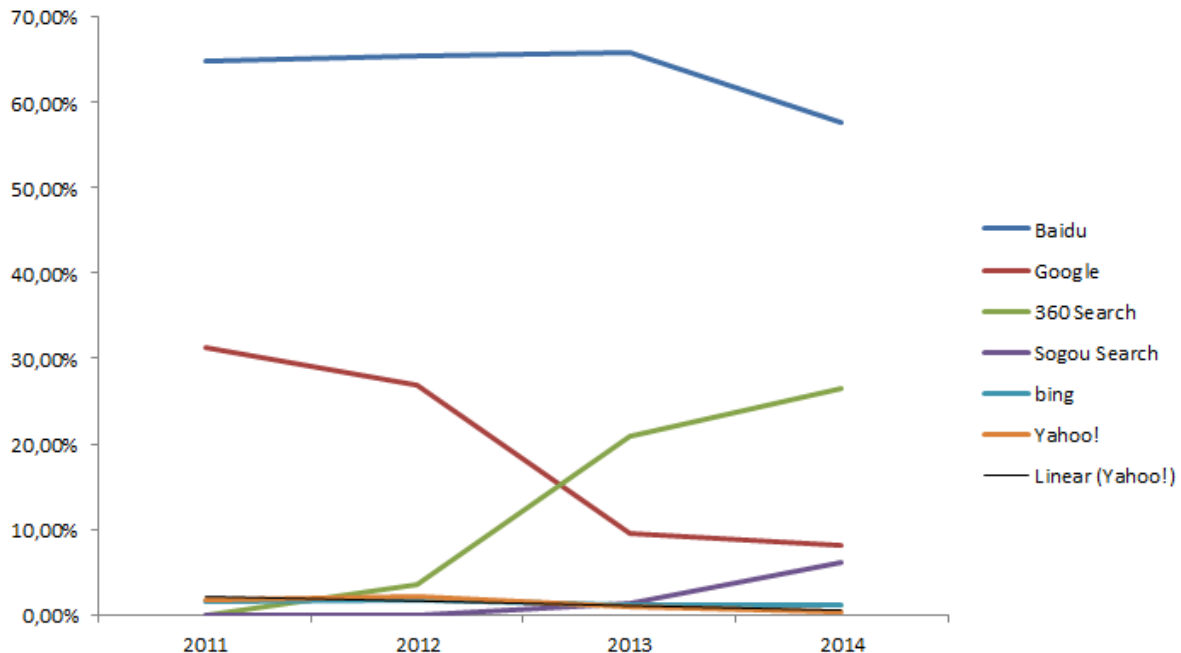
1.2 Search engines

Search engines should form an important part of any e-commerce strategy in China. Google is scarcely present in this market, with Baidu having the largest share at a little over 70% (although this number is falling) followed by Qihoo 360 and Sogou. In 2013, Qihoo 360 gained a 16% market share to become the second-largest player in the search engine market.

Despite some reports saying Google is still being used by highly educated Chinese executives, most of the key decision makers use Baidu. This is even more the case since June 4th 2014 – the Tiananmen Square 25th anniversary – after which the Chinese censorship authorities blocked most Google services in China, including search engine facilities and Gmail. This state of things seems unlikely to change in the near future, making access to Google in Mainland China almost impossible without a VPN.

EU SMEs that focus on the Business to Consumer (B2C) market must also rank their e-commerce operations in Baidu and Qihoo. European e-commerce companies must consider this scenario with regard to organic positioning (SEO) and PPC (Pay per click) advertising campaigns in Baidu and Qihoo. This is the best way to get good quality traffic to your e-commerce business from the outset.

Search engine comparison 2011-2014



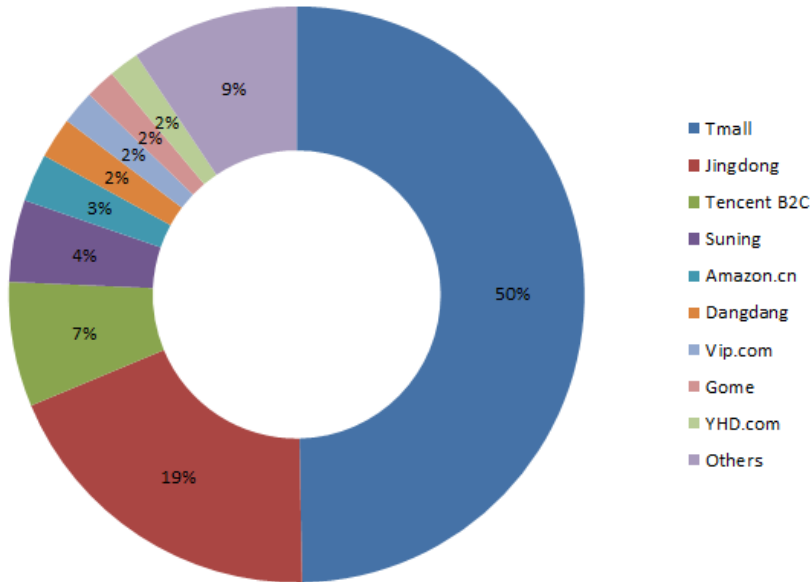
Source: *Internet stats*

1.3 Key portals and players

Alibaba, with its Taobao and TMall websites (online shopping malls), is the largest e-commerce company in the world. It is more than twice the size of Amazon and eBay combined, with a catalogue of 800 million products and a revenue of USD 160 billion in 2012. The two sites occupy almost half of the Chinese market. Taobao – similar to Amazon and Ebay – is the go-to Chinese online retailer for just about everything. The site has millions of independent e-retailers selling clothes, electronics, beauty products and more.

According to news reports, however, these portals are losing traders to “stand-alone” e-commerce. Heavy competition within the same portal, combined with high commission fees and the high cost of advertising to draw traffic, are forcing traders to seek other alternatives. However, entering into the infrastructure of TMall or JD.com (Jingdong) is still the quickest solution for many global companies seeking to start selling online in China. There are a number of agencies that help foreign companies enter these market places and set up their online stores.

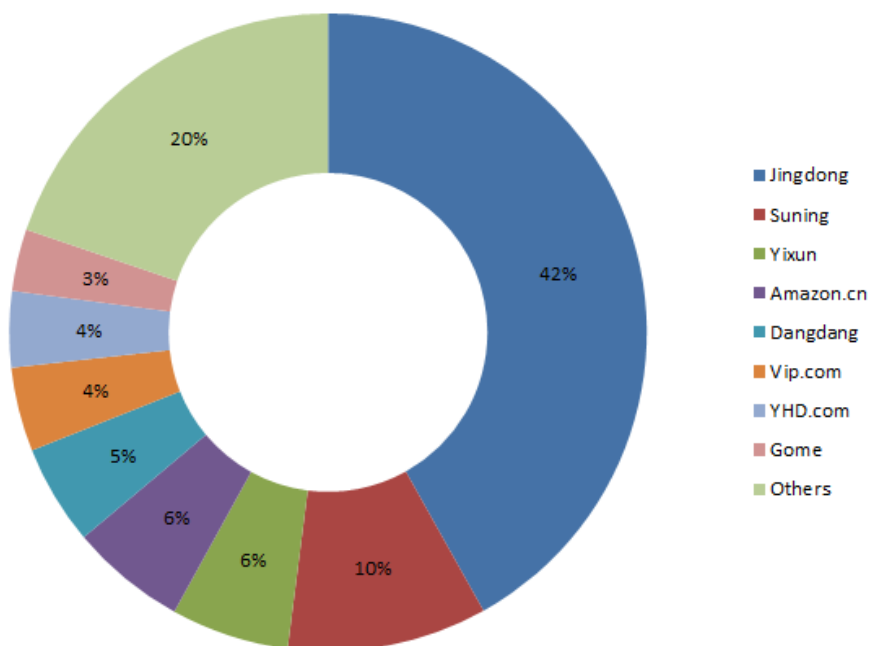
China B2C market in Q4 2013



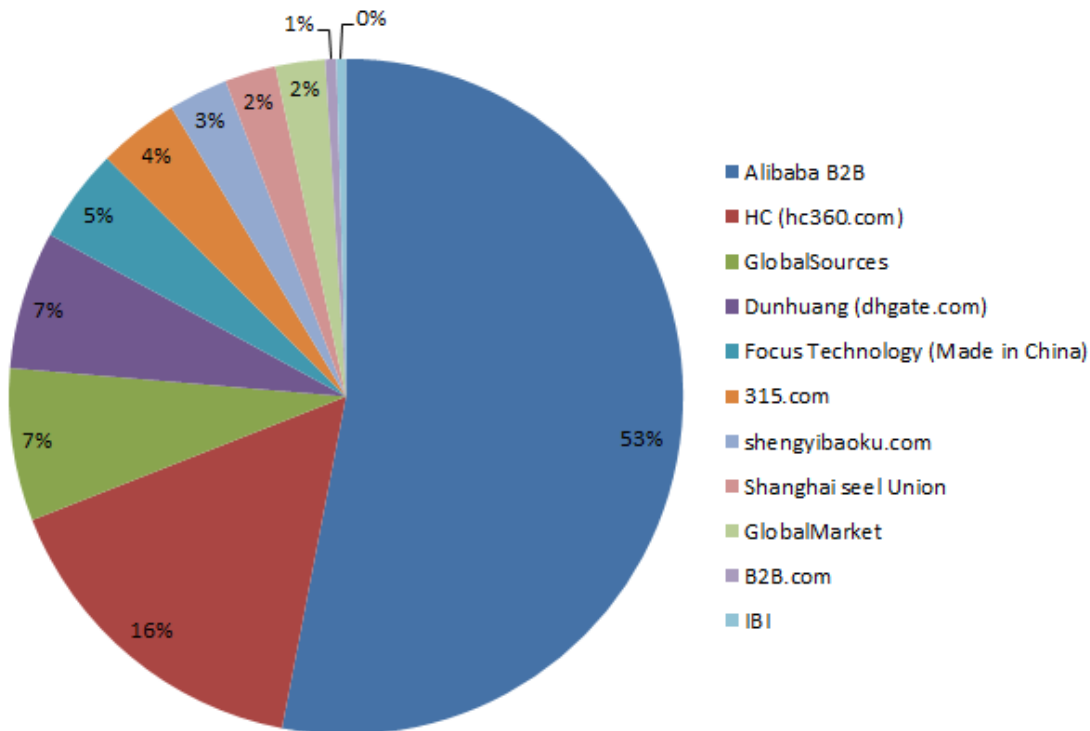
Source: iResearch

JD.com is the second-largest e-commerce company in China. Its strength is the high-speed delivery that it offers via a proprietary infrastructure and a mobile-based tracking system.

China proprietary B2C market in Q4 2013



Source: China Internet watch

Top 10 China B2B platforms in Q2 2013

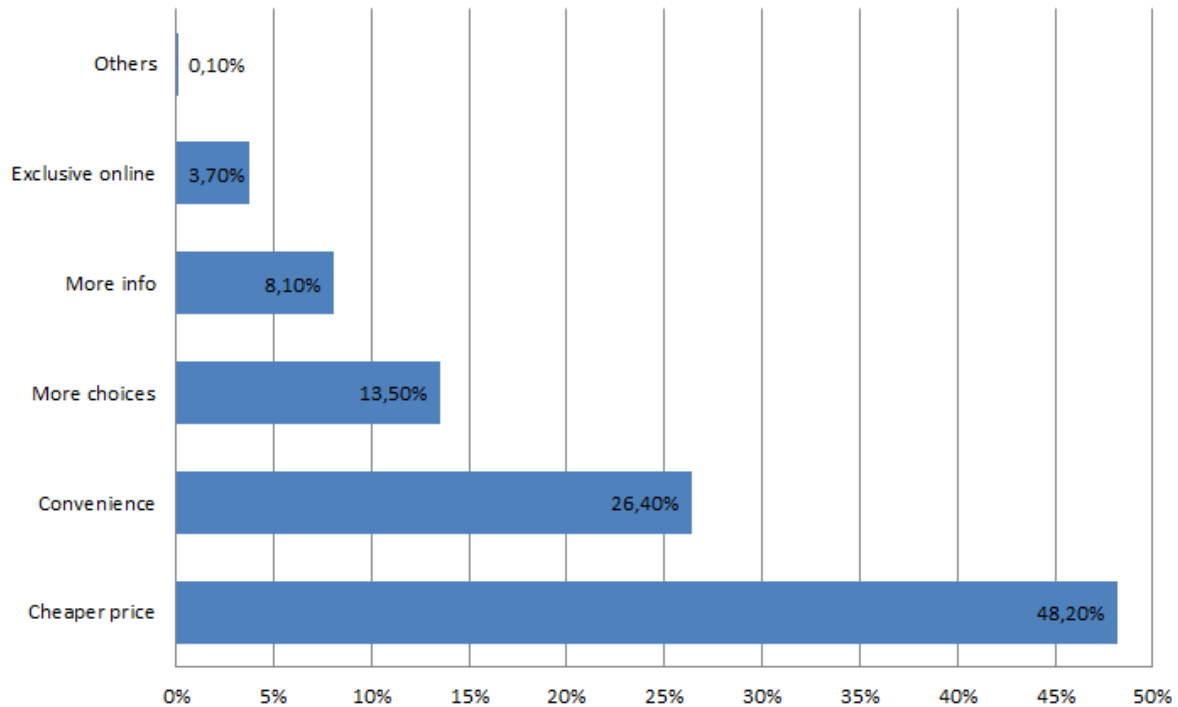
Source: iResearch

1.4 Consumer behaviour

A vast territory, expensive real estate, and a large number of shoppers in third- and fourth-tier cities without access to brick-and-mortar shops all make e-commerce an excellent option. Third- and fourth-tier cities have a higher demand for online shopping, which offers consumers a greater variety of goods to choose from. These shoppers spend a larger proportion of their disposable income than their peers in first- and second-tier cities.

Chinese consumers regularly compare prices between online stores and physical stores. To remain competitive, companies have to develop in response to changes in daily prices, both online and offline.

The Chinese are “bargain hunters”. Getting the best price is their main reason for buying online, and they compare prices across a range of e-commerce sites. On average, the Chinese visit two or three sites before making a purchase.

Why consumers choose online over offline channels 2012

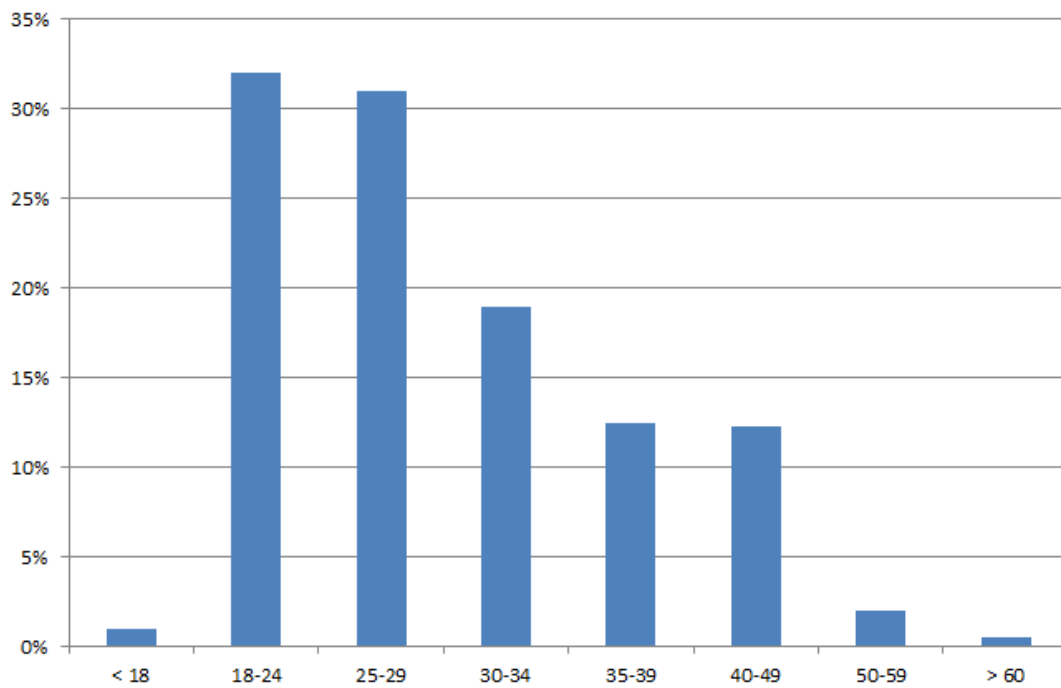
Source: *China Internet watch*

Chinese consumer behaviour increasingly mirrors that of the western world. Consumers are willing to pay a little more for better quality. Increasingly, they spend time researching and exploring the details of a product before taking the decision to buy.

Chinese consumers place great emphasis on brands. However, they differ from buyers elsewhere in that their main focus is the value of the product itself. The needs and interests of their families are very important when buying online. Word of mouth has become the most important source of information about the products they wish to buy – largely due to social networks such as Weibo, Renren and WeChat. Information obtained from these networks is considered to be highly credible. Over 50% of users are influenced by the media when making online purchasing decisions.

These trends represent a transformation in the behaviour of Chinese consumers, who are fast becoming one of the most complex consumer types in the world.

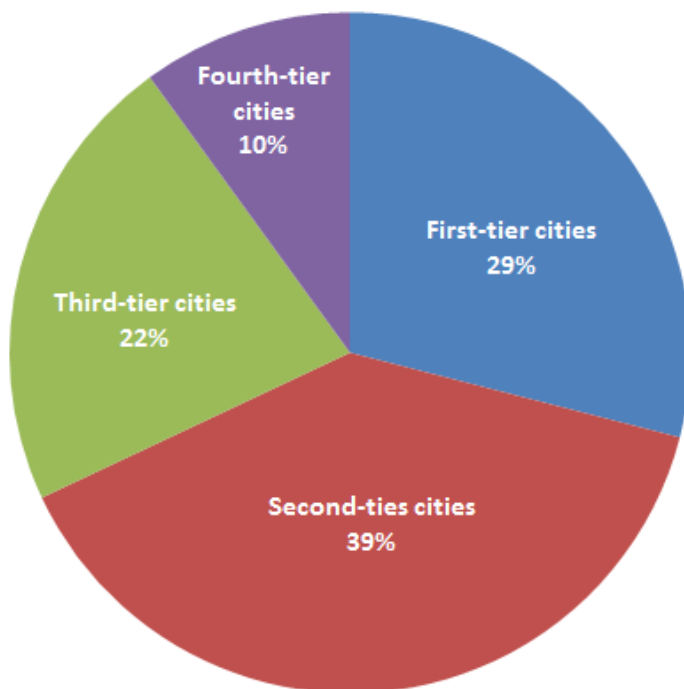
Age distribution of online consumers (excluding Taobao)



Source: *China Internet watch*

This graph is not very different from the European equivalent. More than 60% of those using e-commerce sites (excluding Taobao) are under 30 years old, with only 10% being over 40. Online shoppers are hence very much of the younger generation.

The consumer share of different tier cities



Source: *China Internet watch*

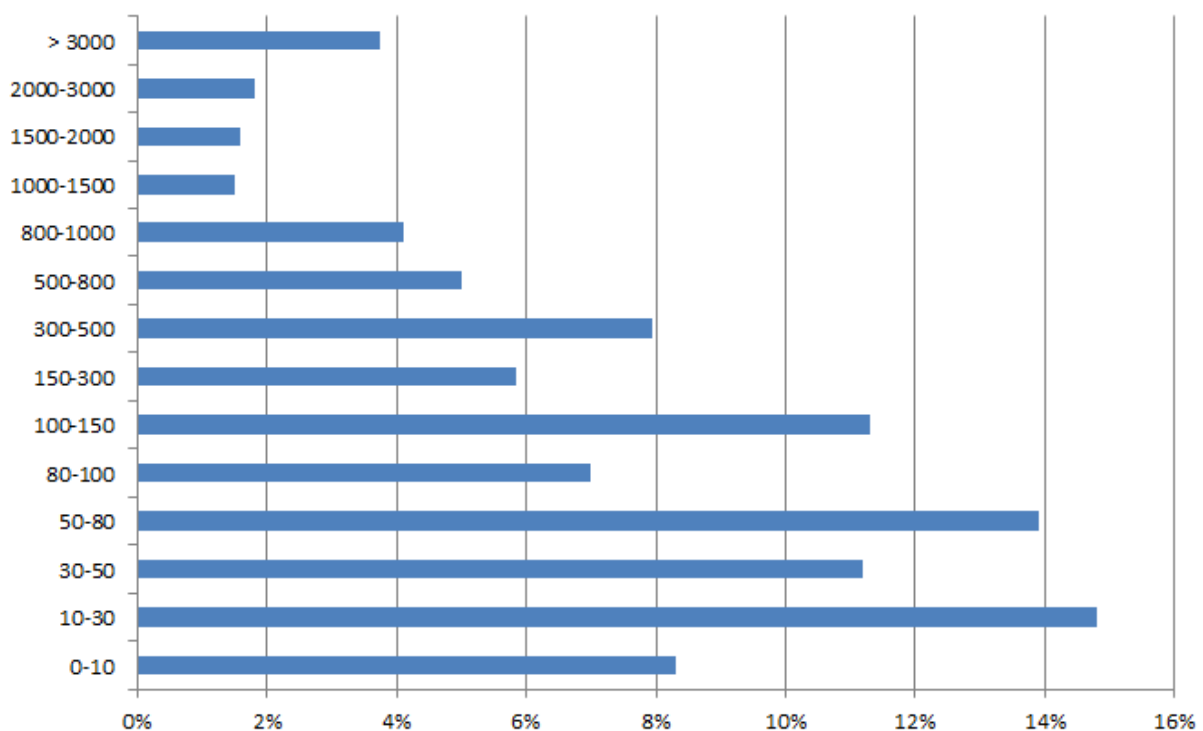
Alipay's annual statement shows that, as expected, the first- and second-tier cities have the largest number of shoppers. However, indicators point to the growth of third- and fourth-tier cities over the next few years. The fact that many products cannot be found in these cities causes people living there to resort to online channels.

The Alibaba Ali Institute and the Chinese Academy of Information Technology jointly set up the "E-Commerce Development Index". In 2013, they released a report entitled "China's top 100 e-commerce cities".

China's top 10 e-commerce cities

1. Shenzhen
2. Guangzhou
3. Hangzhou
4. Beijing
5. Shanghai
6. Jinhua
7. Zhuhai
8. Xiamen
9. Suzhou
10. Nanjing

Cost distribution of goods purchased by online consumers

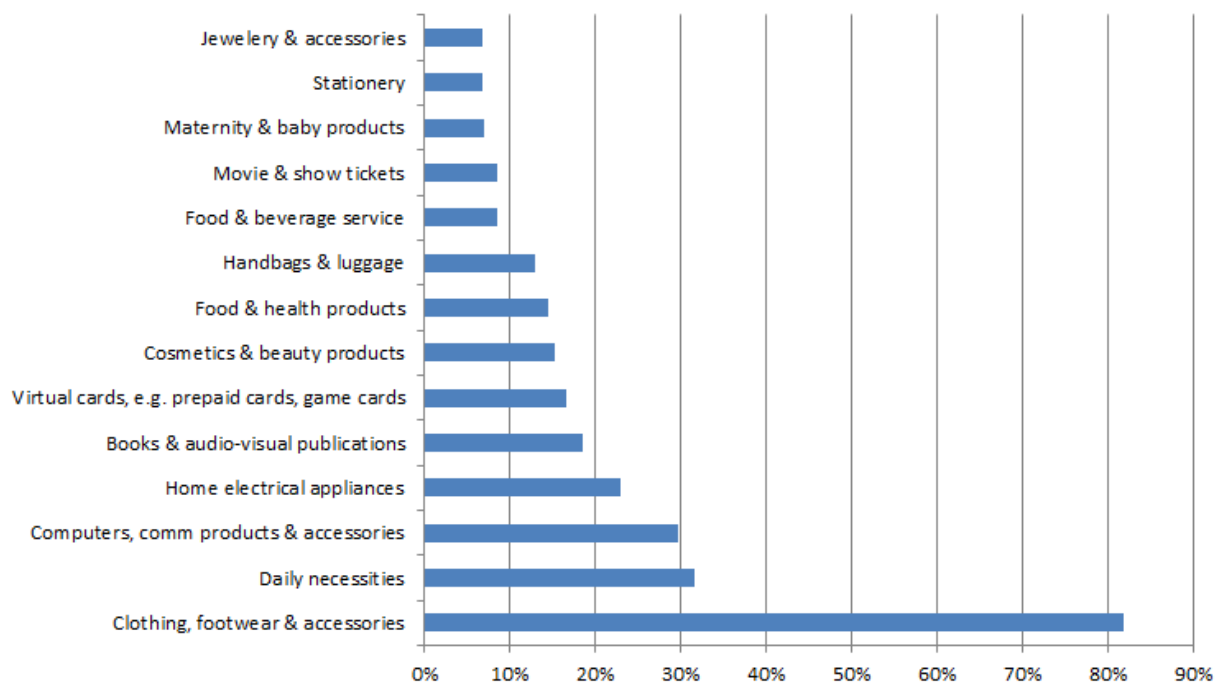


Source: *China Internet watch*

Most customers currently prefer to purchase cheap goods via online shopping. However, this trend is expected to change in the future due to growing confidence in e-commerce and a higher level of wealth amongst buyers.

A survey conducted by PricewaterhouseCoopers shows that Chinese consumers make online purchases at four times the frequency of their European counterparts. Chinese consumers also make a far higher proportion of their purchases online than shoppers in developed countries.

Percentage of Online Shoppers Purchasing Various Commodities in 2012



Source: *China Internet watch*

In 2012, 81.8% of users had bought clothing, footwear or accessories via the internet, mainly due to their strong desire for personalization and the limited diversity and insufficient amount of merchandise available in physical stores.

These percentages are not expected to vary too much in the coming years, as the offline market will remain much as it is today. European companies should look to offer products that Chinese cannot find in the local online market places or in local brick-and-mortar shops.

1.5 Chinese online shoppers buying overseas goods

According to the China Internet watch report from 2013, online shoppers purchased overseas goods from local e-commerce sites an average of four times in the second half of 2012, spending over CNY 400 on each purchase. The major advantage of purchasing goods from overseas is that buyers can choose from a wide variety of brands at relatively lower prices. The major problems encountered when purchasing overseas' goods are long delivery times, expensive delivery, and a lack of after-sales support.

According to an estimate by the China e-Business Research Centre, growth in the purchase of overseas goods this year will remain steady. The figure is expected to increase year-on-year.

1.6 Luxury goods

In 2013, 47% of worldwide luxury goods purchases were made by the Chinese (Source: China Internet watch). China's luxury goods consumer base is expected to expand from 80 million to 180 million people by 2020.

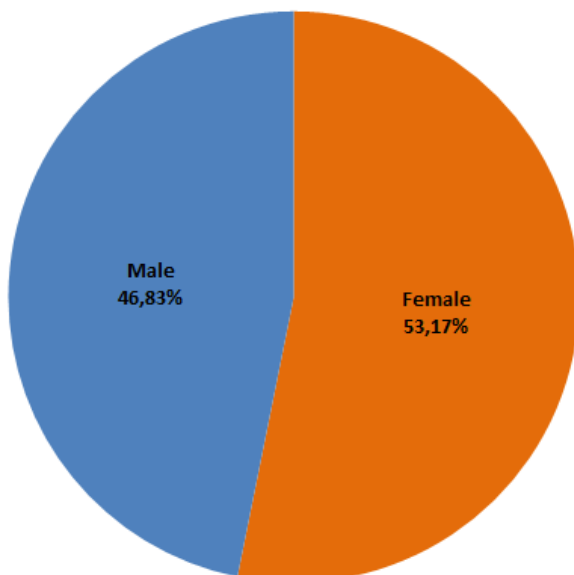
Some luxury brands are convinced that luxury goods and e-commerce are born enemies. Many online stores have lower prices, fast service and long-distance delivery – all of which run counter to the fundamentals of shopping for luxury goods.

Although most purchases are made in physical stores, luxury goods shoppers are increasingly buying online. This is especially true for third-party sites like Tmall or stand-alone e-commerce enterprises.

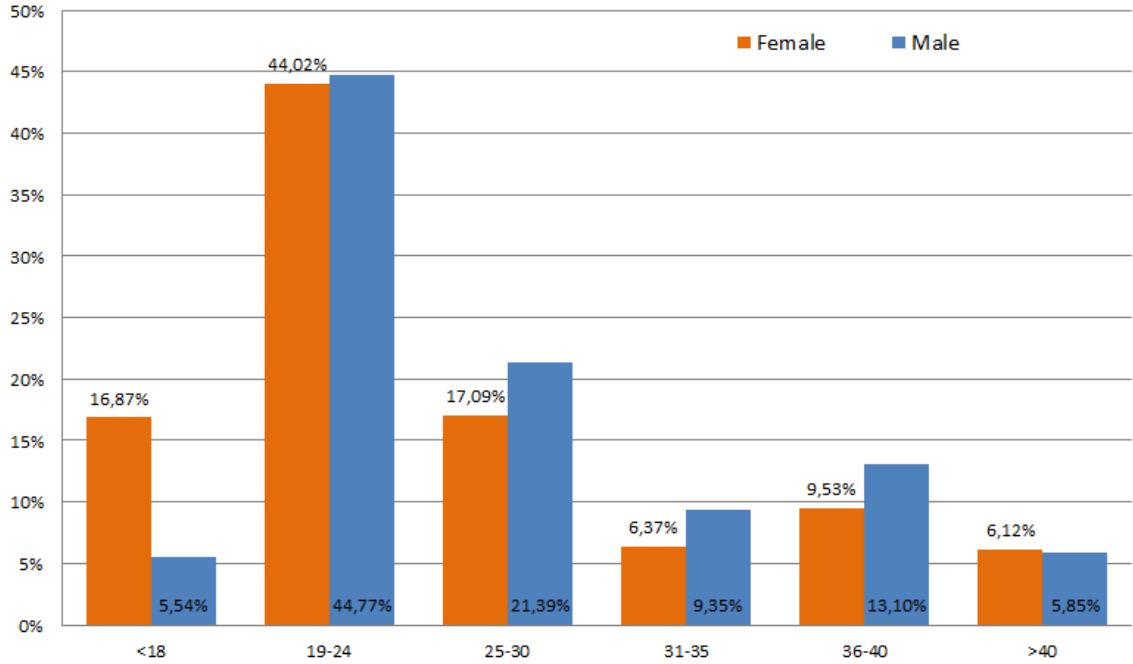
In a survey performed by KPMG in 2013, almost three-quarters of respondents said they preferred to shop online because they could land a better deal, while 55% said they preferred it as it was less time-consuming. Another 47% said that online shopping guarantees the authentic American or European origin of goods purchased.

The boom in China's luxury goods market is evidently making the transition online. However, the best model for luxury brands is online to offline (O2O) and vice versa. This model provides full control for the client, allows for buyer-seller interaction, and remedies the loss of hands-on customer experience. In order to take control of client interactions and establish a workable multi-channel business, companies should look to set up their own stand-alone ecommerce platforms.

Luxury consumers demographic: Gender



Luxury consumers demographic: Age & Gender



Source: China Internet watch

2 E-commerce market forecast

China's global e-commerce transactions (including B2C, C2C and B2B transactions) will reach CNY 30 trillion by 2020, becoming the world's largest e-commerce economy. It is estimated that by 2016, China's online retail transactions will reach CNY 5 trillion, accounting for 12% of total sales of consumer goods. By 2020, this figure is expected to rise to CNY 10 trillion – 16% of total sales of consumer goods.

With projected revenues of over CNY 170 million in 2017, O2O will become the principal way for retailers and traditional businesses to operate an online business. Large companies, especially department stores and chain stores, are seriously considering entering the Chinese e-commerce market.

China's rapidly growing online shopping community, improvement in payment systems and logistics, and highly competitive online pricing will combine to elevate the country's e-commerce penetration to the number one position in the world. In line with the Chinese government's plan, the number of online shoppers in China will grow tremendously, impelling more and more retailers to move their businesses online.

3 Advantages of e-commerce in China

E-commerce brings a number of new opportunities to Chinese consumers. The online marketplace, offers a wide range of goods, many of which cannot be immediately located through traditional retail channels. Categories of goods that may be difficult to find, such as imported foods, books, and international brands not yet established in local markets, are readily available for purchase via e-commerce platforms.

Two factors stand out as the key drivers of e-commerce in China: time and price. Shopping online as opposed to shopping through traditional retail channels is generally a time-saver. And prices for items purchased through e-commerce channels tend to be lower than for identical items in traditional retail outlets.

For EU SMEs, the e-commerce market represents a great opportunity to reach the whole of China from a single geographical position. We strongly recommend that companies open up an online channel, and in so doing be among the first to enter the Chinese online marketplace.

3.1 E-business models for EU SMEs selling goods in China

In contrast to the rapid growth of online shopping and group buying, stand-alone e-commerce has yet to take off. According to China Internet Development in Centre in 2013, the proportion of Chinese companies engaged in online shopping and online sales was 23.5% and 26.8% respectively, and the proportion of companies launching internet-based marketing campaigns was 20.9%. The penetration rates for stand-alone e-commerce vary widely across sectors, with manufacturing, wholesale and retail sales adopting the most e-commerce sites. Comparing stand-alone e-commerce sites across companies of different sizes, micro-companies are those which should give most attention to strengthening their presence in this area.

We have identified four key models for B2C online selling in China, all of which have their own advantages and disadvantages.

3.2 Delivery company competition in China

Types	Selected Enterprises	Pros	Cons	Latest Development
State-owned	-Sinotrans -China Post	-Large-scale -Pan-China network -Good relationship with governments	- Overstaffing - Low operational efficiency - Not customer-oriented	- Improved efficiency by merger and acquisition
The new breed (Privately owned or joint venture)	-PG Logistics -JC Trans -SF Express	-Clear market segment in terms of locations, services and targeted customers -Relatively efficient -Rapid growth	- Limited fixed assets - Lack of funding for market expansion - Constrained by internal management and company structure	- Formed strategic partnership with other competitive counterparts or investors
The spin off	-Midea	- Specialist knowhow - Good network	- Difficult to develop external client base	- Began to operate independently from

(logistics subsidiary of large-scale enterprise)	-Haier	coverage	- Future strategic plan and positioning affected by mother company	mother company
Foreign players	-FedEx -DHL -UPS -TNT	- Strong overseas network -Good logistics knowhow -Widespread adoption of IT	- Relatively weak domestic network in China - Limited scope of business in China - High operating costs in China	- Expanded their Mainland China market by merging or forming strategic partnership with local players

*Note: Pros and cons, and latest development may not apply to the enterprises listed in the table above
Source: Internet sources; compiled by Li & Fung Research Centre*

4. Recommendations

As shown in this report, China has the highest number of internet users and online shoppers, as well as the greatest growth prospects in the worldwide e-commerce sector, surpassing the United States and Europe in almost all respects.

To date, the market is dominated by the “big players” such as Taobao, Tmall, JD.com and others. According to recent news reports on China Daily and other portals, however, many companies are setting up alternate channels due to internal competition and very expensive advertising rates. The most common of these alternatives are stand-alone e-commerce sites, which allow companies to maximize contact with consumers, monitor service levels, improve customer service and maintain brand image.

Owners of physical stores in China claim that e-commerce is slowly killing their business. As such, they are aware that they must enter the online world by connecting their physical stores to the online marketplace, as was previously the case for many companies in western countries. Knowing the Chinese market, it is reasonable to expect this effect to increase over the coming years.

- Before entering the Chinese market, both online and offline, it is essential to first understand the Chinese culture and language, including their shopping habits and their attitudes to online purchasing.
- Before embarking on an e-commerce venture in China, the whole process – from the moment the customer first clicks “go to cart” to when the goods are delivered – should be given careful consideration. After-sales services (e.g. returns) should also be taken into account.
- As part of this process, particular attention should be given to the company’s logistics strategy. Which cities should be targeted? Which logistics providers will the company use to deliver to these cities?
- Take everything step by step. Bear in mind that projects in China are long term. Just as setting up e-commerce businesses in the respective European markets requires time for learning and consolidation, the same is true for China. Indeed, the situation here can be even more complicated.
- If you do not have a company incorporated in China, it is best to start by setting up the e-commerce business in Hong Kong. The Chinese market can then be approached more easily from here.
- Setting up the e-commerce business in Hong Kong is by far the easiest way to enter the Chinese market.
- For the project to be successful, it is essential to select an e-commerce provider with experience in China, Hong Kong and Europe. The business should be advertised on Baidu and other search engines using SEO and SEM, as well as other channels such as social media.
- The resources (time, capital, human) needed to develop and maintain an online business should not be underestimated. Whether you choose to start your online venture through third-party platforms or via a stand-alone platform, you will need a team (either internal or external) to carry out day-to-day monitoring and management.

Before making any large investments, we strongly recommend following the following quick steps in order to start selling online in China. If these are successful, you can then set up your business in Mainland China.

These are the minimum required steps to set up your online store for the Chinese market:

- Set up a branch of your company in Hong Kong if you don't have a legal company in China.
- Hire an experienced IT company to setup your e-commerce platform. Considerations here include:
 - A software that accepts multiple languages (Chinese and English)
 - Ability to generate “fapiao” (Chinese invoices)
 - Connection to a Chinese payment gateway (Alipay) in order to accept UnionPay cards
 - Information storage in a Hong Kong or Mainland China datacentre
 - Requirement to adapt the look and feel of the e-commerce site to Chinese culture and tastes
- Store your goods in Europe or in a FTZ. Deliver them as and when you get orders.
- Hire an express delivery partner that can help you to import the goods and deliver them in China
- Come up with online marketing strategies:
 - SEO: natural positioning in Baidu and Qihoo
 - SEM: pay per click services in Baidu and Qihoo
- Set up an after-sales department that can speak Chinese.
- Set up a Chinese speaking after-sales service in Hong Kong or outsource it to a specialized company based in Mainland China.
- And start selling online!

5. Resources

Further reading

2014-2017 China Internet economic forecast

<http://www.iresearchchina.com/samplereports/5545.html>

Published by: iResearch Consulting Group

Published: March 2014

China's new e-commerce law

http://www.gov.cn/gzdt/2014-02/13/content_2599199.htm

Published by: The Central People's Government of the People's Republic of China

Published: March 2014

China's e-commerce market: logistical challenges

http://www.funggroup.com/eng/knowledge/research/china_dis_issue113.pdf

Published by: Fung Business Intelligence Center, August 2013

Published: July 2011

Useful Websites

Ministry of Information and Industry (MIIT)

The latest statistics on China's ICT and telecommunications industries from the Chinese government.

www.miit.gov.cn

China Internet Network Information Centre

The latest statistics on internet usage in China.

<http://www.cnnic.net.cn/en/index/>

Internet Global Stats

<http://gs.statcounter.com>

China Internet Watch

Latest news and reports about the internet in China

<http://www.chinaInternetwatch.com/>

iResearch Consulting Group

Chinese internet reports

<http://www.iresearchchina.com>



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The EU SME Centre assists European SMEs to export to China by providing a comprehensive range of free, hands-on support services including the provision of information, confidential advice, networking events and training. The Centre also acts as a platform facilitating coordination amongst Member State and European public and private sector service providers to SMEs.

The Centre's range of free services cover:

6. Business development – provision of market information, business and marketing advice
7. Legal – legal information, 'ask the expert' initial consultations and practical manuals
8. Standards – standards and conformity requirements when exporting to China
9. HR and training – industry and horizontal training programmes
10. Access to a service providers directory and information databases
11. Hot-desking – free, temporary office space in the EU SME Centre to explore local business opportunities
12. Any other practical support services to EU SMEs wishing to export to or invest in China.

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