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EU-China E-Commerce Development

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Background Briefing: EU-China E-Commerce Development

Executive Summary

- The Chinese e-commerce market presents a significant and growing opportunity for European businesses. Although China's economic growth has moderated (to a target of around 7.5 percent in 2014), e-commerce is growing at a much faster rate (estimated at a compound annual growth rate of 21 percent a year from 2013-2017), and China's international, cross-border e-commerce value reached €281 billion (RMB2.43 trillion) in 2012 (up 32 percent from 2011).

- Recent Chinese government meetings have outlined plans for deepening reform of the economy and financial system, including a 'decisive role' for the market, a more open service economy for foreign firms, and stronger protection of intellectual property (IP) rights[1]. At the same time business and consumer demands are becoming more value and less price-driven in key sectors, indicating increased opportunity for European companies to engage in cross-border e-commerce.

- China's e-commerce platforms are dominated by a few major national players, including Alibaba in the business-to-business (B2B) sector, Taobao (owned by Alibaba) in the consumer-to-consumer (C2C) sector, and Tmall (owned by Alibaba) in the business-to-consumer (B2C) sector. JD, Tencent (both B2C) and Global Sources (B2B) also have significant platforms, while Alipay (Alibaba), TenPay (Tencent) and UnionPay dominate in payments. These businesses require strategic relationship management in order to maximise the opportunities for European firms.

- B2B makes up the largest share of the e-commerce market, followed by C2C and B2C. The B2C segment is the fastest growing, and is generally the most accessible to European businesses, mainly via 3rd-party platforms such as Tmall and JD. Key sectors to target include luxury branded goods, high-end food and beverages, and services such as travel, hospitality and education. European companies can also use existing platforms to target significant spending by Chinese living or travelling outside China.

- Chinese e-commerce is governed by a number of government departments and a variety of laws and regulations which can be complex to navigate. Imports are also subjected to various approvals, labelling requirements and duties which can hinder all imports, including those provided for by the European companies. The Chinese legal system is developing, but concerns remain around the enforceability of IP and other rights through the courts.

- China includes e-commerce cooperation in its European policy and there is an opportunity to coordinate development through a number of existing bilateral channels. In addition, new initiatives could be introduced to experiment with innovative policies in China's pilot cross-border e-commerce parks, and to provide a strategic and co-ordinated approach to the promotion of the European e-commerce offer, relationships with the key Chinese e-commerce platforms, and advice and support to European companies seeking to engage in e-commerce with China.

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[1] The relevant government meetings were the 2013 Third Plenum and the 2014 National People's Congress. The policies outlined at these meetings set the agenda for the development of China's 13th 5-Year Plan from 2016-2020.

Economic Reform and the E-economy

China's current development planning goals were outlined in the 12th Five-Year Plan (5YP), which runs from 2011 to 2015 and which includes a focus on rebalancing the economy towards domestic consumption and spreading the benefits of development across the country. It also includes a Ministry of Commerce (MOFCOM) plan for developing the service trade industry, including sectors such as tourism, transportation, consulting, and finance, all of which are relevant to EU service-sector export promotion, and to e-commerce development. Leadership on e-commerce development comes from the State Council, which has issued a number of policy documents in association with MOFCOM and several other government departments.

The Communist Party's 2013 Third Plenum (P3), and the 2014 National People's Congress (NPC) provided a preview of what is likely to be in store for the 13th 5YP (2016-2020). Key areas for 'deepening reform' include further economic restructuring, financial and state-owned enterprise reforms, a 'decisive' role for the market in creating economic efficiency, and a more open service economy for foreign investors – with implications for e-commerce, logistics, financial services, education and other areas. Also included is a recognition of the importance of intellectual property rights (IPR). Developments in e-commerce and consumer protection have already resulted, with the introduction of new regulations in March 2014, including the updated Consumer Rights and Interests Protection Law.

China's economic rebalancing away from exports and investment, and towards a consumption-driven growth, has resulted in slower, but more sustainable GDP growth (a target of 7.5 percent was set for 2014). The focus of the growth strategy is now on domestic consumption and the consultancy McKinsey suggests that by 2020 'mainstream' consumers number some 400 million people. This group will increasingly add to their purchases of basic goods a higher proportion of elective, luxury purchases, and spending on leisure activities and other services. In other words they are moving into a space which is well serviced by European companies offering value-added products and services.

Although China is challenging for companies to address as a whole, there are significant pockets of wealth, including the major, first tier cities, that are especially relevant and which can be targeted locally, or via e-commerce channels. Wealthy Chinese consumers are already the largest buyers of luxury goods in the world, but some 60 percent of their spending happens overseas. This happens partly because luxury goods are more expensive in China, and partly because they often want products that are not available in China, or because they want to guarantee genuine products. European retailers have an opportunity to proactively engage the global Chinese consumer on home ground, as well as via in-market and e-commerce channels.

The growth in consumer spending has helped the retail sector grow at a significantly faster rate than GDP (the target is for 14.5 percent in 2014) and China became the second largest retail market in the world, after the US, in 2012. Within retail, the luxury sector has been a strong performer, and is expected to reach a sales value of RMB180 billion (€21 billion) by 2015. Although the Chinese retail sector is famously competitive, the premium positioning and unique heritage of many European businesses means that there is still significant potential.

As well as being active on the high street, Chinese consumers are highly engaged online. The number of Internet users in China reached 618 million in 2013 (45.8 percent penetration).

The scale of opportunity is clear, but European companies need to adapt their strategies, value propositions, and services to local market conditions and to be aware of the risks, including those around enforcement of intellectual property rights (IPR) and other operational and regulatory issues.

E-commerce for Businesses and Consumers

E-commerce differs from the traditional Chinese business in terms of history and ownership. Internet-based businesses emerged after the reforms of Chinese state-owned enterprises in the late 1990s, so they were not dominated by state companies. They were built by private sector entrepreneurs who were quick to adapt to new technologies and trends. The pace of development has been very rapid, and iResearch has estimated that e-commerce will see a compound annual growth rate of 21 percent a year from 2013-2017.

A few large Chinese companies dominate, with Alibaba leading by a large margin. The business-to-business (B2B) sector grew by 19.7 percent and reached a value of RMB7.1 trillion (€840 billion) in 2013, according EnfoDesk, and a government estimate suggests the level could reach RMB15 trillion (€1.74 trillion) by 2015. Alibaba held a 46.4 percent market share in 2013, ahead of Global Sources with 17.5 percent (see Table 1, below):

Table 1: China B2B E-Commerce Market Share, 2013

Platform	Share
Alibaba	46.4%
Global Sources	17.5%
HC360	4.4%
Made-In-China	3.2%
Net Sun	2.0%
Others	26.5%

Source: China Internet Watch, EnfoDesk

According to a 2012 survey, the leading Chinese corporates making B2B online sales include Futaihua Industrial (a Foxconn subsidiary), the State Grid, ZTE Corp. and, in the service sector, China Southern Airlines. The fastest-growing sectors were reported to be energy, wholesale and restaurants, with the highest volumes being in the electronics, wholesale, automobile, tobacco, metals, machinery, chemicals and retail sectors. The further development of e-commerce in the B2B market may also present opportunities for more efficient procurement from, and sales to, China for European firms. In the longer term, and with China's potential joining of the WTO's Government Procurement Agreement (GPA), this opportunity may also extend to government e-procurement.

The number of Chinese e-commerce shoppers reached 302 million with spending of RMB1.84 trillion (€213 billion) in 2013, up 39.4 percent on 2012. iResearch expects China to overtake the US as the largest market for online sales in 2014, and that online spend will reach RMB3.6 trillion (€420 billion) in 2016, accounting for 10.8 percent of total retail sales.

With heavy use of mobile phones as an access point for online services (500 million users), mobile commerce (m-commerce) is a key growth area within e-commerce. It has grown significantly since 2010, and grew by 165 percent in 2013 to RMB168 billion (€19.84 billion).

The majority of consumer-focused e-commerce activity to date has been consumer-to-consumer (C2C), which accounted for just over 63 percent of the consumer e-commerce market at the end of 2013. Alibaba's Taobao is by far leading C2C platform, with over 90 percent market share (see Table 2):

Table 2: China C2C E-Commerce Market Share, Q3 2012

Platform	Share
Taobao	94.53%
Paipai	5.46%
Eachnet	0.01%

Source: iResearch Global

While the C2C sector is still the largest by volume, business-to-consumer (B2C) is growing at a faster rate. Alibaba also dominates B2C, with its Tmall platform accounting for around 51 percent of the market (see Table 3), followed by JD (17.5 percent) and Tencent (6 percent).

Table 3: China B2C E-Commerce Market Share, Q3, 2013

Platform	Share
Tmall (Alibaba)	51.1%
JD	17.5%
Tencent	6.0%
Suning	4.4%
Amazon.cn	2.65%
Others	18.35%

Source: iResearch Global

In February 2014, Tmall launched Tmall Global, with a Hong Kong domain (www.tmall.hk), targeting businesses outside China that want to sell to Chinese consumers. It is initially focused on mothers and babies, food, cosmetics, clothing and shoes, but has plans to expand. From a consumer perspective part of the attraction is that all products sold through the channel are genuine, foreign-sourced items. For foreign businesses, there is the potential to leverage the site's delivery and customs clearance services, and to compete directly with the army of agencies and semi-professional overseas buyers who procure items from abroad for customers back in mainland China.

In addition to individual foreign companies becoming active on Tmall and other platforms, there are examples of national and regional campaigns. In 2013 an Alaskan seafood promotion on Tmall resulted in 50 metric tonnes of sales. In March 2014 a US Meat Export Federation promotion resulted in 7,000 orders over 10 days. In April 2014, New Zealand Trade and Enterprise also used Tmall for a week-long, live seafood promotion that included an offer of 36-hour, air-freight delivery to Shanghai, or other destinations within 72 hours. In May Alibaba announced that it had reached an agreement with the French government to promote French brands on Tmall. Similar promotions could be considered by the EU, individual EU nations, organisations, or industry groups.

Each of the major international social media and e-commerce platforms has equivalent local Chinese players, and in some cases several. Foreign investors can establish e-commerce operations of their own in China (foreign ownership of value-added telecoms services businesses, including 3rd party e-commerce sites, is limited to 50 percent generally and 55 percent in the Shanghai Free Trade Zone)[2], but the international leaders have had limited success, not least due to the blocking of many sites by the Chinese government's 'great firewall', and as strategies have often failed to adapt to local conditions. For example, Ebay invested heavily in M&A and marketing in China from 2003, but fell back from a strong market position as Alibaba's Taobao marketplace adopted a more attractive (free) listing model and flexible, localised operations that made it the market leader, leaving Ebay to exit China in 2006. Groupon failed to gain traction in China due to intense competition and lack of local management, while Amazon continues to operate, but with less than 3% market share.

European companies that want to access e-commerce opportunities in China cannot simply rely on the same platforms they use in other markets, but need to consider using the major local platforms and / or their own physical and localised online offerings.

Social media has proved well-suited to China's mobile-heavy group culture, with Sina's Weibo becoming dominant (over 500 million users), and with newer contenders such as Tencent's WeChat (355 million users, including 78 million outside China) providing competition. The mass adoption of social media networks has had a major impact on retail and e-commerce. The major Chinese social media platforms were quick to develop retail marketing tools, and ultimately e-commerce payment functions (Weibo though Alibaba's Alipay, and WeChat though Tencent's TenPay - though these have been subject to some regulatory review). Alibaba has also made a pre-listing investment in Weibo, and Tencent in JD. The main payment platforms in China are listed in Table 4:

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[2] Telecommunications services, including value-added telecommunications services such as 3rd-party e-commerce sites are listed in the 'Restricted' category of China's Catalogue for the Guidance of Foreign Investment, which includes a foreign ownership cap of 50%. This level has been raised to 55% for relevant enterprises based in the Shanghai Free Trade Zone.

Table 4: China's Third Party Payment Platforms, Q2 2013

Platform	Market Share
Alipay	49%
TenPay	20%
UnionPay	10%
Other	21%

Source: China Internet Watch, iResearch

Due to lack of trust, limited access to payment services and/or a preference for cash, some e-commerce transactions still require cash-on-delivery, complicating the logistics of a transaction.

The e-commerce boom has been good for retailers who have been able to serve more customers more efficiently, but also highlighted the need for improved logistics, especially in relation to the 'last-mile' local deliveries. More investment has resulted, including from Alibaba and partners, who are spending US$16.3 billion (€11.78 billion) on a 10-year logistics development plan that seeks to allow for nation-wide 24-hour product delivery. Logistics has also been a focus of reform and government investment, and a plan approved by China's State Council in June seeks to achieve a modern logistics service by 2020.

Cross-border e-commerce between China and other countries is estimated by iResearch to have reached €281 billion (RMB2.43 trillion) in 2012 (up 32 percent from 2011), with the majority being B2B transactions by foreign firms buying from Chinese suppliers. Some 5 percent of the total was made up of Chinese shoppers buying direct from foreign e-commerce sites, with the main sources being the US (47.3 percent), the UK (13.6 percent), Japan (15.5 percent) and France (12.7 percent). Cross-border e-commerce is set to grow further with the introduction of policy initiatives that include the 2013 development of pilot cross-border e-commerce parks,[3] the first of which was set up in Shanghai's Pilot Free Trade Zone and has already seen the launch of a pilot cross-border e-commerce platform (kuajingtong.com) which is focused on five product categories - bags, fashion accessories, skin care and cosmetic products, food and beverages, and maternal and children's products). Another of the parks is in Chongqing's Liangjiang New Area, which lies at the end of the Chongqing-Xinjiang-Europe international line, which opened in 2011 (the other end is at Duisburg in Germany). Since April 2014 a regular freight link has operated on the line, offering 2-week delivery times (against 8 weeks for shipping, and saving 80 percent on the cost of air freight). Additional international air routes to regional hubs such as Chengdu and Chongqing, as well as the development of innovative international logistics services, may provide further opportunities.

Chinese companies are responding to the new reality of higher manufacturing costs and more competition at home, and are being encouraged by the government to rise up the

[3] 5 pilot cities have been selected for cross-border e-commerce trading by Chinese Customs, including Chongqing, Hangzhou, Ningbo, Shanghai, and Zhengzhou

value chain, to invest in research and development and innovation, and to develop brands that can create more value. In combination with China's going global strategy, it is likely that more leading Chinese companies will follow in the footsteps of companies such as Lenovo, Huawei and Haier, and to try to create international brands, and develop business in markets such as the EU and the US. The Rhodium Group has estimated that by 2020, Europe will have received between US$250 billion (€181 billion) and US$500 billion (€ 362 billion) in Chinese investment. This investment has not only being going into manufacturing, automotive and technology companies, but also into consumer brands in the EU, such as Club Med and Follie Follie (Fosun), Weetabix (Bright Foods), Volvo (Geely), and Sunseeker (Dalian Wanda). Chinese investors are keen to leverage these brands in their home market. In the case of Club Med, from the time of Fosun's 2010 investment to 2012, the number of Chinese visitors to their international resorts increased by 30 percent. Chinese investment can have a significant impact on a brands sales back to China, including via e-commerce. As China's largest trading partner, with a business environment that is perceived to be welcoming, Chinese investment into the EU is set to continue to grow and this is likely to have an impact on two-way trade in goods and services, including via e-commerce.

E-commerce activities are regulated by a number of different bodies, including the Ministry of Commerce (MOFCOM), the State Administration of Industry and Commerce (SAIC) and the Ministry of Industry and Information Technology (MIIT). Other agencies, such as the General Administration of Customs (GAC) and the Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) also have an impact on the processes, standards and labelling for imported goods. Imported medical devices, cosmetics and food also require approval from the State Food and Drug Administration (SFDA), while imported dairy products are subject to special registration requirements (which are to be confirmed) from May 2014, and EU-certified organic products require additional local certification.

Cross-border e-commerce sales should not normally be classified as personal effects, and may be subject to customs processes and import duties (1-56 percent for 14 categories) and VAT (13-17 percent), which would need to be paid by the importer. Although China is moving towards one-stop approval and 'single window clearance', the complexity of import processes acts as a barrier to some consumers and companies. Additional challenges include the need for a locally registered Chinese business to obtain an ICP (Internet Content Provider) license in order to set up a website in China, so local investment, a local partner or an agent may be required in China, resulting in transaction costs in addition to the 3PP and payment service commissions.

Conclusions

The e-commerce opportunity in China is already significant, but it is likely to grow substantially over the next few years, especially for cross-border transactions.

As China continues to climb the value chain and upgrade its industry, it has more need for value-added goods, services and technologies, including those which act as enablers for e-commerce - all of which can be offered from the EU.

The addressable Chinese consumer market includes wealthy, urban, China-based consumers. Value consumers in China may look to local suppliers for low-priced, commodity goods, but luxury consumers in the bigger cities are a key target for EU brands, especially where there are price differentials between markets, where counterfeiting is perceived to be a risk, and where products or services are not currently available within China. The concentration of high-end consumers in a relatively small number of urban areas in China, combined with a developed logistics infrastructure and high penetration of online shopping and payment facilities, provides a manageable target. Once established, and as demand and delivery infrastructure builds in other areas over time, the geographic coverage can be expanded.

In the medium to long term China may reduce import duties on luxury goods in order to retain more spending at home, but in the near term foreign retailers also have an opportunity to serve the "global Chinese consumer". The EU, in welcoming more Chinese tourists, students and visiting business people, can help local businesses start to engage with wealthy Chinese consumers on home ground. Consumer product categories from the EU with good potential for e-commerce in China include:

- Luxury branded goods, including fashion, cosmetics, jewellery and accessories. These products are often cheaper abroad, or are not otherwise available in China. As imported products they are also trusted to be genuine.

- Food and beverage products (especially meats, wines and spirits). China became the largest market for food and grocery retail in 2011, and is the fourth largest importer. There is strong demand for safe, high quality products and for those which can be used as gifts.

Digital content, including software, videos, games and apps, suffer from risk of IPR abuse in China and from the fact that consumers do not want to pay for content. But advertising-driven business models and in-app sales could be considered. In the longer term better IPR enforcement could help create more opportunity.

In addition there are opportunities for services. China became the third largest importer of services in 2010, with growth of around 11 percent a year. Services trade has been projected to reach €450 billion (RMB3.88 trillion) by 2015. Key e-commerce service areas include:

- Travel. This is a fast-growing sector in China, with the number of outbound visitors expected to double from 100 million to 200 million between 2015 and 2020. Travellers are also travelling further afield, and the EU is likely to see an influx of visitors as visa restrictions are eased.

- Hospitality providers such as hotels and restaurants will be beneficiaries of the growing number of Chinese visitors, who generally plan their trips and budgets in detail, and often use online platforms to book – especially with the rise of the independent traveller.

- Education and training in the EU have a good reputation among Chinese consumers, and the range of distance and online learning tools means that there are more opportunities to service Chinese consumers at home and aboard.

The development of e-commerce in China means that businesses can use multiple channels for sales, including via physical stores, online, or both. European businesses need to understand the different Chinese consumer segments, the platforms they use for social, mobile and e-commerce, and their purchase drivers. They also need to design appropriate business structures to be able to deliver e-commerce to Chinese customers and to ensure that they have protected their IPR. This can be done with a relatively small up-front investment, but requires ongoing monitoring.

Many European businesses, including larger retailers, have already established physical businesses in China or have distribution, franchise or agency agreements with local partners. Small and medium-sized enterprises (SMEs) may not have the resources to make such investments, but still have opportunities. Larger companies can invest in their own and 3rd-party e-commerce solutions in China, while coordinating offers in physical stores in China and internationally. For SMEs, the burden up up-front investment can be prohibitive. By taking steps to customise their offering for Chinese consumers overseas, and by enhancing their online presence with on and off-line promotions, Chinese language content, and mobile-friendly sites, smaller companies can offer exclusivity (if not available in China) to customers, and test the waters with minimal investment. Access to customised market research and business planning support, of the type provided by national-level trade support bodies can help to bridge the gap. But there is often a reticence to invest the time and money required to set up e-commerce operations for China. Another barrier to engagement is fear of risk, especially around IPR. EU businesses should at the very least conduct a review of IPR risks, and consider registering relevant trade marks, domain names, and other IP in China.

Despite the inevitable occasional trade disputes, China and the EU's aspiration for an Investment Agreement and potentially later a Free Trade Area (FTA) provides a positive backdrop for the further development of trade and investment links, including for e-commerce. Bilateral focus on potential barriers and bottlenecks such as standards, certifications, customs, payments, currency exchanges, and other issues will be of benefit to businesses and consumers on both sides. There have already been moves to identify and develop synergies between China's 12th FYP and the Europe 2020 Strategy, and this mutually beneficial approach can now focus on the development of the 13th FYP and its targets.

Policy Recommendations

- China is keen to obtain Market Economy Status (MES) and has re-applied to join the WTO's GPA. These are areas of policy leverage for the EU in bilateral discussions, and e-commerce issues should be highlighted where relevant to ensure there is sufficient attention given to protection and enforcement of IPR, as well as market access, tariff and non-tariff barriers, and equal treatment with domestic competitors.
- China's domestic policy to support the development of e-commerce is reflected in its stated European policy, which includes a desire to strengthen EU-China e-commerce cooperation. This policy focus can be leveraged through a number of existing channels[4] with a coordinated approach to the highlighting and promotion of common EU-China e-commerce issues such as standards, consumer protection,

[4] These channels include the EU-China High Level Strategic Dialogue, the High Level Economic and Trade Dialogue, the China-EU Economic and Trade Joint Committee, and the High Level People-to-People Dialogue, a well as the annual Comprehensive Innovation Cooperation Dialogue, the EU-China Cyber Task-Force, and ongoing work to improve the China-EU Customs Agreement and the Strategic Framework for China-EU Customs Cooperation. In addition the 2012 EU-China Year of Intercultural Dialogue included agreement to follow-up in a number of areas, including education, and this could include e-commerce in its scope, especially as distance learning and massive open online courses (MOOCs) are developing so rapidly.

customs, duties, taxes and payments. Equally transport policy has been noted as an area for additional bilateral cooperation, with a focus on five key areas, some of which, such as aviation, railways, and logistics, have obvious links to e-commerce delivery.

- The rapid growth of the e-commerce sector in China combined with policy initiatives, and the emergence of pilot cross-border e-commerce parks, provides potential for policy experimentation. Engagement with relevant central and local government departments should seek to identify and leverage existing investment and policy initiatives that may provide opportunities to drive forward e-commerce cooperation and test new initiatives. Areas such as the Shanghai Free Trade Zone and the Liangjiang New Area's cross-border e-commerce park (benefiting from the new EU-China freight link) provide examples of possible targets.

- The development of a China e-commerce hub for promotion of European products and services to Chinese buyers, and for provision of advice and support to prospective European sellers, could build on existing EU-funded business resources in China (such as the EU SME Centre and the China IPR SME helpdesk) and provide significant impact. Additionally, strategic relationship management with key Chinese e-commerce players (on trade and investment issues), government departments, and with cross-border logistics providers could help create innovations and efficiencies to benefit European companies.

- The development of e-commerce aligns with aspects of China's current 5-year plan, and with policies outlined for the future. While China gives more weight to consumption and the role of the market at home, it is also keen to develop exports and overseas investment opportunities for Chinese businesses. China is attracted to an open investment environment in the EU, and to the opportunity to access European and neighbouring consumer markets. As a result e-commerce development initiatives focused on Chinese investment and partnerships in the EU may be welcomed, and could help to ensure that cross-border e-commerce development is seen to benefit both sides.

- Although supportive of e-commerce development, China is sensitive to issues relating to information dissemination and the financial system, so issues around access to the Chinese internet and the management of payments will be considered in a political as well as commercial light. China is also unlikely to rapidly change customs and certification rules, but dialogues to exchange experiences and shared concerns could usefully be established at institutional and trade association levels to facilitate cooperation, and to target specific issues, for example recent delays in customs clearance for some products (such as mobile phones), and the current inefficiencies around local re-certification of organic products.

- Different Chinese government departments may not have aligned interests in relation to the development and operation of cross-border e-commerce with the EU. High-level Chinese policy support for related initiatives should be sought in order to facilitate progress for working-level dialogues, and e-commerce should be developed as a horizontal issue across sectoral and functional lines, with agreed points of contact on the EU and Chinese sides.