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CHINA – THE RISING DRAGON IN E-COMMERCE
WHAT FOREIGN COMPANIES SHOULD BE AWARE OF
WHEN ENTERING THE CHINESE ONLINE SHOPPING
MARKET

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<p>CHINA – THE RISING DRAGON IN E-COMMERCE What Foreign Companies Should be Aware of When Entering the Chinese Online Shopping Market</p> <p>Commissioned by Karelia University of Applied Sciences, Finland University of Applied Sciences Hof, Germany</p>	
<p>Abstract</p> <p>China is expected to become the world’s largest e-commerce market by 2015. In the next few years, the Chinese online business market is forecasted to surpass the US market in terms of online shoppers and spending power. At this juncture, particularly local online companies reap the benefits from China’s growing online market. However, the burgeoning market also represents a tempting investment opportunity for foreign companies. Firms that plan to tap into the Chinese online shopping market have to tailor its strategies to the unparalleled ecosystem and behavior of Chinese digital consumers.</p> <p>The main aim of this paper is to provide an overview over Chinese e-commerce landscape and to develop a guideline for foreign companies that wish to reap the benefits of this attractive market.</p> <p>Within the framework of this paper, a research and analysis were conducted in order to find out how to enter and to successfully compete in China’s dynamic e-commerce market. In the course of this, China’s e-commerce industry with its main players and customer behavior patterns is examined. Additionally, market entry strategies and a marketing mix are described to be able to overcome initial barriers. Eventually, business related challenges such as integration of online payment, delivery options and differentiation from competitors are presented.</p>	
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LIST OF ABBREVIATIONS

3C	Computer Communication and Consumer Electronics
B2B	Business to Business
B2C	Business to Consumer
BCG	Boston Consulting Group
BRIC	Brazil Russia India China
BRIC	Brazil Russia India China
CEO	Chief Executive Officer
C2C	Consumer to Consumer
CNNIC	China Internet Network Information Centre
COD	Cash on Delivery
ICT	Information and Communication Technology
ICP	Internet Content Provider
ID	Identification
MIIT	Ministry of Industry and Information Technology
OECD	Organization for Economic Co-operation and Development
POS	Point of Sale
Q	Quarter
QQ	Quite Quality
QQIM	Quite Quality Instant Messenger
RMB	Renminbi
SME	Small and Medium-sized Enterprises
UK	United Kingdom
USA	United States of America
URL	Uniform Resource Locator
VATS	Value Added Telecommunication Service
VIE	Variable Interest Entity

“The road to Internet riches in China is paved with corpses of American giants, and the body count continues to grow.”

*(Communications of the Acm, p.147
January 2009, Vol.52, No.1)*

1 INTRODUCTION

At this juncture, no online business industry is gaining momentum like the one in China. By 2015, China is expected to become the world's largest e-commerce market, as the number of people gaining access to the Internet is constantly increasing. In the next few years, the Chinese online business market is forecasted to surpass the US market in terms of online shoppers and spending power. Thanks to its population of 1.3 billion, China represents a vast untapped market for online trade.

Initially, growth of the online industry was spurred by consumer to consumer sales. This attracted numerous companies to sell products online, which triggered growth in China's B2C online market. The then relatively low barriers of entry beget a bevy of online companies to start operations in China. In addition, the Chinese government has realized that e-commerce has become a significant tool to enhance economic competitiveness and has been supportive in the development of the Internet industry. However, the rise in e-commerce has led to a mushrooming of local and foreign online stores and therefore a hot competition. With the e-commerce market being dominated by indigenous players, in particular Jack Ma's e-commerce empire, foreign companies have been struggling to get a piece of the promising market. Numerous high-profile foreign companies, including Amazon, Groupon, eBay and Rakuten, have failed to repeat their success in China. As a part of this paper a number of large e-commerce entries were examined to identify the key errors of the heavyweights. Among the crucial errors the new entrants have made are serious underestimation of local competition and a low degree of adaptation of the business model to the Chinese market. New entrants have ignored the peculiarities of China's unique online shopping system and have demonstrated a lack of flexibility in responding to the evolving market. The intense competition in China's e-commerce industry drove several players out of the market. Others have chosen a new strategy after incurring serious financial losses.

The future China's e-commerce looks bright, however, the online shopping market remains immature. Consequently companies that wish to take full advantage of the opportunities arising from the further development of the Internet industry in China, have always to be in touch with that is happening in the highly dynamic market.

2 CHINA'S E-COMMERCE ON THE RISE

2.1 Online Shopping Takes Off

Research conducted by the Boston Consulting Group (BCG) pledges China to experience an e-commerce explosion in the years ahead. It is well-known that China is home to the largest Internet population of the world, within the next few years it will also be home to the second-largest population of online shoppers. According to the latest report of the China Internet Network Information Centre (CNNIC), the number of online shoppers reached 210 million at the end of June 2012. This is slightly more than the number of the United States (184m) and five times the number of the United Kingdom (43m) (Statista 2012/BBC 2012). An OECD study revealed the UK to be the biggest online shopping nation among developed countries, suggesting that 60 percent of its population use the internet to buy products (Hall 2012). Given the fact that 210 million Chinese online shoppers account for around 15 percent of the population and just under 40 percent of all Internet users, there is enormous room for growth in the Chinese e-commerce market (CNNIC 2012). Moreover, BCG forecasts the number of online shoppers to touch 329 million in the year 2015.

Figure 1 clearly illustrates the fact that e-commerce penetration goes hand in glove with the Internet accessibility. In the period from 2007 to 2010, China saw accelerated growth in the number of new Internet users. For each year, between 73 million and 88 million people went online, numbers that surpass the population of France. Since new Internet users need to gain familiarity with the web in order to achieve a certain level of comfort and adaptation, the number of new e-shoppers follows the exponential growth of new Internet users with a slight time lag. In 2006, less than 10 percent of China's urban population engaged in online shopping activities. From that low level, e-commerce penetration has more than doubled by 2010. But ever since 2011 the growth of online shoppers has become steady. Against the backdrop of positive Internet usage predictions, 30 million Chinese are expected to join the e-commerce world every year until 2015. That astounding number of new online shoppers comes close to Canada's population. (BCG Perspectives 2012.)



Figure 1: China's Rapidly Expanding E-Commerce Market Follows Growth in New Internet Users

2.2 Factors Spurring Rapid Expansion of China's E-Commerce Market

The underlying dynamics behind this development are the increasing availability of the Internet and growing confidence in online payment security. A further aspect is the rising per-capita income of China's urban residents which promotes a trend of consumerism.

Thanks to the government's effort to shape up the country's telecommunication infrastructure and further develop the information technology industry, Internet is to become widely available. So far China has lived in the shadow of other countries when it comes to the sophistication of broadband, however such a technology is crucial in order to trigger both economic growth and national competitiveness. Even though China is already known to have the largest Internet population in the world, the Internet speed is still lagging far behind the global average. As provided by the 12th Five-Year Plan, the Ministry of Industry and Information Technology developed a project for a broadband network at the national level. The "Broadband China" project aims to increase the average broadband speed and enhance the availability of broadband services in rural areas. By the end of 2015, China is expected to reach 250 million broadband subscribers. Though the number of broadband users in China amounts to 159

million, the broadband penetration rate of 11.7 percent is far behind the rate of developed economies, which reaches 25.7 percent. (Jingting 2012.) According to the 30th Statistical Report on Internet Development in China, the Internet penetration rate has hit 39.9 percent in June 2012. At that point, China recorded 538 million Internet users. Compared to the United Kingdom and the United States, where 82 percent respectively 78 percent of the population are using Internet, Chinese internet users account for around 40 percent (CNNIC 2012/ Quilty-Harper 2012). According to the Data Center of China Internet (DCCI), China's broadband charges are four times higher than in the United States and 29 times higher than South Korea. Obviously, China's current fees of broadband service are high relative to the average income and therefore, mostly available only to the middle class and above-average earners. However, China Telecom as well as China Unicom – the two major telecommunication providers – have announced to decrease broadband service charges and to raise broadband access speed in the coming five years (Xinhua, 2011).

Another factor driving growth of the e-commerce industry is the continually increasing trust in online paying methods. As per the latest CNNIC report, the number of users using online payment keeps rising constantly. Just within half a year the number of online payment users went up from 161 million in December 2011 to 187 million in June 2012, and the utilization rate up to 36 percent. (CNNIC 2012.) Only a few years ago, online payment was considered as one of the most challenging hurdles to e-commerce adaptation in China. Since credit-card usage was not a rampant phenomenon in the country and trustworthy and satisfactory methods of online payment were lacking, e-commerce initially suffered from teething problems. In 2003, however, the Alibaba Group, which owns the country's largest e-commerce website, launched Alipay, its innovative escrow service. The online payment platform ensures secure and safe transactions by holding payments from consumers in escrow and only releasing these after the receipt of goods. Alipay is China's leading third-party independent payment platform that aims at building up trust with e-shoppers by protecting their details. Nearly 50 percent of Chinese online shoppers use Alipay (Statista 2012). The second most common payment method, with a usage rate of 16 percent is cash on delivery (COD) (Statista 2012). This type of transaction is also widely accepted by online shoppers. (Statista 2012/ BCG Perspectives 2012.) The third-party payment enterprises

generate their profits from 1 to 4 percent fees, which, according to industry experts, might be lowered due to tough competition.

The boost in online shopping can also be traced back to the issue of third-party online payment permits by the People's Bank of China in 2011. The "License of Payment Transaction" encompasses Internet payment, mobile phone payment, bank card acquiring service and accept of prepaid cards and currency exchange. Alipay, China UMS and Tenpay are among the qualified electronic payment platforms. Giving legal status to the first 27 third-party online payment platforms can be viewed as a milestone for China's e-commerce, as it will foster standardization of the e-payment sector and integration of e-payment and e-commerce. (Chen Zhi 2011.)

Another key point of the 12th Five-Year Plan, announced by Hu Jintao, is the launch of an income distribution reform plan to lift domestic purchasing power and speed up growth of the national economy. The predominant objective of this policy is to expand middle class and narrow the widening income gap. While in the United States and Europe middle-income earners account for up to 70 percent of the population, in China it is merely 23 percent of the total population. In order to release consumption potential and to stride over the middle income trap, China's government plans to raise the number of middle-income earners to 40 percent by 2020. The policy is to cover an increase in disposable income through cutting enterprise taxes (particularly for small-scale and labor-intensive businesses) and regular salary increments. Simultaneously, the government is to tackle the shortfall in consumption by extending social security, which is a major concern for Chinese people who accumulate savings to be able to pay for health care and retirement.(Jia 2012.) If successfully implemented, such measures are likely to stimulate domestic consumption intensity.

Research undertaken by McKinsey suggests that China is at a turning point because the wealth of many urban consumers is expected to soar rapidly. The per capita disposable income of urban consumers is expected to double from about \$4,000 to about \$8,000 within the period from 2010 to 2020. Figure 2, clearly depicts that the vast disparity in income levels will persist, although the level of income will rise at each level. Currently value consumers¹ make up the great majority of the population. Households of value

¹ Value Consumers: consumers with an annual household income of \$6,000 - \$16,000

consumers have an annual disposable income of between \$6,000 and \$16,000. This amount is just sufficient enough to cover basic needs. Relatively prosperous households are referred to as mainstream consumers, which have a disposable income of between \$16,000 and \$34,000. Mainstream consumers represent 6 percent of the urban population or roughly 14 million people. By 2020, the situation will have changed, as mainstream consumers will account for 51 percent. This group of urban residents will be the basis for increasing consumption, affording better-quality products and family cars. Affluent consumers, with a household income of more than \$34,000 are and will remain a tiny group, even though they will make up 6 percent (21m households) of the urban population. (McKinsey Insights China 2011.)

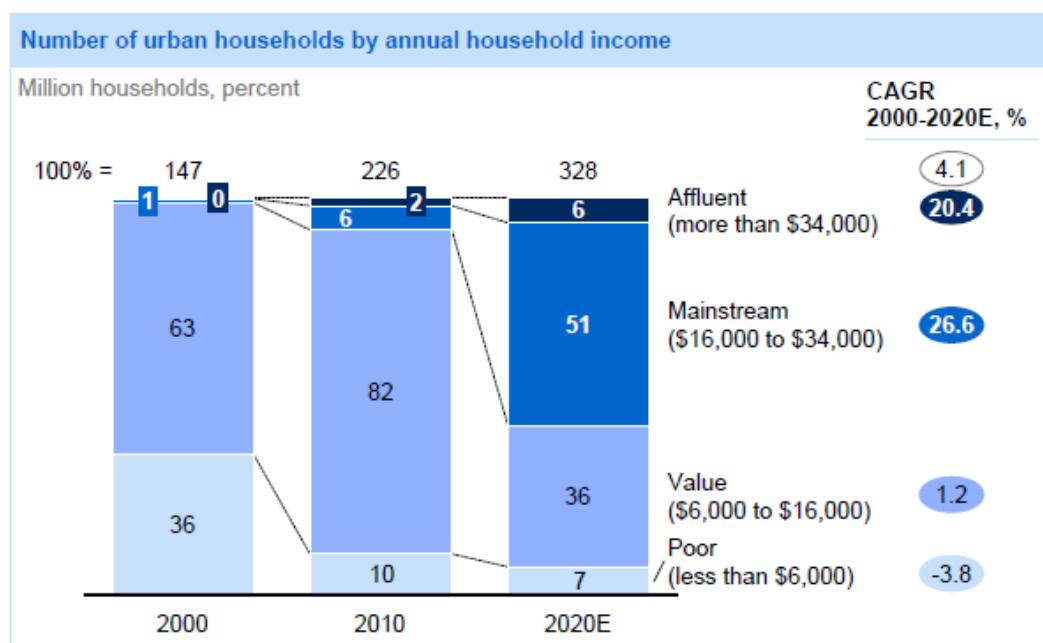


Figure 2: Number of Chinese Households by Annual Household Income

2.3 The Potential of the E-Commerce Market in China

As Internet usage ramps up, so does the value of China's e-commerce market. While in 2010, the transaction value² of the e-commerce market in China was equal to the amount of RMB 476 billion, in 2015, it is expected to surpass the RMB 2 trillion barrier, achieving a compound annual growth rate of above 33 percent. Additionally, e-commerce will go from representing 5.3 percent of total retail value today to 8.6 percent

² The actual value of sales, including all fees.

in 2015. (Statista 2012.) Pundits forecast China to outnumber the figures of the United States and become the largest online shopping market in the world. Online spending is expected to boom in China, the Boston Consulting Group claims that by 2015, average annual online spending in China will run up to \$940, close to the current average in the United States that stands at \$1,000.

At this juncture, however, particularly local online companies reap the benefits from China's growing online market. In December 2012, Jack Ma, the CEO of the Alibaba Group (a family of Internet-based businesses) announced the sales of Alibaba already exceeded the RBN 1 trillion mark, or US \$161 billion. This would make Alibaba the largest e-business company in the world, outstripping U.S. giants like Amazon.com and eBay.Inc. Nevertheless, Alibaba Group does not find itself among the top 500 online retailers, as it does not sell on its own behalf. Ma also tweeted that; "It's very likely that next year, our transaction volume will be bigger than all the American e-commerce companies combined."(Davis 2012.)

The fast growing online market attracts also foreign e-commerce giants. Amazon was among the first movers when it entered the Chinese B2C market in 2004 (Wang 2012). Neiman Marcus – a large American department store has been running its Chinese online shop since December 2012. UK's largest online fashion and beauty store ASOS.com revealed its plans for going China by posting a recruitment advertisement for a Chinese manager on LinkedIn. (iResearch News 2012.) In light of the fact that China's burgeoning e-commerce market represents an increasingly tempting investment opportunity as it is likely to be the world's most valuable e-commerce economy over the next four years. Therefore, foreign companies that wish to catch the e-commerce wave need to understand China's unique e-commerce environment as well as the trends and consumer behaviors that will shape the future development of the online market. Companies that have realized this window of opportunity must be quick to tailor its strategies to the unparalleled online ecosystem and unique behavior of Chinese digital consumers.

3 UNDERSTANDING CHINA'S DIGITAL CONSUMER

To keep pace with the rapid expansion of the e-commerce market and the emerging online shopping trends, the companies need to understand the distinctive online behavior of the Chinese consumer and factors affecting their way of spending. Those will be elaborated in the following.

3.1 The Average Chinese Internet User

Despite the fast expansion of Internet usage and e-commerce in China, there are still differences among the Chinese online consumers with respect to their demographics and socio-economic characteristics. When it comes to age, youths and young adults are the main Internet users in China.

With respect to the utilization ratio for the group of 10-29 years old remains at a similarly high level of approximately 70 percent. For the group of 30-39 year old, however, there is much enhancement space as the number of Internet users at that age keeps rising constantly. For the population of 40 years and above, there is only little upward change in the utilization ratio. (CNNIC 2012.)

With regards to education background, the Internet utilization ratio for people with a college degree and above reached up to 96 percent. Similarly, the penetration rate for people with a senior high school degree went up significantly to 90 percent. For the population with primary education and below, the Internet penetration rate is rather slow. It stands to reason, that it is hard for elderly persons and people with a low education level to adapt to the Internet, compared to young and educated people. From these findings, it appears self-evident that students cover the lion share of Internet users, with total 30.2 percents, followed by free-lancers. In addition, clerks and unemployed account for approximately 9 percent each. The proportion of Internet users with an income above RMB 2,000 adds up to 40.2 percent is on rising considerably. Unfortunately, the CNNIC report does not provide unambiguous and complete data on the income structure of Chinese internet users. (CNNIC 2012.)

The average time Chinese Internet users spend online comes up to 19.9 hours per week. Consequently, Chinese Internet users are online for an average of 2.8 hours per day,

which is longer than the average users in any other BRIC country. This behavioral pattern is rather similar to the one of Internet users in the United States and Japan, where Internet users spend 2.3 (USA) and 2.9 (Japan) hours online per day. (BCG Perspectives 2010.) As in many other countries, the ratio of Chinese male Internet users is higher than the number of female users, namely 11.8 percent (CNNIC 2012).

At present, China's Internet population is mushrooming, however, at the same time there are significant differences in the Internet penetration rate among the 31 provinces. In twelve provinces, Internet penetration rate is higher than 70 percent, which is above the national average. Beijing, Shanghai, Guangdong, Fujian Zhejiang, Tianjin, Liaoning, Jiangsu, Xinjiang are among these provinces that are primarily concentrated along the east coast. On the other hand, there are ten less developed rural provinces, such as Tibet, Hunan, Guangxi, Sichuan, Henan, Gansu, Anhui, Yunnan, Jiangxi and Guizhou where Internet penetration is lower than the global average. Whereas, more than 70 percent of urban residents use Internet, the proportion in rural areas is at about 27 percent. The key reason for this is that people in rural areas do not own a computer and lack Internet usage skills. (CNNIC 2012).

It remains to be seen how fast broadband and Internet connectivity will penetrate into rural areas. However, in tandem with the telecommunication infrastructure development and the anticipated increase in per capita income, rural Internet users represent future growth potential.

Interestingly, the results of a study conducted by the International Journal of Consumer Studies, disclosed that being a member of the Communist Party increases the probability of becoming an Internet user and online shopper. This might be traced back to the privileges or advantages that Chinese Communist Party members enjoy which provide them access to limited resources. (Lingfei Wu 2012, 467.)

As mentioned above, it takes some time to complete the transfer from a new Internet user to an experienced Internet user and even certain conditions and factors to become an online shopper. Given the expected e-commerce growth trajectory, there is huge penetration space in the future, particularly for middle-aged groups and rural users. From this follows that the average Chinese online shopper of tomorrow will not have

the same consumption behavior pattern as today's online shopper. It is difficult to make meaningful forecasts on the consumption pattern of potential online shoppers. This is owing to the fact that additional factors such as purchasing power, logistics distribution capabilities, popularization of smartphones, just to name a few, will have severe implications on the industry. However as a starting point, online shopping behavior of today's Chinese e-shopper will be described in the following.

3.2 Distinctive Online Shopping Behavior

The number of online shoppers in China is astounding. But who are these people? How do the online shopping behavior patterns of Chinese online shoppers differ from the online shopping behavior around the world? Marketers, who seek to capture the opportunities emerging from the swelling online shopping population in China, will need to find answers to these questions. It is insufficient to take a look at the demographic information of consumers only, the essential information is concealed behind the basic data on demographics.

According to a number of studies, online shoppers in China are unique in many ways. The most obvious fact is that Chinese e-shoppers shop more often online than their counterparts in other countries. As many as 70 percent shop online at least once a week. In contrast to the USA and UK, where the number comes up to mere 40 percent and France and Netherlands, with 20 percent respectively, the findings reveal that Chinese consumers shop online nearly four times as often as their European peer groups. (PwC 2012). This explains why 85 percent of online shoppers admitted in a survey conducted by McKinsey that online shopping was at least as good as offline or even better. The industry research also suggests that just 6.2 percent shop once and are done. Most of Chinese Internet users try e-shopping and become repeat customers. (McKinsey 2012.)

The more experience a consumer gets with click-through shopping, the wider becomes the variety of things he/she is buying online. In China, apparel seems to be the first commodity people buy online. After they have gained sufficient experience in online shopping, they extend the range to household supplies, cosmetics, books and consumer electronics. The predominant reason why consumers are buying apparel, skin care, cosmetics and consumer electronics online is because certain brands are not yet available in stores in cities. This is particularly true for cosmopolitan and well-traveled

consumers, who are not able to find the brands that they look for in low-tier cities. (BCG Perspectives 2011.)

Another key finding of the industrial research is that the more experience and familiarity people have with online shopping, the more they spend online. The Boston Consulting Group has divided Chinese online shoppers into four segments according to the amount of money they spend online. The classification ranges from light and moderate to heavy and super heavy spenders. One critical result from this segmentation is that super heavy spenders, who usually spend online more than RMB 10,000 annually, only make up 7 percent of online shoppers. At the same time, this smallest group among the segments, accounts for the highest percentage of total spending that is 40 percent. Together with heavy spenders, whose annual online spending reaches from RMB 5,000 to 10,000, the two top groups make up 64 percent of total online spending. By contrast, the numerically largest group within the segmentation, namely light spenders account for just 14 percent of total online spending. This implies that experience and the income level are the driving forces behind online spending. Furthermore, BCG predicts the average annual online spending to double by 2015. As early as, in three years, annual spending of the average online shopper will rise to RMB 6,220 which nearly touches today's average in the United States. (BCG Perspective 2011.)

When it comes to the types of and Internet users, who research for products online or read reviews, there is a significant difference from those in other countries. In China, merely 16 percent of consumers inform themselves about a product online, whereas in the United States and the European Union 60 percent visit the official brand website. This might be due to a low level of adaptation or localization of foreign brand websites to the Chinese markets, which are mostly direct translations of the original website. Hence, the website is not attractive enough to be visited frequently. (BCG Perspectives 2011.)

The popularity of electronic commerce is rooted in several factors. Online shoppers around the world are consistent in the fact that convenience and a greater variety of items are the principal reasons for shopping online. However, except for the obvious reasons for purchasing online such as a 24/7 access to shopping or availability of the

latest fashion and entertainment, there are two major factors that are mainly appealing to the Chinese consumer. First, Chinese consumers have a propensity to bargain and they tend to be fairly price sensitive. Browsing through numerous online shops, online shoppers are searching for the best deals. There are customers, who achieve a relatively high satisfaction degree when they gain the best deal online. Secondly, online shoppers in China are the most social e-shoppers around the world. Compared to online shoppers in other countries, Chinese are reading and posting product reviews most frequently. Chinese consumers trust blogs, review sites and social networking sites more than official sources such as information from the manufacturers. Recommendations and reviews from friends are viewed as reliable information and serve to ease the distrust towards online sellers. Chinese, who engage in online shopping, also like it when others buy products because of their recommendations and helpful reviews. (BCG Perspectives 2011.) Simply put, online shopping in China lures shoppers searching for bargains and a social and entertainment factor.

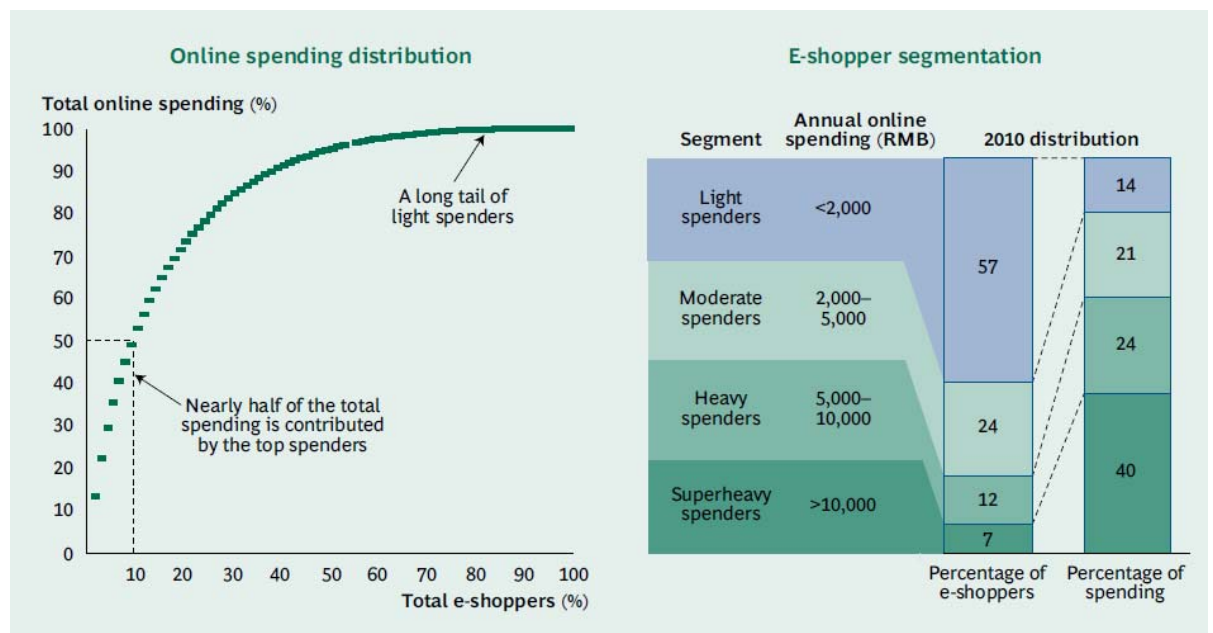


Figure 3: Online Spending Distribution and E-Shopper Segmentation

The substantial differences in demographics of Chinese Internet users and the distinctive online behavior of e-shoppers, provides evidence for a unique online shopping eco-system with its own opportunities and challenges.

4 CHINA'S E-COMMERCE LANDSCAPE

The unusual circumstances of the country's economic ascendancy have spurred to the emergence of a unique e-commerce ecosystem. Illuminated below are the main players and dominant factors that shape China's online shopping landscape.

4.1 The Main Players in the B2C Online Shopping Business

It is striking that in China predominantly one company defines the online shopping landscape, while in other countries e-commerce markets are more fragmented. In Japan, the top-seller Rakuten has a share of 30 percent, in Germany as well as in US, the leading online seller is Amazon with merely 15 percent respectively, but no company is able to hold a candle to the Chinese Tmall (Taobao Mall) which registered a market share of over 54 percent among B2C online shopping businesses (Figure 4). (BCG Perspectives 2011/ Buchreport 2012.) Due to the dominance of Taobao, it is of paramount importance to retail companies, which create their strategies for China, to understand the extent to which the Taobao phenomenon can influence its presence – even if the companies are not engaged in e-commerce.

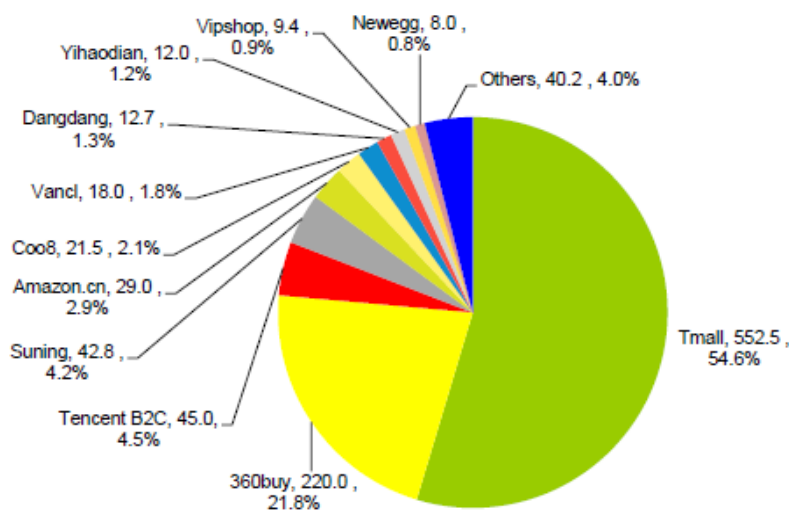


Figure 4: Market Share of China B2C Websites Gross Merchandise Value (bn Yuan) in Q3 2012 (iResearch 2012)

Taobao Mall is China's largest B2C online business by transaction value. Tmall is favoured by the young Chinese online shoppers. This has been proved on "Singles Day"

(11th November 2012), when Taobao Mall achieved total revenue of RMB 3.36 billion (\$533.5m). (iResearch China 2012.) The platform, owned by the Chinese biggest online giant Alibaba, does not yield profits by selling goods on its site but by the commissions it receives from the more than 50,000 virtual stores that have their presence on the Tmall site. (Bloomberg 2013/ Hille 2011.) Taobao Mall offers a comprehensive selection of Chinese and international brands. Last year, it closed contracts with Levi Strauss, Gap and Adidas to open online shops on the Tmall website (Lee 2013.)

Jingdong Mall (360buy) is the largest competitor of Tmall, following the ranking leader with a market share of 21.8 percent. The company started selling online in 2004 with a focus on 3C (Computer, Communication and Consumer Electronics). Gradually it was adding new products in its portfolio. Today, 360buy offers over 3,500 brands in electronics, home appliances, apparel, books childcare products, gourmet food and even flight tickets. It is China's number one independent B2C online retailer (by transaction value). (360buy 2012.)

Tencent B2C business occupies the third position with a tiny proportion of 4.5 percent. However, one should not be deceived by the marginal market share of the Chinese Internet giant, since it has just launched its B2C platform Buy QQ in 2011. The platform includes sites covering sectors such as clothing, shoes, food, cosmetics, jewelry and 3C. Tencents' strategy aims at winning market shares from Tmall and 360buy. Initially, Tencent Inc. has been founded in 1998 and became China's most used Internet service portal. (Tencent 2013.) It is primarily known for its Instant Messaging Service QQIM, which has 812 million active users (iChina Stock News 2011). This impressive user base provides Tencent huge potential to win market share in China's e-commerce business.

Suning, ranking fourth, moved its commerce from bricks to clicks in 2011 and has found impressive success. The company - Suning Appliance Co. Ltd - was founded in 2001 as a chain retailer. Today it operates nearly 700 stores that offer a broad 3C product portfolio. (China.Org.Cn 2013.) Suning Appliance and Gome Electrical Appliances are China's largest home appliance retailers. Both have launched their own online businesses to tackle competition from Jingdong Mall and Taobao Mall. The new successful model of e-commerce has become a niche market for appliance

manufacturers, who intent to reduce operating costs and, simultaneously, boost their sales. Usually, small appliance manufacturers spend up to 80 percent of their operating costs on the rent they pay to brick-and-mortar retailers. Numerous niche sellers have surfaced online on Taobao or Jingdong Mall and realized a surge in sales. Due to the reduced operating costs the prices could be lowered which attracted many consumers to purchase electronic appliances online. After the dominant retailers Suning and Gome felt the trend of appliance manufacturers switching their trade to the online commerce giants, they decided to establish their own online operations. (Ying-Feng 2011.)

Amazon.cn, VANCL and Dangdang find themselves directly behind the consumer electronics sellers, with market shares of less than 2 percent of the B2C online shopping business. However, their presence on the Chinese e-commerce arena should not be underestimated.

Amazon, the US-based web titan, is struggling in the China's e-commerce jungle. Although its sales grow at triple digit rates it is far behind the leading Chinese e-commerce retailers. Therefore the worlds' largest online retailer is planning to increase its investment by 50 percent in order to rank third behind Tmall and 360buy. Reaching the third place might be quite a challenge for Amazon, considering the highly competitive environment in China. (Poleg 2012.) When Amazon entered the Chinese market nine years ago its subsidiary supposed to be in nature of North America's Amazon. This is still not the case, which can be traced back to Amazon's global strategy and teething problems it faced in the Chinese market due to a low level of adaption. The next chapter will shed some light on the company's experiences in China.

Dangdang has introduced itself as the Amazon of China, but it is rather considered as a failed copycat of Amazon. Set up in 1997, Dangdang started with its main focus on selling books online. In 2004, Amazon acquired Joyo, which emerged as a fierce competitor for the Chinese online vendor. One year later, Dangdang has altered its strategy and launched other product categories to increase revenue. In 2009, Dangdang became a third-party platform, in the vein of Tmall, and offered other businesses to sell their products online. (Jiang 2011.) Since Gome's sales through its own online shop were behind those of Dangdang and 360buy, Gome has initiated cooperation with Dangdang to sell its products on its platform. With this move Dangdang expects to raise

its revenue and put pressure on 360buy. In the year 2011, Dangdang recorded a turnover of RMB 3.6 billion (\$571m), whereas, 360buy reached a revenue of RMB 30 billion (\$4.8bn). (Want China Times 2012.) It is up in the air, whether, Dangdang can become a threat to 360buy considering these dimensions. The main reason, why Dangdang is lagging behind the leading B2C platforms is because it does not have any advantage in any of their services or in logistics. It is simply a late imitator of its competitor's successful strategies.

Another player worth mentioning is VANCL. According to iResearch, it is China's largest apparel retailer. Launched in 2007, the company has started as a specialty men's shirt e-tailer. With its cheap and cheerful shirts it has achieved a high penetration of the market. (Vancl China 2013.) Today VANCL offers a broad fashion and lifestyle product assortment at reasonable prices. Due to its large-scale and sometimes controversial marketing activities VANCL has become a very strong brand. (Advertising Age 2011.)

Additionally, niche Chinese e-tailers such as VIPshop, M18, Mbaobao maintain market shares of relatively low relevance compared to e-commerce giants such as Tmall or 360buy, however, these online retailers are the leading platforms across their product categories. M18 is a brand-neutral fashion and beauty-oriented B2C marketplace. (Yahoo! Finance 2012.) Mbaobao is one of the numerous specialist e-commerce sites. It concentrates only on women's bags and related accessories. VIPshop is a discount apparel retailer for international and Chinese brands.

So far China's e-commerce market has been reigned by a few large-scale business platforms that woo for investment as they are all listed on a stock exchange. An increasingly intense rivalry has been developing among the platforms, which is displayed in price wars and rapid adaptations of strategies to the changing environment. It remains to be seen how the situation will change in the next few years, but investment plans of foreign e-tailers and the emergence of new internet users are two factors that will largely determine further development of China's e-commerce landscape. Also independent B2C e-commerce sites seem to be a promising growth industry.

At this juncture, however, Taobao remains the undisputed market leader whose successful strategies have been emulated by others. But what is the secret behind the

innovative business model that has attracted and managed to retain such a tremendous amount of customers.

4.2 Jack Ma's E-Commerce Empire

It must be considered astonishing that the most popular and most successful Chinese business-to-business, business-to-consumer and consumer-to-consumer sites were all build up under one roof.

In 1999, a former English teacher, Jack Ma has started a small-scale local B2B company, that helped small and mid-sized firms to conduct business online (W.Sheridan 2012, 115-202). When eBay entered the Chinese market in 2002, Jack Ma felt the danger that eBay might attract Alibaba's existing customers, so he did not hesitate for long and decided to launch his own C2C auction site to ward off eBay. (Wang 2010.) Taobao - which means "searching for treasure" in Mandarin –has a market share of 90 percent in the Chinese C2C market. It is the third-most visited website in China and it is expected to be worth \$14.3 billion by the end of this year (Bergmann 2011). As eBay tried to bury Taobao in 2005, Ma has underestimated the company's potential but he has foreseen his success: "Ebay may be a shark in the ocean, but I am a crocodile in the Yangtze River. If we fight in the ocean, we lose – but if we fight in the river we win."(Bergmann 2011). Taobao experienced a swift start with its for-free strategy and gained momentum. Given the fact that in 2010 more products were bought on Taobao than at the top-five physical retailers combined, made it China's biggest retailer which it remains to be until today (BCG Perspectives 2010). Additionally, Ma has established Taobao Mall – a B2C expansion of his business. Today, Tmall features online retail storefronts of UNIQLO³, Adidas, Procter&Gamble, L'Oreal Paris, Revlon, Lenovo and popular Chinese brands such as Li Ning (Alibaba.com 2013).

Surveys have revealed that consumers were confusing the two platforms: Taobao (C2C) and Tmall (B2C business previously known as Taobao Mall). Online shoppers assumed that Tmall was the same as Taobao that provides goods of lower quality for a reasonable price. In order to increase the brand equity of Tmall and to clearly separate those two platforms, the operators decided to change the name from 淘宝商城 (Taoball Mall) to

³ Japanese casual ware designer, manufacturer and retailer

天猫 (Sky Cat, pronounced as Tian Mao). Alibaba Group – the parent company of Taobao and Tmall – took this strategic step to facilitate distinction between the two platforms and to ensure more precise market segmentation. In a design contest a cat was chosen as a winning logo to represent Tmall. Chinese online companies have a propensity towards using animals as mascots or logos. For example, Tencent uses a penguin as the brand mascot for its QQ messenger. (Labbrand 2012.)

With Alibaba (B2B), Taobao (C2C), Tmall (B2C), shopping search engine eTao.com Ma has build up a business ecosystem for itself which appears to dominate the Chinese online business. Ma seems to have recognized the zeitgeist and tailored his business models perfectly to the Chinese market. Industry pundits claim that the most successful online business models in China are open-end platforms such as Taobao (C2C), Alibaba (B2B), 360buy (B2C) and Tencent (B2C “Buy QQ”and C2C “Paipai”).

In January, however, Jack Ma has declared his resignation from his position as CEO of the Alibaba Group. The main reasons for his decision is the pressure from new market entrants and the increasing difficulty to coordinate activities of the e-commerce empire. To achieve more flexibility and simplify coordination, Ma has announced to restructure the group and split it into 25 small divisions managed by the younger generation. The founder did not declare his retirement. He will remain control over the business from the background and decide on strategy and corporate development. (Chyen Yee 2013.)

5 WHY DO WESTERN COMPANIES STRUGGLE?

A surprising number of prominent American companies have failed to gain traction in China. Expedia, Amazon, eBay, and Groupon are among the Internet heavyweights that have thrown themselves at the Great Wall hoping to capture a piece of the market. Having spent millions of dollars and investing years of effort the high-profile companies were not able to perform in China as positive as they do in other markets. So, why are these companies not able to withstand their Chinese competition? In the following, the best-known cases of eBay and Amazon will be presented. Analysis of these cases will provide greater insight into the characteristics of the Chinese Internet economy and its key implications for potential foreign investors.

5.1 How eBay Lost to Taobao

The acquisition of EachNet - a local C2C player – marked eBay’s entry in 2002. The US market leader was willing to invest more than \$150 million in the acquisition. Since then EachNet’s market share dropped from 85 percent (2002) to 8.2 percent in 2007. (Xing Wang 2012). The startup Taobao has managed to supersede eBay within a time period of one year and controls today more than 90 percent of the Chinese C2C market. Which strategic tools helped Taobao to become the largest e-commerce platform and win the David against Goliath battle with eBay?

5.1.1 Free-of-Charge Strategy

EachNet replicated eBay’s business model and charged transaction and listing fees from its users. By contrast, these two services were provided by Taobao free-of-charge. With this for-free-strategy, Taobao penetrated the market rapidly and gained a substantial market share of 60 percent within two years (Lixia 2009). Today, the no-fees-strategy is a common tool of online businesses or Internet networks to make the first penguin jump⁴ and consequently reach a critical mass of users.

However, as Milton Friedman described in his book “There’s no such thing as a free lunch”, even if something seems to be for free, there will always be hidden (indirect) costs or the user will be charged after a certain period of time. This is also true for Taobao. In the beginning, Taobao generated its income mainly through advertising. After three years of free service, Taobao tried to introduce its first fee-based service, which turned out to be a PR disaster. This new “bidding for ranking” service was perceived as a violation of Taobao’s promise of free service (People’s Daily Online 2005).

As consequence of this, Taobao has extended its free service commitment for another three years to attract more users and establish loyal network dealers. Nowadays, seller-paid rankings in search results (Taobao Express) and the sale of user-defined storefronts (Taobao Hot Store) account for a part of Taobao’s revenue. The bidding prices define

⁴ The Penguin Effect: each potential user will be reluctant to do the first move due to the potential risks of the unknown environment. When the first “penguin”/user was brave enough to make the first move, the risk potential for the followers is lower, consequently they start exploring the new environment as well. (Herd Behavior/ Network Effect Theory)

the seller's position on the results list. As a result, this new model engenders a continuous revenue stream as sellers tend to pay additionally to improve their position on the results list (Wang 2012).

5.1.2 Integrated Communication Channel

Another innovative model of Taobao is its integrated instant messenger system WangWang. Taobao's embedded search engine allows the potential buyers to list the products, whose sellers are online. Buyers can see the online status of a seller and communicate with the seller immediately via Wang Wang. According to one buyer: "when I shop in Taobao, I only select items from sellers who are online because I like to communicate with the seller and solve transactional problems immediately. [...] By appearing online, those sellers express their readiness to communicate with customers, and so I trust them more." (Xiao Juan Ou 2009, 145-148.)

On the contrary, EachNet users can communicate either via Skype⁵ or leave a message on an online message board. In China, however, Skype is not as common as it is in the Western world, so just a few users might have a Skype ID. The rest has to download and install the software first. (Xiao Juan Ou 2009, 145-148.) This method has a number of serious disadvantages. First, it is perceived as inconvenient for the user to leave the eBay webpage and install a new instant messenger before being able to contact a buyer. Second, seller's online status is not indicated directly on the website, so that the buyer can see it immediately. A seller, who is online, displays his willingness to communicate with the buyer and might have an advantage over those that are not online as they cannot react to the buyers needs at the very same moment.

The WangWang service creates a sense of a social community. The buyer can contact the seller immediately and communicate about product features, its availability, delivery terms, payment methods and, probably the most important aspect: the price. In light of the buyer's desire to reduce risks, WangWang provides the opportunity to facilitate the development of trust and to bargain. These aspects should not be underestimated, as to a Chinese it is crucial to establish trust before conduct business transactions. Product

⁵ Skype: is an instant messaging service that allows users to communicate by voice or video over the Internet.

reviews and reputation systems are simply not enough to identify counterfeited products and reduce potential of frauds. Chinese will prefer to build a relationship with the seller to develop the necessary confidence before engaging in a transaction. (Xiao Juan Ou 2009, 145-148.) As described in the previous section about Chinese online shopping behavior, potential customers search for good deals on the Internet and expect the products to be cheaper than in stores. Therefore, WangWang satisfies the need of being able to bargain for a good deal.

5.1.3 Adaptation to the Chinese Context

Taobao and WangWang are perceived as typical Chinese products tailored to the needs of Chinese people. On the other hand, eBay's EachNet did not adapt significantly to the Chinese online business environment. As the global format of eBay, EachNet emphasizes product listings and price information, which is less attractive for Chinese online shoppers. Taobao provides the Chinese online shopper more than that. Apart from the instant messaging service that promotes the social community aspect, Taobao actively fosters product recommendations, suggestions and practical tips for online shoppers. The operators of the platform have realized that Chinese consumers are fashion followers, so they display fashion trends and entertainment news on their webpage (Xin Wang 2012). All these small services make online shopping an emotional experience.

Apart from the above mentioned aspects, eBay's division in China made further mistakes on its conquest of the Chinese C2C e-shopping market. The fact that eBay has a strong position and brand in the US market did not automatically mean the company will be able to achieve a similar status and success in China. Obviously, eBay failed to understand the Chinese online business environment as well as needs and preferences of Chinese online shoppers.

Since China is too big to ignore, eBay has created a new approach for the market. This time, eBay concentrated on an essential advantage it has over its Chinese rivals: the consumer reach outside of China. The company saw a window of opportunity in connecting Chinese sellers to buyers worldwide. In collaboration with China Post and the U.S. Postal Service, eBay has introduced a new service that enables foreign buyers to track the purchases they made in China. Additionally, sellers are offered free

shipping within China. The company remains doing its core business activity of connecting buyers and sellers, however, in a segment of the Chinese online market that is not dominated by Taobao. (Bremner 2011, 41-43.)

5.2 New Name, Same Game: Amazon's Strategy for the Chinese Market

With the acquisition of Joyo.com in 2004 Amazon has entered China's online shopping market. The purchase of China's largest online retailer of books, music and videos was worth \$75 million to Amazon (Wiles 2004). Today, the world's biggest Internet retailer has a market share of 2.9 percent, whereas indigenous players claim greater shares of the market. So, what are the stumbling stones that hinder Amazon from becoming one of the market leaders in China and how does the company plan to further develop its strategy?

Joyo Amazon has incurred losses during the process of building up its business in China. Right from the start it had to face tough competition from Dangdang, Joyo's biggest rival, and Jingdong Mall (360buy) (Wang X 2012).

Industry experts believe Amazon's strategy for China was not aggressive enough and slow in growth. In spite of being the world's second largest online market, China had a low priority in Amazon's global strategy, following North America, Europe and Japan. Therefore, the company neglected the importance of emerging opportunities and did not adapt swift enough to the Chinese online market conditions. Consequently, it gave up market shares even to late entrants such as Taobao Mall, which started its operations in four years later. To cut the chase: although Joyo Amazon entered the market at an early stage, its current position in the Chinese e-commerce market lags far behind its competitors. (Jiang 2011.)

Even though, Joyo Amazon invested immense amounts of money in its operations, slow expansion of product lines and ineffective marketing are reasons for Amazon's poor performance in the Chinese Internet market. One blatant example is that the selling-on-Amaزون ("I want to open a store") service was officially launched in 2011, although it was known to US customers from the year 2002 (Jiang 2011).

In 2011, Amazon has started a rebranding campaign. Now Internet users simply need to type in “z.cn” to be forwarded to Amazon’s Chinese website. The previous URL Amazon.cn was replaced because it is not a Chinese word and apparently hard to remember for Chinese consumers. (Wee 2012.) Additionally, Amazon has displayed its rebranding campaign in subways in Shanghai, on billboards and on TV. If this campaign achieves the expected results, it will be applied in other big cities in China. The company’s marketing has never been so public and aggressive. By displaying this advertising, Amazon is making the attempt to show that it is more than an online book store. It is finally trying to stand out of its competition. (Zhou 2011.) According to Wang Hanhua, president of the Chinese division, Amazon China particularly emphasizes Chinese customers ‘experience. Therefore, further measures of localization, so called “micro-innovations”, were introduced. For example, Amazon.cn will indicate what time of the day the products will arrive at the buyer’s doorstep. When comparing different products, non-Chinese tend to click the back button if they want to see the item, they looked at priorly. Chinese, however, open another window in their browser to compare items. The company has adjusted its website accordingly. In addition, studies conducted by Amazon China, revealed that 70 percent of Chinese online shoppers prefer to pay on delivery. The conclusions Amazon China has drawn from that study, led to the launch of portable POS (point of sale), using which the customer can pay via credit card at the time of delivery. (Wee 2012.)

Compared to other competitors, Amazon has an advantage in logistics. Logistics plays a significant role in China’s e-commerce market especially when companies plan to expand. Amazon did not realize this in the beginning of its venture with Joyo. When bought by Amazon, Joyo had its own delivery team. Amazon China decided to outsource logistics to strategic partners. In 2007, Amazon learned its lesson and reconstructed the delivery team (TechRice 2011). China is the only market, where Amazon maintains own delivery operations. This competitive edge, might not sustain for long, as Alibaba announced it plans to invest up to \$4.5 billion to build up logistics. (Zhou 2011.)

In a nutshell, Amazon’s strategic adjustments that were made in China one year ago provide the company potential to rise up from the ashes and gain market shares as China’s online market is clearly at an early stage of development. However, Amazon’s

abysmal performance in China could have been avoidable if the company had clearly distinguished itself from its competitors and localized their operations earlier.

5.3 Key Errors of Foreign Investors

After an analysis of several market entries into China, four key blunders that had severe consequences on the performance in the Chinese online market were tracked down and summarized:

A Failure to Modify the Business Model for Chinese Customers (Xin Wang 2011)

As previously stated, eBay's Chinese subsidiary EachNet failed to understand the needs of the local customers and was defeated in a battle against a startup that simply knew exactly what the target market wanted. The need of Chinese buyers to establish trust by direct communication to the seller was not addressed in the right manner by EachNet. Taobao, by contrast, created - WangWang - a tailor-made and convenient solution for this issue. The innovative approach of an integrated instant messenger simultaneously made trading at Taobao a social experience. Recommendations, tips on how to identify counterfeits, fashion trends complete the range of options and help to overcome the skeptical consumer mentality. Moreover, Chinese online shoppers are very price sensitive and are prone to look for online shops that offer the best deals. Taobao also realized that and provided them the ability to bargain with the seller directly via the instant messenger.

One reasons for Amazon's poor performance was its low degree of localization, which it has started to improve by the development of "micro-innovations".

Another US Internet giant that was not able to adapt to the local market conditions was Google. Similar to other foreign high-profile companies, it is lagging far behind the Chinese leading search engine Baidu. Google's business in China has certainly been affected by its conflicts over censorship with the Chinese government, but another reason for Google's failure was the lack of local knowledge. Operators of Baidu learned that Chinese are not familiar with online advertising and conducting online advertising campaigns. As a result, Baidu established a sales force team that educates customers about online search and advertising. According to one Baidu executive: "Google may

have a better search engine, but we know what Chinese customers need and how to sell to them.” (Xin Wang 2011).

Insistence on a Standard Global Technology Platform (Xin Wang 2011)

When eBay acquired EachNet, all EachNet users were transferred to eBay’s global platform. The mistake eBay did, was to dissolve EachNet’s platform and let the data migrate to its global platform. China’s censorship firewall, however, decelerated the browser speed and caused frustration among users. On the day the switch to the global platform was completed, traffic on eBay’s webpage plummeted by about half. (Xin Wang 2011.) eLong, the Chinese division of Expedia - an US online travel website company – has also recognized that it is inconvenient and cumbersome for its Chinese consumers to use its services at the global platform.

Prior to this, eLong’s customers were forwarded to the Expedia website to settle their payment for hotel booking outside of China. The process has been recently transferred to a Chinese website. Today, eLong emphasizes better customer service to achieve customer retention in China. (Yiqi 2012.)

Generally speaking, convenience is one of the principal reasons to engage in online shopping, so e-tailers should facilitate the buying process to provide a positive shopping experience.

Overlooking the Competition (Xin Wang 2011)

Compared to the previously mentioned market entries Groupon’s venture in China was downright unsuccessful and turned into a complete disaster. The company had to close offices and lay off hundreds of people. Several reasons explain Groupon’s failure in China, however, the high degree of competition turned out fatal. When Groupon – an US daily-deal online company – has entered China there were already hundreds of companies providing the same group-buying service. And if it was not enough, the domain Groupon.cn was owned by a local competitor (Bishop 2011). The number of unique visitors⁶ was far behind its competitors, so in some cases Groupon was forced to renounce on its commission to gain subscribers. Although the enterprise invested a huge budget into its venture in China it failed tremendously in less than a year. (Xin Wang,

⁶ one visitor is counted by setting a browser cookie (visit per browser)

2011.) Additionally, Groupon made the mistake to select the wrong partner: Tencent (a social network operator) finally became a competitor by founding QQ Group Buy (Gobry 2011).

Neglecting Advantages that Make a Difference

Given how difficult it is to compete with local players, foreign companies are at a disadvantage as they lack understanding of the local market conditions and their foreign brands are mainly unknown to their potential customers in China. As it can be seen on the presented cases, foreign companies try to win the battle against their rivals without distinguishing themselves from the tough competition. The attempts of being better than the leading indigenous players without a distinctive feature will not lead them to the pole position. Foreign enterprises should unlock the real advantages they enjoy over the local competition and implement these in their strategies.

One example for that is eLong - Expedia's Chinese division. Initially, the enterprise was trying to overtake Ctrip; the second largest online travel service provider in China. Similarly to its competitors, eLong offered a broad range of services from arranging vacations, booking flights, renting cars to arranging a hotel accommodation. This strategy did not bring about the expected success. eLong's CEO realized that this strategy will not bring eLong to the top. He explained: "We do not want to be the second Ctrip, but the first eLong." (Yiqi 2012.) Consequently, eLong has focused on only one service: hotel booking. eLong's CEO believes that by being lean, the company will succeed. The main reason for the fundamental change of the company's course is Expedia's overseas hotel network. This provides eLong with a major competitive advantage over Ctrip. While Expedia can draw back on its 150,000 overseas hotels, Ctrip has resources of only 30,000 overseas and domestic hotels. (Yuqi 2012.)

Likewise, eBay has discovered a segment in which it has a competitive edge against Taobao. Its brand awareness outside of China was of great help to create a new strategy for China. Now it links Chinese sellers to buyers overseas.

5.4 Implications for New Entrants

Taking into account the fatal mistakes committed by first-movers, followers can draw out lessons which they can learn from in order to win in China's e-commerce. To sum

up the previous findings: in order to compete in China's e-commerce eco-system a new entrant requires well thought-out strategy and an appropriate degree of flexibility to be able to react to the dynamic and fast-changing environment. Success in a market like China's requires a high degree of adaptation of the business model, payment methods, delivery options and website features that are tailored to the preferences of the target group. Chinese online shoppers are quite sophisticated and expect transparency, on which they can build trust, and a great customer experience. Indigenous competitors should not be underestimated as they understand local consumer preferences and are very experienced in dealing with challenges of the local online market.

Facing the cut-throat competition in China's e-commerce, it is essential for new entrants to find a way to differentiate themselves from the local players. Particularly because the Chinese e-commerce market is characterized by an exhilarating tempo and high complexity, rapid adaptation and a long-term business strategy are required.

6 HOW TO JUMP ON CHINA'S E-COMMERCE BANDWAGON?

When it comes to market entry strategies, there is no one-size-fits-all approach because the companies differ in its objectives, target groups and available resources (Xin Wang 2012). However, foreign electronic market entrants do not have any other legal option to set up a business in China than cooperating with a local partner or local distributor. When the Chinese government has tightened its regulations for electronic businesses the policy resulted in hurdles for foreign businesses.

Foreign companies are only allowed to conduct online operations, as long as they do not generate any profit online; for example: advertise online in addition to a physical store (Schanbacher 2012). Companies that plan to start selling online require an ICP (Internet Content Provider) license, which is only issued by the MIIT (Ministry of Industry and Information Technology) to wholly Chinese-owned companies. Apparently, local enterprises clearly benefit from governmental policies that were launched to promote the development of a domestic ICT (Information and Communication Technology) industry. The costs of the ICP registration are not stated on the website, however, a company that wishes to register has to fulfill a multitude of requirements which will drive costs up. One of the requirements is a high amount of registered capital. The ICP

registration can be done at the following webpage: www.miibeian.gov.cn. As if this were not complicated enough, the regulations also state that the website has to be hosted in Chinese mainland. If the website is hosted outside of China (also in Hong Kong) the website might either be accessed very slowly or be not accessible at all. (China Internet Watch 2012.) In any case, a Chinese native speaker is necessary to deal with red-tape since the ICP registration website as well as the website of Tmall are not available in any other language.

As it can be seen, foreign companies will face a highly complicated decision of how to overcome market access barriers. Under the prevailing circumstances, a foreign company should seek for a local partner. The choice of a partner should depend on financial resources and the understanding of the Chinese market. The very first step, however, should be a visit to the country in order to gain first insights into the local market and business culture. According to IT industry experts, there are three possible options to enter China's electronic market. One option is to work with distributors or platforms that provide fee-based services to represent the foreign company on the mainland. Another option is to team up with large established IT suppliers or system integrators that already conduct business in China. The third option is to partner up with like-minded Chinese small and medium sized companies (SMEs) that provide complementary skills and technology. (Ibp 2011). These options are broadly formulated by experts of an US-based investment centre and are to be applied for all participants of the IT industry. The writers of the annually updated handbook for e-commerce and investment opportunities in China emphasize several times in their publication that the facts and strategies mentioned are subject to change due to the high dynamism of the information and communication industry and the volatile Chinese Internet business. The analysis of the above mentioned cases allows the assesment of a fourth option, which is the acquisition of potential local competitors as in the cases of Amazon and eBay.

With respect to the form of market entry, it becomes apparent that large e-tailers which offer several brands and product ranges in the vein of Amazon or YOOX are well-advised to acquire a Chinese online mall and build up their own China specific site as well as sharpen their profile amid the competition. Strong, internationally known brands, however, might be better off when partnering up with popular Chinese giants

such as Tmall or the apparel e-tailer VIPShop. The risks and benefits of the options will be outlined in the following.

6.1 To Taobao or Not to Taobao?

Entering the Chinese online market seems intimidating when taking into consideration that even high-profile companies with great financial resources struggle in this e-commerce jungle. There are numerous of issues a company has to deal with initially: establishing, an own e-commerce channel, learn about the consumer behavior, obtaining licenses for online shops, just to name a few. With respect to these challenges, the services of Tmall and Taobao appear as reasonable options to circumvent some of the challenges and remove certain entry barriers.

6.1.1 Selling on Tmall.com

Featuring over 400 m registered users the Tmall platform offers a tremendous opportunity to merchants (China Daily 2011). It generates huge customer traffic and is among the most visited websites in China. Moreover, the local elite platform enjoys trust by Chinese online shoppers as it represents licensed brands only and ensures safe online payment.

Since Taobao's B2C marketplace is the most powerful online business platform, the presence of a store at the platform is more efficient than operating an own webpage. According to the chief executive of Coos8 – a website of China's largest electronics retailer Gome – the costs of customer acquisition in the 3C business have increased sharply to RMB 400. This is how much a retailer needs to spend to make a consumer purchase a product on its website. Acquiring a customer on Tmall, however, costs about one-tenth of the amount need when selling on their own website. (Hille 2011.)

The Tmall and Taobao services include delivery to the buyer by a third-party express delivery service. Since, Alibaba is not equipped with own warehouses or trucks, therefore, it contracts major independent express companies. The delivery is affected within 3 days after placing the order. In case of a delay the buyers will receive a compensation of RMB 5-10 (\$0.80-\$1.60). (Want China Times 2012.)

While there are significant benefits, Tmall is not the best choice for all types of businesses. Thousands of small merchandisers protested in 2011 when the operators decided to quintuple its service fees for businesses. Alone the annual service fee for a registration on Tmall for the first year was raised from RMB 6,000 (\$955) to RMB 30,000 or RMB 60,000, contingent upon the scale of the company. The great outcry of small and mid-sized businesses led to a postponement of the new regulation to the year 2012. Lifting the annual service fees, would drive small operators out of the platform. This consequence is believed to be a strategic move to facilitate differentiation and segmentation of Taobao and Tmall. (China Daily 2011.)

Setting up a Tmall shop requires the applicant to be a verified seller who can guarantee that the products to be sold online are real and genuine. The deposit fee ranges from RMB 50,000 – 150,000 (\$23,885) depending on the store format and the trademark status. As mentioned above the first year contract entails an annual service fee of RMB 30,000 – 60,000. A renewal of the contract costs the fee for the fourth quarter of the previous year and the annual service fee for the coming year.⁷ The amount of the total annual service fee depends on the scale of the online operations and the product sold online. The total annual service fee can reach up to RMB 3.75 million or 7.5 million (\$1,194,270). In addition, the seller has to pay a commission of 5 percent for every item sold on Tmall. However, there is a silver lining for merchants, the annual service fee can be redeemed by 50 percent or even 100 percent if the shop is able to reach Tmall's sales target for the product.⁸

But all that glitters is not gold, and so there are also downsides and risks involved in selling on Tmall. The popular platform does not only lure shoppers but also sellers. Today there are 50,000 registered businesses and 70,000 commodity brands on Tmall (China Daily 2011). It is probably not advantageous for a company to be listed directly next to its competitors. Particularly, apparel retailers will find themselves among a variety of international brands like Gap, Adidas, or UNIQLO. Another disadvantage of Tmall is that there have been complaints about sales of counterfeits and cases of fraud. (China Daily 2011). The problems Tmall experiences with counterfeited goods are not

⁷ Example for calculating annual fees for a renewal for 2013: Annual services fees of 2012 shall be divided by 12 (months) and multiplied by 3 (quarter year). The result is to be summed up with the annual service fee for 2013.

⁸ Translated from: <http://www.tmall.com> (viewed at 25.02.2013). See appendix for the complete list of fees.

as severe as Taobao's, however, this indicates that the bigger the consumer coverage is, the more difficult it becomes to coordinate such platforms.

The bottom line is that Tmall is aimed at large-scale branded companies and perceived by domestic online shoppers as a destination to purchase branded goods of good quality. Although, the service fees have been increased dramatically, Tmall offers a huge consumer base and removes several red-tape barriers for a market entry. Selling on Tmall is a perfect short-term solution to enter the Chinese online shopping market, cut one's teeth and gain insights into the Chinese online industry as well as the behavior of the target group.

6.1.2 Using Taobao.com as an Online Channel

Despite the fact that Taobao is a C2C platform anyone can register there. Small-sized businesses that cannot afford being registered on Tmall have the option to use Taobao as their online sales channel. The C2C platform does not charge any service fees. (China Daily 2011).

Being the biggest retailer in China, Taobao provides a large platform with high consumer traffic, which is attractive for merchants as they can save on marketing expenses. Similar to Tmall, Taobao offers its domestic online payment service Alipay free of charge. Taobao is often compared to eBay, though they differ in some aspects significantly. While eBay primarily sell used products, the majority of items sold on Taobao are new. Additionally, Taobao's instant messenger and seller-credibility rating system enhance the level of consumer's trust. The social and interactive features of the Taobao platform provide an emotionally appealing shopping experience. (China Daily 2011).

As enticing as selling on Taobao appears to be, there are multiple drawbacks merchants face when teaming up with Taobao. One of the problems Taobao is trying to cope with, is the presence of banned items and counterfeited goods on Tmall. A blatant example for the violation of federal law is the scandal of dried and ground human placenta being sold on Taobao that was all over the news in 2011. When Taobao and Tmall were interconnected as one platform, it has also been very difficult to prevent counterfeits

from being sold on the platform. In July 2011, the Swiss watchmakers Omega, Longines and Rado sued Taobao Marketplace for not being able to stop the sale of fake watches on the website. The Swiss companies demanded Taobao to prohibit listings of their watches at the price of under RMB 7,500 (\$1,180). Some months later there were still Omega watches being sold at the half of that price. (Bergman 2011).

Taobao operators have launched keyword filters and price filters. These should prevent sellers from offering luxury goods at low prices and posting banned products. The website is also scanned manually in order to remove listings that violate the policies of Taobao. Additionally, a reporting system has been introduced. It allows sellers to submit product listings they consider to be counterfeits. The stores of those who repeatedly break the rules are being closed. Furthermore, Alibaba created a fund to pay compensation to consumers who wrongly receive fake items. (Bergman 2011).

Things went so far that in 2012, the US Trade Representative put Taobao on its name-and-shame list; a report about intellectual property violations. The violation of intellectual property rights is one of the most tenacious problems in the business relationship between Western countries and China. As a result Jack Ma agreed on working with US trade associations and other companies to fight counterfeits and take violators offline. At the same time, Ma admitted that it is quite a challenge to monitor and coordinate the enormous amount of traffic and commerce on Taobao. (Einhorn 2012, 24). However, customers and sellers should be aware that there is still no guarantee of quality and authenticity of the items sold on Taobao. Another vital aspect that might deter potential vendors is that Taobao is mainly popular because of the good bargains online shoppers can make on the platform. Allegedly, online shoppers can find products on Taobao that cost 25 percent less the price offered on other channels. (BCG Perspectives 2011). As a consequence, Taobao users have developed a bargain-hunting mentality. Simply put, Taobao users put more emphasis on discounts rather than on quality or design. Numerous of sellers are suppliers or distributors that sell excess inventory. Hence, there is a possibility one will compete with own suppliers. Eventually, a vendor has to realize that he might not be able to undercut prices offered by competitors and will have low control over branding. (Hung 2012.)

It is of utmost importance that a potential vendor understands that both Taobao and Tmall are especially appreciated by the users because of its social character. Buyers expect a vendor to be online and ready to communicate with the potential customer via the instant messaging service at any time of the day. Also, customer experience is reflected in the rating system that entails feedback about the sellers. Finally, it requires engagement of personnel and effort to build up and to maintain a good reputation on the platform.

All in all, one can say that Tmall is more sophisticated than Taobao, because it is more reliable, trustworthy and offers a better customer service. As a consequence, it is more preferred by large-scale branded companies. Taobao, in contrast, is considered by Chinese online shoppers as a paradise for bargain hunters. As mentioned in the previous sections, except for Tmall and Taobao, there are also product-line specific platforms such as VIPShop or VANCL which are fashion and beauty oriented. Tencent has just recently emerged as a competitor to the Taobao empire when it launched its platform Buy QQ. Initially, Tencent was predominantly focused on 3C products but gradually added product categories such as clothing, cosmetics and jewelry. Listing the conditions and possible service charges of these platforms is beyond the scope of this paper.

6.2 Local Representation in China

Local presence is essential in China. In a country with a relationship-oriented culture face-to-face interactions are preferred before engaging in any kind of business. A local partner would give the foreign company “face”. Moreover, the foreign partner would be able to draw on personal ties of the partner that might pave the way to other successful strategic alliances. Being present in the Chinese market will provide the foreign enterprise more credibility and aid to develop brand recognition. As recognition of differences in business and cultural styles between the home-country and China is crucial, a local partner is the right medium to acquire knowledge of the local market conditions. Additionally, Chinese are skeptical towards foreign companies without a local presence. This might mean calling the home-country office in case there are problems or need for technical support. (Ibp 2011.)

6.3 Joint Venture with a Local Partner

Obviously, the choice of the business partner can make or break a venture. Partnering up with a large IT supplier or any kind of business that deals with information and communication technology would provide skills and technology for the venture. Market knowledge, experience in the industry, access to the target group (Internet users) are the benefits of a partnership. However, a partner who operates in the same industry is not a guarantee for success.

For example, Groupon has entered the market by forming a joint venture with Tencent which was previously an Internet service provider that had nothing to do with e-commerce. Unfortunately Tencent became Groupon's competitor. Tencent's e-commerce business has quickly gained momentum due to its large pool of instant messaging service users. The crucial mistake that Groupon made was not to include a "non-competition" clause into the contract. This example displays that it is of critical importance to find a reliable and trustworthy partner. In addition, joint ventures in the Internet industry do only allow a maximum of 50 percent control of the company (Schanbacher 2012). Given the fact of how cumbersome and tedious it is to deal with bureaucracy in China and in particular to obtain a license from the Ministry of Industry and Information Technology, the Chinese partner will have a higher negotiating power as well as more insight into the administrative side of the business which he could play off against a foreign partner.

A further unfruitful joint-venture was closed in 2010 by Baidu, China's biggest search engine company, and Rakuten, Japan's largest e-commerce player. Baidu and Rakuten jointly invested \$50 million into the venture with Rakuten holding 51 percent of the JV and Baidu controlling the remaining 49 percent. (Want China Times 2012.) This venture has been made before the national regulations of foreign investment in the Chinese ICT industry were enhanced (Out Law 2011). After, two years Rakuten decided to shut down its site in China because its performance was the weakest among foreign e-tailers. While Baidu was responsible for the page design and site traffic, Rakuten dealt with the main operations. Initially, Rakuten benefited from Baidu's heavy traffic and connected its member accounts to the search engine's. By doing so, users were able to directly log into the online shopping platform. The search engine handled advertising and additional services for Rakuten. For some reason, Rakuten's position in traffic ranking has

declined by 10,000 places within three months. Finally, Rakuten was overtaken by the tough competition. According to insiders, Rakuten simply applied its Japanese business model and therefore failed to adapt to the conditions of the Chinese market. It is also said that Rakuten experienced disputes with Baidu over details of adaptation. Cultural misunderstandings and a low degree of localization are believed to be common reasons for failures of foreign companies in the Chinese market. The Japanese market leader has lost more than RMB 100 million (\$15.8m). Now it is planning for another way to approach the Chinese online shopping market. (Want China Times 2012.)

Establishing a joint venture is a double-edged sword. On the one hand the local partner can be a great help when new entrants lack brand recognition and make the attempt to gain foothold in the country. In this case a collaboration and integration of technologies might reach a widespread customer base. It is a fact that Sino-foreign joint ventures offer important benefits, however, especially in 50:50 joint ventures there will be power struggles and cultural clashes. If worse comes to worst, the partner operating in the IT sector can easily turn into a competitor.

6.4 Partnership with a Like-Minded Chinese Enterprises

An alliance with a like-minded Chinese company with similar skills and technologies is another effective way to penetrate the market. Of course the success of such a partnership also depends on the company culture and organizational goals of both participants. Industry experts believe that Chinese SMEs are eager on partnering up with foreign companies because of the possible technological exchange, training by the foreign partner, financial resources, talented management and qualified staff. (Ibp 2011.) After a long research, only one partnership of a foreign company and a local like-minded medium-sized enterprise could be discovered in the e-commerce sector. Expedia teamed up with eLong when it started gradually to buy up stakes of the local enterprise and made it its Chinese division after two years. Before the partnership eLong was in the red and suffered from negative profitability, which might have been the main reason for the partnership. (Yiqi 2012.) The largest US travel service provider invested \$41.2 million in eLong in order to increase its shares by 8 percent and become the largest shareholder with 56 percent. In the same year (2011), the foreign investor has paid \$72.4 million to buy 8 percent of shares from a Chinese investor. (BBC 2011.) These investments have tightened the relationship between eLong and Expedia,

advanced their cooperation and enhanced knowledge sharing between the companies (Forbes 2012). It remains to be seen if this partnership turns out to be a successful venture. It is too early to draw conclusions as Expedia was just recently able to implement its restructuration program. It cannot be ruled out that there is a possibility of a merger and acquisition.

6.5 Acquisition of a Local Player

A new entrant can avoid the arising challenges of a joint venture by acquiring a Chinese company. This option gives the enterprise tight control over its business operations, intellectual property and profits. However, full involvement and control are dovetailed with full capital costs and risks of setting up overseas operations. This might not be a suitable option for mid-sized companies as their financial means and other resources are usually limited, so these enterprises will have to resort to a more reasonable option such as selling on a platform like Tmall. A company that has planned to offer a wide range of products to a broad customer base will not be able to start off as a storefront at Tencent or Tmall as these platforms tend to exclude potential competitors. Worthwhile mentioning is that an acquisition is an extended process and therefore the learning phase will be longer than with an entry mode that does not require this level of involvement. Nevertheless, an acquisition is beneficial for foreign companies that wish to establish their own company culture yet still desire to gain knowledge about the new market, its bureaucratic procedures, and get familiar with the behavior of the potential customer. Additionally, the new entrant can draw on the established customer base, qualified employees and use the established Chinese domain (.cn). Still, it has to be stressed that the acquisitions run into millions of dollars. A decade ago eBay and Amazon have invested \$150m and \$75m respectively. Costs of the latest acquisitions have not yet been revealed to the public. Ultimately, trade-offs are inevitable when selecting an entry mode.

The proposal of using an acquisition to enter the Chinese market seems contradictory to the fact that foreign ownership in China's new media industry is restricted. As previously mentioned, foreign Internet operations that provide "value added telecommunication service" (VATS⁹) are prohibited. Foreign Equity Ownership is

⁹ VAT includes: Internet access services, call-center services, provision of content, gaming, commerce, etc.

confined to 50 percent. (Orrick 2012.) The prominent way most foreign investors use to gain control over local business is the Variable Interest Entity (VIE) structure. This highly controversial structure, allows foreign e-commerce businesses to gain foothold in the market and simultaneously, local players benefit by increasing their capital outside of China. The VIE structure enables foreign investors to gain de facto control over a Chinese company that is restricted for foreign investment without direct equity ownership. One requirement for the VIE structure is overseas listing of the Chinese company. Owing to the popularity of this structure, today, more than two-third of Chinese enterprises are listed on Nasdaq. However, the Chinese government plans to regulate the controversial corporate structure in the foreseeable future. (Flannery 2012.)

6.6 New Entrants

Notwithstanding the challenges, there are numerous foreign enterprises that are in the process of entering the market. China remains too tempting as significant growth of the number of online shoppers provides immense opportunities. Among those new investors are high-profile fashion retailers such as ASOS, Net-a-Porter, YOOX, Neiman Marcus and the Australian luxury fashion trader Orotan. These companies have another few things in common: they all have realized the increasing demand for brands, particularly foreign brands that are perceived superior by Chinese shoppers and the majority of the companies target the luxury e-commerce sector. China is believed to be the world's number two luxury goods market. (Dishman 2011.)

YOOX Group

The Milan-based luxury e-commerce company YOOX Group positions itself as an end-of-season multi-brand boutique. The founder, Federico Marchetti has discovered a unique concept which made YOOX world's leading virtual store for multi-brand fashion. The Italian Internet retailer offers leftover designer merchandise or last year's designer clothes to discounts of up to 50 percent (Bloomberg Businessweek 2002). Additionally, YOOX powers websites for 23 fashion designer outlets. Thanks to relations to around 300 leading designers like Prada, Chloe, Emporio Armani, Dolce & Gabbana the exceptional online retailer generated a turnover of €300 million in 2011. (Friedman 2012.) In the same year, the YOOX Group has announced to cater sophisticated Chinese luxury shoppers. Its Chinese luxury boutique Thecorner.com is

Shanghai-based. However, YOOX will not be spared from the Chinese luxury tax which ranges from 20 to 40 percent (Dishman 2011).

Net-a-Porter

After less than one year of business operations, Shouke.com – a Hong Kong multi-brand e-tailer – was acquired by London-based online luxury fashion retailer Net-a-Porter. The costs of the acquisition were not mentioned to the media. In March 2012, the UK retailer has launched its Hong Kong-based website TheOutnet.cn and announced to open a second distribution center in Hong Kong to ensure its Chinese customers 24-hours delivery. Net-a-Porter follows its parent company Compagnie Financiere Richemont SA that already conducts business in China with its brands like Cartier and Montblanc.(Yannan 2012).

Neiman-Marcus

The Neiman Marcus Group, an US luxury chain, has entered the Chinese market, in 2012, with the establishment of a partnership with the Chinese e-commerce company Glamour Sales Holding. The investment of \$28 million will provide Neiman Marcus a 37 percent share of the Hong Kong e-commerce enterprise. (Internet Retailer 2012.) Glamour Sales runs a “flash sales” website. The flash sales – concept means that the e-tailer provides a limited time offer of exclusive items with high discounts. Flash sales are considered as extremely successful. (Timberlake 2012.) The site will also contain editorial content, behind-the-scenes-videos and fashion trends (Internet Retailer 2012).

ASOS

The British online fashion retailer ASOS has announced in October 2012 to launch its own Chinese language site within 12 months. The fast fashion retailer already exports to China where it has a strong growth in sales. The domestic market seems to be saturated with a 13 percent increase in sales in UK, whereas the company achieved a 46 percent rise in international sales in the same period of five months in 2012. Apparently, ASOS can tap into enormous financial resources as it plans to expand to China and Russia simultaneously. By 2015, ASOS plans to reach the £1 billion (\$1.6bn) mark of total sales. Unlike Neiman Marcus or Net-a-Porter, ASOS is a discounted fast fashion retailer targeting the twenty-something Chinese consumers and will face cut-throat competition from a multitude of local platforms and international brand retailers such as ZARA that recently begun to launch its online operations in China. (Jing Daily 2012.)

7 PRACTICAL ADVICES FOR DEVELOPING MARKET ENTRY STRATEGIES

In our interconnected and increasingly globalized world, one is inclined to believe that the World Wide Web removes numerous obstacles between retailer and online shopper. This assumption creates the deceptive impression that a standard Internet business model can be applied successfully in any country with a relatively high Internet penetration rate. It may be hard to believe but Chinese online shoppers differ in their preferences, shopping behavior and demand. Some of the previously mentioned failures of foreign investors can be ascribed to their ignorance of the local electronic business environment. Companies that want to capture opportunities need to customize their business model and marketing mix including product standards, pricing, distribution channel and promotion to better tally with local conditions of the unique online ecosystem in China.

7.1 Product

According to the findings of a study conducted by iResearch, footwear, apparel along with 3C products remain the most popular product categories for Chinese online shoppers. The largest product groups of the Chinese online market are apparel and consumer electronics, with a transaction volume of more than 25 percent, followed by skin care products (4.9 percent), maternity products as well as books and games (Figure 5). Generally, there will be further growth across all product categories as the number of online shoppers is expected to surge. With increasing experience and convenience online shoppers gain gradually, they will broaden the range of products they buy online. However, the growth potential will differ by category. Certain products such as modern consumer electronics will become more and more popular. Also other product categories will face further growth as consumer will progressively switch from brick-and-mortar shops to online shopping websites. These categories, in which consumers will move a major amount of the spending online, entail casual wear, travel, consumer electronics and cosmetics. For example, in China e-commerce sales in skin care and cosmetics have exceeded sales in the USA, UK and Japan and will continue to grow in the following years. (BCG Perspectives 2011.)

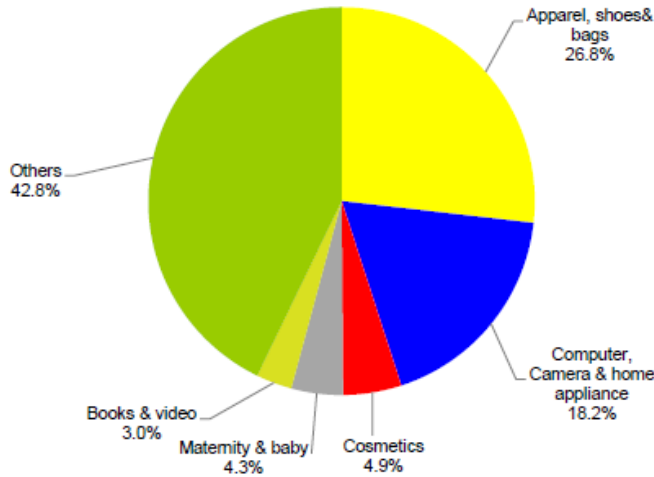


Figure 5: Gross Merchandise Value of Online Shopping by Product Category in Q2 2012 (iResearch)

In contrast to Western online shoppers, Chinese are more prone to shop across various product categories. According to a recent PwC report, 70 percent of Chinese online shoppers have purchased products online in more than 10 categories within the past 12 month (Figure 6).

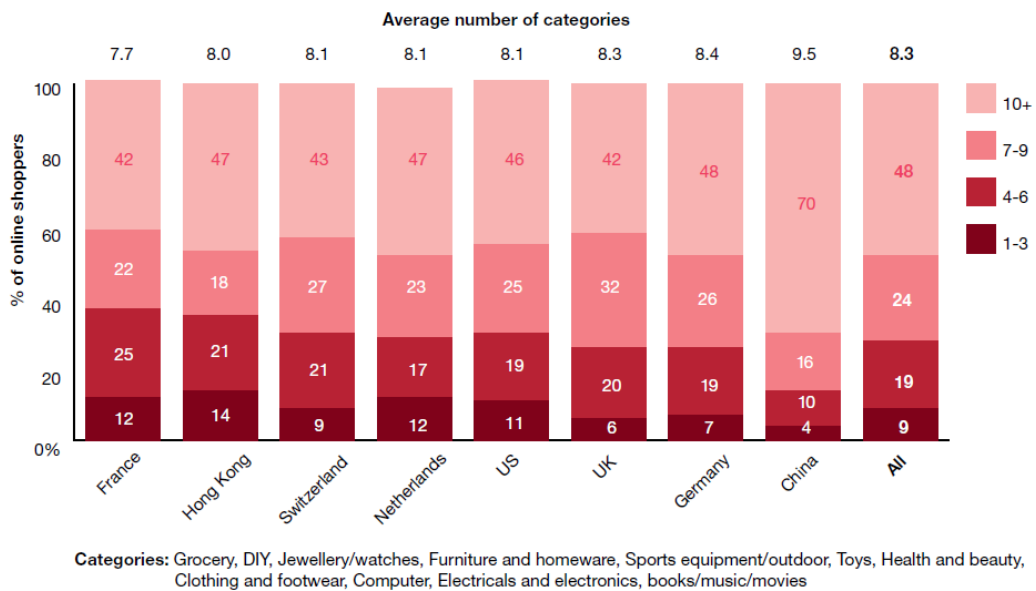


Figure 6: Number of Categories Shopped Online in Last Twelve Months (PwC 2011)

So, Chinese online shoppers are more willing to buy a variety of products online than their counterparts in other markets. This finding is also supported by the fact that the five leading B2C online merchants; Tmall, 360buy, Suning, Tencent, Amazon.cn operate platforms that offer a wide range of products. It is obvious that main players of

Chinese e-commerce offer a broad product portfolio but only a few market participants focus their activities on niches. As previously mentioned, two main trends are emerging: the expansion to new product categories by dominant platforms and the surface of more and more niche players. It seems as the Long Tail business model is very popular and profitable in China's online market. The Long Tail concept is also named by its creator Chris Anderson as "selling less of more", which means that a vendor concentrates on offering a large amount of niche products, although these items are sold infrequently. It is the opposite of the traditional Pareto principle (also known as the 80-20 rule), where a small amount of the most popular products account for the largest proportion of revenue. This model is applicable to digital goods that do not require any warehouse as well as products that are not available in brick-and-mortar stores. It rests on the assumption that the demand for those products that are not being sold in physical stores is as big as for those that are. (Kirsch 2006.) The main advantages the platforms enjoy is that they can keep their storage costs low. However, the platform has to offer a wide portfolio of the tail-end goods and the operators have to adapt the search engine algorithm to these niche products.

When selecting goods to be sold to the Chinese consumers, marketers should be aware of the behavioral patterns of mainstream consumers. Annual surveys, conducted by McKinsey since 2005, have outlined the development of different consumer segments throughout the years. In the frame of this study more than 60.000 people in 60 cities were interviewed. These interviews were the basis for a report on trends of the behavioral patterns of the 2020 Chinese consumer. The outcomes of the study revealed, that Chinese are and will remain to be pragmatic consumers. Compared to consumers from the USA, Chinese are more conservative when it comes to spending. They tend to fix a budget before they decide what they buy. After a thorough evaluation they hunt down the best deal. This rather conservative shopping behavior is deeply anchored in Chinese society and will most probably remain unchanged despite the growing wealth. Additionally, it has been tracked down that Chinese shoppers become more and more brand-loyal. At the moment, there is relatively low brand loyalty among Chinese mainstream consumers. However, young people are an exception as their brand loyalty is greater than of any other consumer segment (McKinsey 2012.)

Since income will increase, the consumer market will mature and ultimately consumer expectations will rise. Chinese consumers increasingly feel the need for quality, durability in consumer electronics, user-friendliness and comfort in apparel. Furthermore, the consumer of 2020 will place greater emphasis on individuality. With the growing income the sense of self-expression will increase. The companies will have to satisfy consumer's desire for individuality. Niche-brands represent an option to stand out from the masses. McKinsey analysts claim that Chinese consumers will dare to try lesser known brands. Particularly foreign brands were reliable indicators for quality when the inexperienced consumer bought his first car, bulky house hold appliances or other major purchases. Now the Chinese consumer has gained more experience and product knowledge. (McKinsey 2012.)

As already mentioned in the description of the average online shopper, China's today's e-shoppers are mostly young and educated. They primarily seek value, convenience and products that are unavailable in most physical stores. Unique product assortments, several convenient payment and delivery options are among the critical aspects of winning Chinese customers. In addition, men occupy the majority of Internet users in China. As a consequence, online shops offering casual ware or apparel for men in vein of just4men.de, powered by Herrenaustatter.de (a German vendor of branded fashion), might be a promising niche with a relatively low competition intensity compared to.

With the changing lifestyle, Chinese consumers will experience further increase in demand for convenience, unique assortments of goods, quality of service, social networking and easier price comparisons (McKinsey 2012). Finally, all these aspects should be factored in when making the decision on product categories, target consumer segments as well as product characteristics.

7.2 Price

One of the primary reasons for buying online is the expectation to find a product on the Internet for a lower price than in a physical store. Chinese consumers do not mind to do a comprehensive research among online and offline stores in order to get the best price on products. Especially in categories such as apparel and consumer electronics, Chinese consumers expect to save costs by purchasing online. Indigenous companies are aware

of this phenomenon and offer discounts, sales and promotions regularly. On Single's Day (November 11 (11/11) representing four single people), Taobao has broken previous records, when in the first 70 minutes of a 24-hour 50 percent off-shopping more than two billion renminbi were spent at China's largest online shopping website. The sales target set for the 24 hours was already achieved ten hours in advance. (China.Org.Cn 2012.) These discount campaigns even go so far that price wars escalate between online vendors. Only last year, home appliance vendor Suning and Jingdong Mall (360buy) fought a comprehensive price war, when Suning started a 30 percent sales promotion on home appliances. Industry giants tend to trigger price wars to drive incompetent competitor out of the market in order to gain larger market shares. (People's Daily Online 2012.)

Nevertheless, one cannot use the same yardstick to assess different Chinese consumer segments. There are extreme cases such as bargain hunters that prefer to comb through Taobao for best deals or heavy spenders such as married, wealthy Chinese men who buy luxury gifts for their second wives or girlfriends (xiao san or the third person in a relationship) (Boyle 2012). Taking everything into consideration, companies planning to sell in China should be aware of the fact that mainstream Chinese consumers are price-sensitive and expect lower prices on the Internet. However, price is not the only factor that mainstream shoppers consider when they engage in online shopping. E-tailers might avoid price wars when they offer a great product variety, convenient delivery options, reliable content and reviews additionally to reasonable price offerings.

7.3 Promotion

One crucial element of online shopping is that Chinese Internet users primarily rely on word of mouth advertising. Social media and e-commerce are stronger dovetailed with each other than in Western countries. This is reflected in the development of the advertising market, as Chinese online advertising has surpassed print advertising when it reached a volume of RMB 51.1 billion in 2011. According to China Internet Watch, online advertising is the main source of revenue of almost 70 percent of all webpages. However, search engines are the most popular online marketing instruments. For example Baidu, the top search engine in China, has generated RMB 14.36 billion from online advertising. Although, online marketing is widely present in China, marketers and social media strategists have to learn that China has a unique web and social media

culture which bears different risks. (Chou 2012.) However, as Chinese online shoppers are attracted by a social and entertainment factor, the usage of social networks for promotion purposes seems self-evident.

7.3.1 Social Media

The social networking phenomenon is more popular and prevalent in China than in the Western world. Half of all Internet users have more than one profile in social networks. Over 220,000 new blog- posts are published on China's largest micro blogging service Sina Weibo per minute, whereas, only 98,000 blog posts are recorded on Twitter. In addition to cultural differences that shape social networking, the whole social media landscape differs completely from the one in the Western world. There are fifteen social networks and micro blogging services in China. With 480 million members, Qzone is the leading social network which ranks second worldwide right after Facebook. Also, there is no dominant video-sharing platform like Youtube. Videos are mostly uploaded on more than ten online-sharing websites. Moreover, users do not add links or sources to news articles, which aggravates verification of plausibility of the information and exacerbates reactions to so-called shitstorms¹⁰. This situation is compounded by the fact that each of the fifteen social networks has its target audience that differs in age, residence, level of education and so on. It might be a challenge for the marketer to find out which networks to use in order to address its target group. The marketer should take into account that the number of users of a network is not a guarantee for the success of a marketing campaign. Paying attention to the quality of the users and the content is much more important when choosing the right network for effective promotion. A great number of online services are predominantly used for entertainment only. For example, Sina Weibo is very popular because it is widely used by celebrities that post jokes or blog about their life. The micro blogging network is also known for a high number of fake accounts which raise the number of followers. (Chou 2012.) In general, companies should be careful when using social networks as a communication channel as it requires constant monitoring, guidelines of communication, readiness to respond to any kind of comments, sensitivity and flexibility.

¹⁰ Shitstorm: a wave of outrage in a communication medium on the Internet, which is partly accompanied by insulting remarks (Duden.de/German Lexicon)

7.3.2 Search Engines

Although, search engines are the most popular online communication instruments, their reliability should be taken with a grain of salt. A host of letter box entities sell unlicensed products by paying for top search results listings on Baidu (Chou 2012). There is also the fact that Chinese online shoppers rely less on search engines to find products online. When online search for products in most other markets begins with Google, this is not the case in China. Taobao, for example, blocks the Baidu spider, so Taobao product listings cannot be found on Baidu. Consumers have to search on Taobao using its embedded search engine eTao (BCG Perspectives 2011). Added to this, it is not transparent on which criteria Baidu's search results listings are based. It is not unambiguous what is the dominant factor influencing the Baidu's listing: the bid of the advertiser or the conversion rate¹¹:

7.3.3 Affiliate Marketing

Affiliate marketing is another form of online marketing. It is considered as performance based marketing in which the advertiser rewards one or more affiliates (publishers) for each user who executed a transaction. The basic concept of affiliate marketing is that the advertiser or vendor integrates his ads on the affiliate's website. After the user has visited the affiliate's website and clicked on the placed ad (banner, video ad, etc.), he/she is forwarded to the website of the advertiser, where the user carries out a transaction. The affiliate receives a commission based on the number of transactions. The key advantage of the affiliate marketing concept is that affiliates provide the advertiser the possibility to reach the target group without being competitive. (Smithüsen 2011, 4-7.) Affiliate marketing is among the most used online marketing tools in Western countries, however, it was not possible to find reliable data on the affiliate marketing industry in China, and therefore the suggestion of using affiliate marketing is rather informative but not based on reliable insights into China's online marketing industry.

¹¹ conversion rate: how often a click on an ad resulted in a conversion, a meaningful action like a sale, lead, or sign-up (Google AdWords)

7.3.4 Adaptation of Promotion

Localization is equally important when it comes to promotion. In 2004, when eBay was strongly competing against Taobao, it started an aggressive online and offline marketing campaign. The US giant has reserved exclusive advertising rights with major Chinese online portals such as Sina Weibo, Sohu and Netease. Additionally, eBay distributed its advertising using offline channels such as buses and subway platforms. Jack Ma, however, knew better than the foreign newcomer that most Chinese business people would prefer to watch TV than log on to the Internet. Consequently, he booked advertisement on popular TV channels. (Wang 2010.) This example displays once again how vital it is for the configuration of a marketing mix to be informed about the potential customer and his preferences.

Another characteristic feature of dissemination of information is that Chinese tend to express their dissatisfaction about products or services publically. A prominent case that happened recently in China is Luo Yonghao's protests against Siemens' defective refrigerators. Luo has posted on his blogging website "The Siemens refrigerator and washing machine I purchased three years ago are all broken" and added "I will never again buy this lousy brand, Japanese-made appliances are still the most reliable". His blog post was reposted over 3000 times. In addition, thousands of his followers have started to post comments about deficiencies of their Siemens products. Hence, Siemens' reaction to the complaint was not satisfying for him, Luo arrived at Siemens' headquarters to smash refrigerators using a sledgehammer. Other volunteers joined Luo to advocate consumer rights and to make Siemens recall its defective refrigerators. (Mayer-Kuckuk 2011.)

Nevertheless, such a comprehensive and active networking of the users can also be advantageous. The strong on- and offline connection of the users enables to combine online and offline campaigns. For instance, the Ariel laundry detergent brand has placed a huge shirt out of doors. Passerbys were able to spray ketchup and sauce on the shirt using a remote control and eventually clean it with virtual Ariel detergent (Chou 2012.)

Apart from the instruments mentioned above there are further online marketing tools such as e-mail and news letter marketing. However, due to the lack of detailed information on online advertising in China, practical advice can be given to this extent

only. Common sense suggests, that a combination of offline and online channels is meaningful to attract numerous of potential online shoppers as well as experienced ones. Additionally, it should be pointed out, that for China it is crucial to find the right mix of paid, owned and earned media, since analysis has revealed high importance of word of mouth which is viewed as the most reliable source of information.

7.4 Distribution

With regard to the distribution of goods the main online channels namely platforms like Tmall and Taobao as well as the establishment of an own website were discussed in the previous sections of the paper. Equally important is the fact that qualified and experienced Chinese speaking manpower is required to support or build up these online channels. Even selling products on Tmall requires a Chinese speaking team that understands the local market. Amazon China, eLong, and ASOS are among the companies that employ professional Chinese executives to realize their operations in China. eBay did the mistake to sent a German manager and a chief technology officer from the USA to carry out operations in China. Neither had an understanding of the business environment, nor was speaking Chinese which was probably the reason for wrong resource allocation. (Wang 2010.)

Companies that just wish to test the market and start exporting to China using Tmall as an distribution channel have the possibility to avoid middle man such as trading companies or employing Chinese speaking manpower. Frank Levin, a former undersecretary for international trade at the US Commerce Department, has founded Export Now, a company that shall facilitate export to China. The experienced American has teamed up with Tmall and ensures that his service is more reasonable than contracting a middle man. Since Levin is offering his service to American companies, shipping takes place from Long Beach to Shanghai. Except for the shipping, Export Now is responsible for selling the goods on Tmall, translating product information into Chinese, distribution in China as well as constant web support of the online store. The fee Levin charges for his service amounts to \$3,000. All in all, 30 to 40 percent of the Chinese price will be kept by Tmall, Export Now and the tax collector. (Flanery 2011.)

Making use of the service provided by Export Now or similar companies appears to be a safe and reasonable option to gain initial experience in the market. Step by step, the

company can extend their presence by using multiple online channels. Li Ning - a popular Chinese sportswear brand – has successfully gone down this path. What made Li Ning's strategy so successful and advantageous was that each of the channels was targeted at different consumer segments. Initially, Li Ning contracted three core agents to start up eleven online stores on platforms such as Taobao, Sina and Eachnet. Since these platforms serve price sensitive online shoppers, out-of-season goods were offered there at a discounted price. Additionally, Li Ning's products are sold by around 400 consumer-to-consumer unauthorized vendors. In order to avoid damage to the brand, the company manages these vendors through training, product services and an effective use of the supply chain. Also here, out-of season products are sold at a discount. One year later, the sportswear company has launched flagship stores on several platforms such as Taobao. By doing so, Li Ning was able to build up own e-commerce capability at low cost and better manage the online brand image. This channel was targeted at the loyal fans of the brand who purchased newly arrived goods at high prices. Eventually, Li Ning established its own online shopping channel in the same year. Similar to the flagship store, an own shopping site is targeted at loyal Li Ning fans willing to buy new arrivals sold in limited quantities. The example of Li Ning illustrates that a diversity of online options aids to engage different consumer segments and enhance brand recognition. (BCG Perspectives 2011.)

To draw a conclusion, the choice of the distribution channel strongly depends on the financial and human resources of the company, its positioning, knowledge of the local e-commerce business and the target group. At the end of the day, each company has to configure a marketing mix which suits its objectives and resources.

8 REMAINING CHALLENGES AND RISKS

When taking a look at Figure 7, one clearly discovers that there are additional factors which play a significant role in China's ecommerce ecosystem. Apparently, it is not sufficient to find one's way into the market by establishing a well-designed online platform and tailor a marketing mix for the undertaking. There are further challenges such as payment and delivery services which are equally momentous for a successful e-commerce operation in China. Moreover, due to the cut-throat competition there is the

risk to be easily driven out of the market. Therefore, foreign companies need to find a unique way to differentiate themselves from competitors.

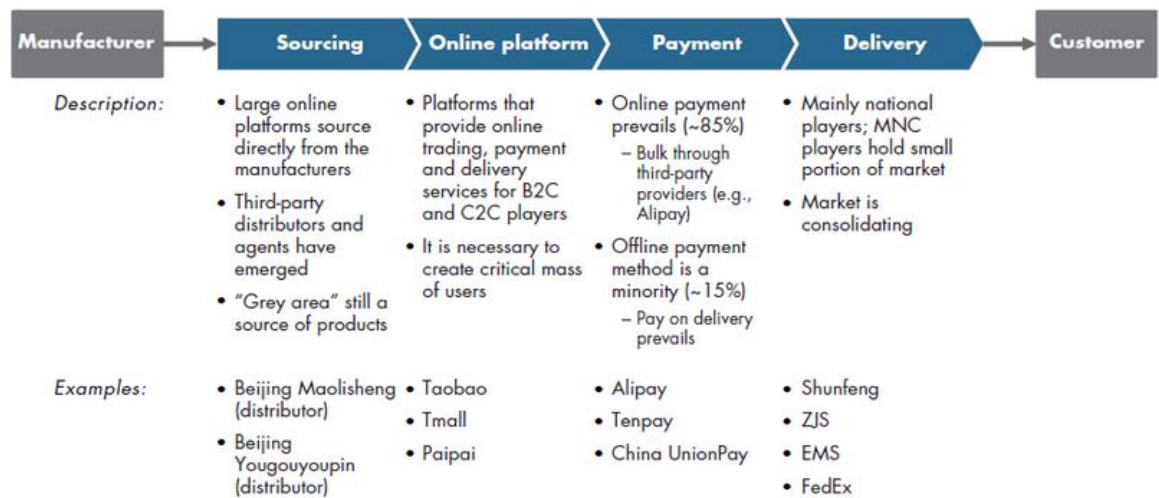


Figure 7: E-commerce Ecosystem in China (Hoffmann 2012)

8.1 Online Payment

A few years ago, China's online payment system was underdeveloped and represented an obstacle to e-commerce. Gradually, the electronic payment network became increasingly reliable. Today, online payment methods are widely used. Only a minority of online shoppers pays either on delivery or at their local post office (Hoffmann 2012). Alibaba's Alipay is the preferred and most used online payment scheme of Internet vendors. The online payment service has more than 550 million registered users. In China, it provides payment solutions for more than 500,000 online merchants in the fields covering online shopping, virtual gaming, utilities fee payment transactions, air ticketing and digital communication. The main benefit of Alipay is that it teams up with numerous financial institutions such as Visa, MasterCard as well as all national banks in China. The company additionally offers offline services such as POS (point of sale) payment in rural areas. (Alipay Global 2013.) It is no surprise that Alipay is the main player in China's third-party online payment industry with a market share of 48.6 percent. It is followed by Tenpay (20.2 percent), China UnionPay (9.3 percent), 99bill (7 percent) and China PnR (6.8 percent). (iResearch 2012.) A foreign company that is new to the Chinese market will certainly gain customer's trust easily by integrating Alipay in its website. However, the company has to pay service fees to obtain Alipay's solutions. In 2011, Alipay has lost one of its key customers. China's online vendor

360buy has fully terminated its collaboration with Alipay due to high service fees. Allegedly, Alipay's fees are four times higher than those of 99bill. (IT-Times 2011.) The extra fees ranged from RMB 5,000,000 (\$776,830) to RMB 6,000,000 (\$932,196) each year. There was also an outrage of 360buy's customers, as the majority only used Alipay to settle their payments. They criticized Alipay for harming customer's interests by charging high rates. (Global Times 2011.) The rates of the online payment companies are not stated on their web pages and are therefore probably negotiated individually. New entrants should weigh the pros and cons when deciding on a suitable online payment service. Establishment of an own payment service might turn out as a cumbersome and costly undertaking, as one has to contract Chinese national banks and obtain a "License of Payment Transaction".

8.2 Logistics Challenges

The main challenge for online merchants in the next couple of years will be the question of how to ensure delivery service to keep pace with the soaring growth of customer orders. In the next few years, customer orders in China will experience a growth of 200 percent. It is inconceivable how such an amount of orders will be delivered smoothly, since China's distribution networks seem to be strained already. In contrast to other countries, where sophisticated logistics operators dominate the business, logistics in China are extremely fragmented. Owing to the circumstances, major e-tailers do not have distinctive service differentiations and they offer a similar low price. Basically, packages are regularly delivered to small depots throughout the day. From there, the orders are transported by motorcycle, bicycle, three-wheeled cart or any other mean to the customer. (Tompkins International 2012.) The scarcity of sophisticated logistics providers often results in problems for the e-commerce companies such as damaged and lost parcels, late deliveries, slow cash-on-delivery processes (COD), poor return procedures, negative attitudes from delivery personnel and consequently reputational damage. Poor last mile delivery inevitably affect brand image of the online trader and his creditability. In addition, e-commerce leaders in niche industries such as consumer electronics, baby goods, computer products and furniture suffer from the failure of logistics suppliers to cope with large irregularly shaped shipments. The situation is aggravated by the fact that freight companies do not provide door-to-door service. Only a few local express companies are able to handle freight. (Goh 2011.) Moreover, a large part of the country is not serviced at all due to inadequate infrastructure (Tompkins

International 2012.) Faced with these challenges, ATKearney consultants recommend three strategies to deal with logistics challenges in China.

8.2.1 Establishment of Own Networks

To ensure quality, leading e-commerce players chose to build own internal logistics networks and train own delivery teams. Some online vendors established in-house logistics from the start, others only after they encountered severe logistics bottlenecks from third-party logistics suppliers. The outcome was an increase in speed and quality of delivery, improved resource control and as a consequence better customer experience. (Goh 2011.)

Companies such as Dangdang, Amazon China and 360buy have benefited from the establishment of their own logistics businesses (KPMG Global 2011). For instance, 360buy experienced a growth rate of 300 percent within the past years after the online business built up its own express delivery system in 2009. The company's network allows same- or next-day deliveries from its distribution centers in Shanghai, Beijing, Guangzhou and Chengdu. Last year, 360buy has started to build a new distribution center in Shanghai which will have the capacity to handle 100,000 orders per day. The massive 150,000 square-meter warehouse costs the company more than \$100 million. (Goh 2011.) Net-a-Porter, that has launched its Chinese-language site in February 2013, realized the importance of optimized logistics and has established a 12,000-square-meter warehouse in Hong Kong to cut delivery times in the Asia-Pacific region. Hong Kong is a free port with reliable courier networks, which will enable same-day delivery in Hong Kong and next-day shipping service to big cities in Australia. (Jing Daily 2013).

It is worth mentioning that the establishment of own logistics operations is a 'privilege' of companies with big enough pockets. Additionally, the company has to process large order volumes, particularly in last-mile delivery. One assumes, a company carries out about 500 deliveries per day in a city. The costs of an own delivery team would amount to RMB 15 (\$2.28) or more per parcel which is uneconomical for the company. In case of more than 10,000 deliveries per day in a city, delivery costs go down to less than RMB 2 (\$.30) per parcel (Figure 8). Therefore, it is questionable if even leading e-commerce companies are able to satisfy demand internally and profitably taking into

account the vast geographic distances in the market. (Goh 2011.) As such, e-tailers should carefully examine if and where they establish own logistics operations.

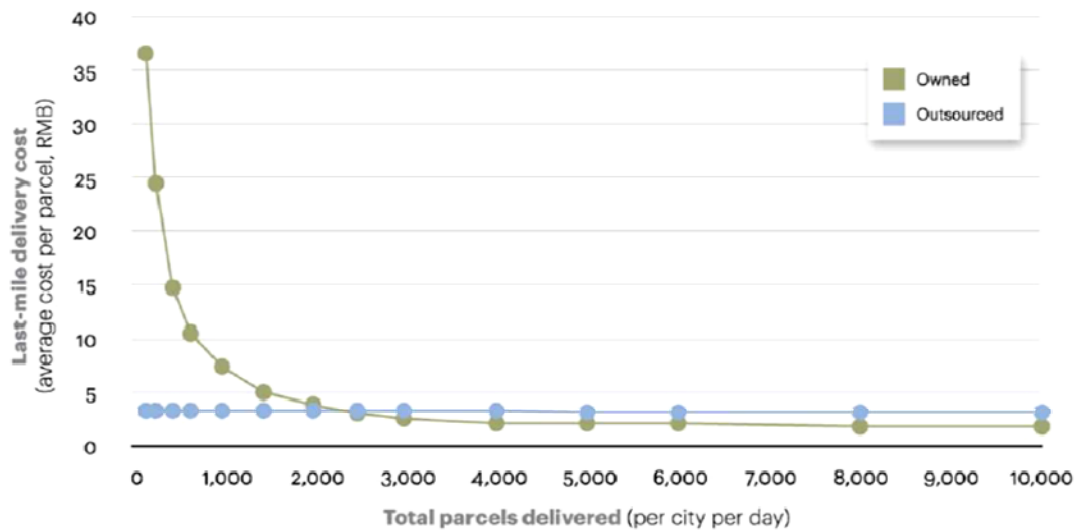


Figure 8: Last mile (intra-city) delivery economics (Goh 2011)

8.2.2 Outsource to Third-Party Providers

The majority of online trading companies outsource their delivery operations to third-party express companies. China's express delivery companies can be divided into two groups (Figure 9). On the one hand there are large networks offering basic services and on the other there are smaller networks that offer more complex services. Companies that belong to the first type benefit from their large network coverage but are only able to offer basic delivery services. Using franchising as a business model allows these companies to expand quickly and compete on speed and price. Back-up from state postal services enables wide network coverage. However, these service providers do not offer complex services such as exchanges, scheduled returns and collect-on-delivery (COD). Another drawback is that such companies offer a one- or two-week COD repayment cycle putting e-tailers at risk. (Goh 2011.)

China's largest private express delivery company, Shunfeng Express is an exception. The company owns more than 2,000 locations and ensures fast and reliable service. Although Shunfeng Express enjoys a premium position, it offers standardized services. The largest network is provided by China Post's EMS which has more than 20,000 locations. However, it lacks speed and reliability. (Goh 2011.)

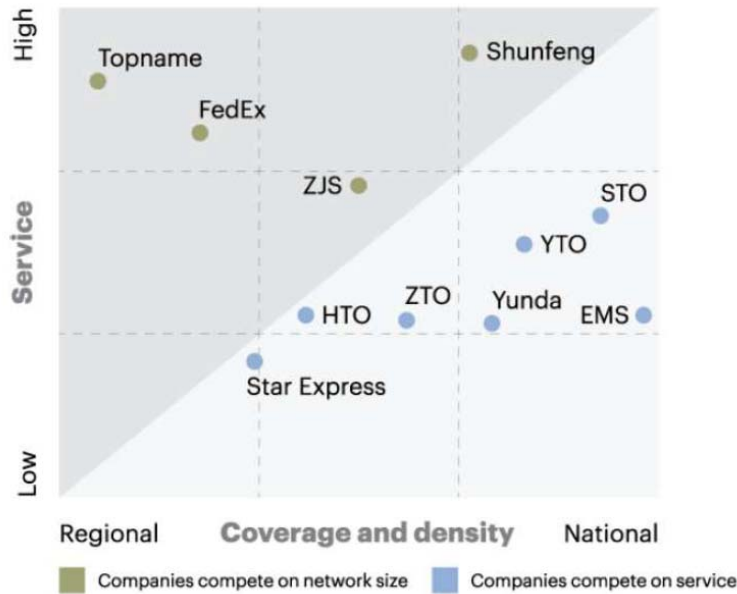


Figure 9: The Competitive Landscape for Domestic B2C Parcel Delivery Providers (Goh 2011)

Companies that offer more complex services are mostly fully owned, but have smaller network coverage and therefore compete regionally. FedEx, TNT or Topname are able to offer value added services such as COD, customized delivery or warehousing mainly because of their focus on the regions. They concentrate predominately on the B2C market as well as big cities where there is enough volume. International players are more reliable but their networks are more limited than those of domestic players. Their commitment to provide a broad range of high-end services is believed to be their main advantage. (KPMG 2011.) However, domestic online vendors tend to opt for local delivery providers, mainly because “They like our services, but not our price.” as FedEx Express’s Head of China mentioned. (Goh 2011.)

At this juncture the situation is that e-commerce companies demand a service that is not offered by any express delivery company. Online traders expect a wide range of services at a competitive price dovetailed with broad network coverage. The consequence is a gap in the market. So, numerous logistics companies as well as e-commerce businesses invest heavily to expand their capabilities. When selecting a potential third-party delivery service provider, one should not only take their current capabilities into consideration, but also their investment plans. (Goh 2011.)

8.2.3 Form Partnerships or Acquire Existing Firms

China's e-commerce giant Alibaba invested \$4.5 million in Star Express to form a partnership with the logistics operator. Additionally, Jack Ma has also invested in Best Logistics which acquired a 70 percent stake in HTO – one of China's large express delivery service providers. Alibaba also plans to build a network of own warehouses across China. This undertaking is expected to cost \$4.6 billion. These strategic steps are understandable, in light of the fact that no logistics company alone is currently able to meet Taobao's speed and service requirements for 3 million shipments per day. (Goh 2011.)

According to industry experts, strategic partnerships between e-commerce companies and third-party logistics enterprises will have the necessary resources and capabilities to provide real solutions to close the gap in the market (Goh 2011).

8.3 Differentiation from Competitors

Given the intense competition from local online businesses, brands and companies that are new to China are well-advised to create a differentiation strategy for the market. YOOX has realized that in order to withstand China's fierce competition, the company has to lure customers with innovative concepts. In the first place, the operators of YOOX's website apparently understand that Chinese customers expect entertainment when they shop online. Hence, the webpage will feature photo shoots, short films and behind the scene videos. Additionally, a special voice recognition technology is integrated in YOOX's site. By telling preferred color choices in Chinese, the algorithm will search for the customer's specific color scheme (Fashion United 2012). The icing on the cake is that YOOX offers its Chinese customers a special service. After delivering the products, a FedEx delivery worker will wait until the customer tries the cloths on or inspects accessories and return the item to the supplier in case the customer is not satisfied. (Dishman 2011.) It is obvious that YOOX's target group are sophisticated luxury shoppers, who are willing to pay extra for additional service.

Another way of differentiation is engaging the customer to participate in promotion. For example, VANCL, China's number one online apparel brand, allows customers to set up own personal stores on the website. The co-called "VANCL Star" campaign

provides customers the opportunity to upload photos of themselves wearing the brand's products. In addition, they can recommend combinations and styles. VANCL rewards the participants with 10 percent of the sales generated with their efforts. (Trend Watching 2012.)

The British online seller ASOS, offers value and entertainment to its customers with a slightly different concept. Selected shoppers can participate in a free Style Session via Skype. They can ask ASOS Style Advisors about ASOS apparel and get advice on items they plan to purchase. (Trend Watching 2012.)

A further, more futuristic approach is using virtual dressing room software to be able to virtually try on clothing and see if the color and style suit the shopper, by using a webcam (Zugara 2013). Augmented reality is a live view of the real world into which additional data is extracted from the Internet and layered or superimposed. It has been tested and advanced by companies like Google, Microsoft of car manufacturers such as Toyota, BMW or Mercedes. The Mercedes Dice concept will enable the driver to call up information about passing landmarks, places of interest while driving. (Steward 2012.) E-tailers that integrate augmented reality will definitely be considered as innovative.

The augmented reality concept is not only to be used as a virtual dressing room for apparel vendors. Sony, the electronics manufacturer, has developed an augmented reality web app which allows visualizing how a TV would look in the buyer's home before the actual purchase. The aim of the web app is to facilitate the choice of a TV. Users shall be able to envision different-sized TVs in their living rooms. (The Independent 2011.)

All in all, it would be a great advantage of a newcomer to find a tailored differentiation strategy for the Chinese e-commerce market. There are certainly many options of differentiation in various areas; be it delivery service, entertainment, social content or promotion by celebrities in micro blogs. The company's differentiation concept has to match its resources and be of relevance to the Chinese online shopper.

9 CONCLUSION

Taking everything into consideration, the research has revealed that there is no one-size fits-it- all solution for such a dynamic and unprecedented online shopping market like China's. The situation is aggravated by the fact that, the Chinese e-commerce market is not yet fully mature, electronic retailers that wish to tap into its opportunities have to be flexible enough to adjust their strategy to the fast paced development of the online industry. In the first place, the entrant should define its main objectives and investigate whether their financial and human resources are sufficient. The next step would be the creation of a strategy based on an online market analysis. Worthwhile mentioning is that learning about the evolving Chinese e-commerce landscape as well as defining a suitable strategy will turn out to be a long-winded and cumbersome process, unless it will be supported by a native speaker who is familiar with the online shopping business in China. Companies that plans to start exporting its products to China and sell them online, are well-advised to partner up with large indigenous players such as Tmall, Taobao, 360buy or Tencent. These e-commerce giants offer a wide range of services from online payment to delivery, which facilitates the market entry and provides the opportunity to learn about consumer behavior. When choosing an eligible platform service fees, image of the platform as well as its users should be scrutinized.

Experienced online sellers that wish to establish their own online retail store in China can do so by pursuing one of the following options. First, the foreign company can found a joint venture with a local partner. In this case, however, the choice of the partner is of utmost importance as a partner who operates in the Internet industry can easily turn to a competitor. Another option is to form a partnership with a like minded Chinese enterprise that has similar goals. Also here, a partner with a low conflict potential should be chosen. The third option is an acquisition of a local player, which is only possible through the controversial Variable Interest Entity Structure (VIE) that will probably be reviewed by the Chinese government as it is considered to be a loophole to the present regulations on ownership in the Internet industry. Alongside a suitable market entry strategy, the new entrant has to configure a marketing mix that is tailored to the target customer and the conditions of the Chinese e-commerce industry. In this context adaptation of the marketing mix to the Chinese customers and their online shopping behavior is vital for a successful venture. As such, foreign companies should

be aware of the fact that local knowledge and consideration of cultural aspects are critical to success in China's online shopping market and to better address the potential customer. Further challenges to be taken into account are online payment methods and delivery options. Equally important, is the aspect of differentiation. Given the cut-throat competition in China's online shopping industry, especially a lesser known new website should create a differentiation strategy to attract and retain customers.

It remains to be seen how the competitive environment in the online shopping business will change further down the road, but in order to keep up with or even surpass the competition, an e-tailer has to be able to adapt in China's rapidly changing e-commerce market.

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APPENDICES

Appendix 1 Overview of Tmall's Commission Rates (5)

Commission Technical service charges an annual fee Corresponding to annual sales of return of 50% of the annual fee Back to 100% annual fee corresponding to annual sales

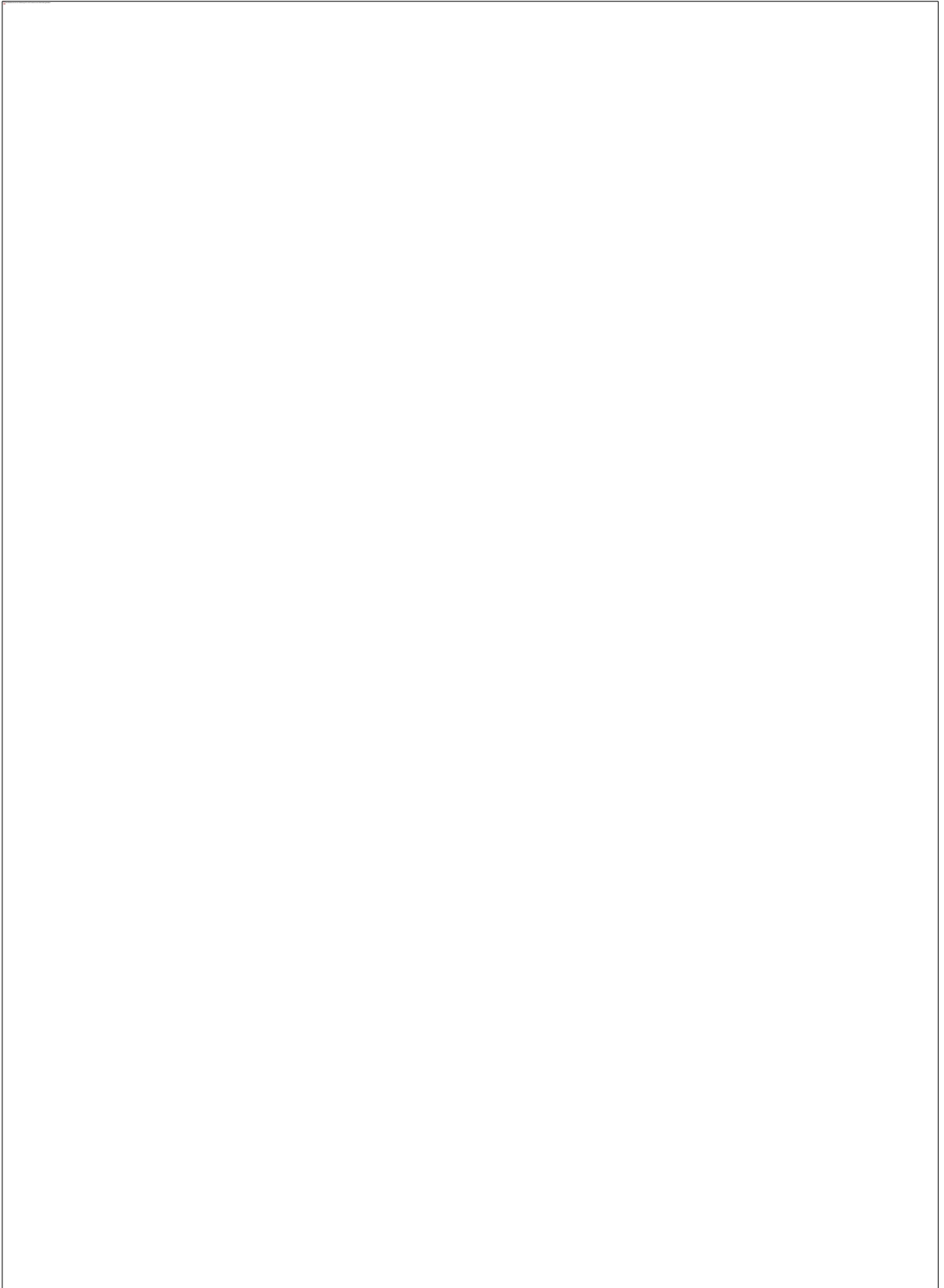
《天猫2013年度各类目技术服务费年费一览表》

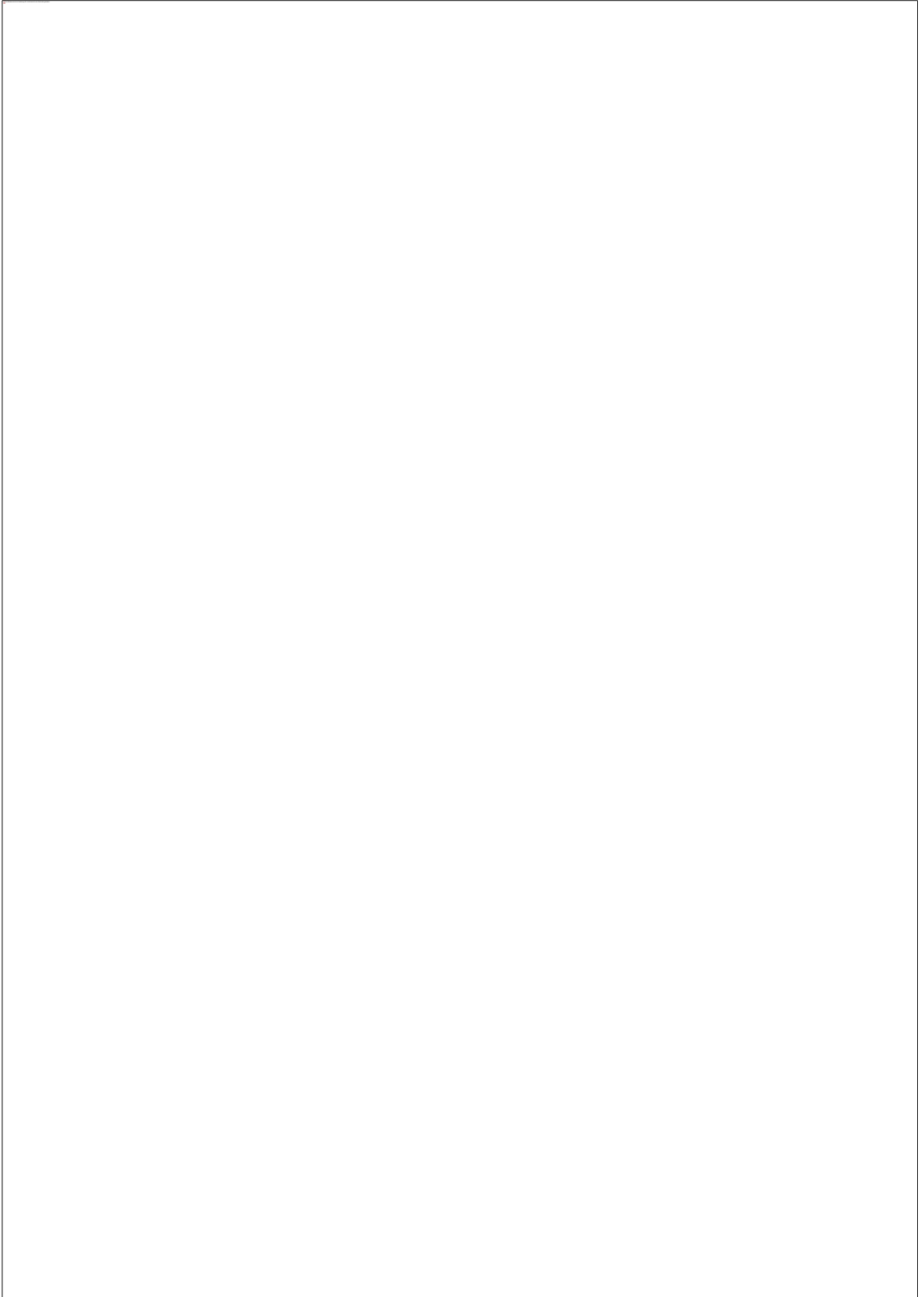
天猫经营大类	一级类目	二级类目	技术服务费费率	三级类目	技术服务费费率	技术服务费年费(元)	技术服务费年费(元)	技术服务费年费(元)	
服饰 Clothing	配饰/皮带/帽子/围巾 Accessories/Belts/Cap/Scarf	5%				30,000	100,000	600,000	
	女装/女士精品 Ladies' Fashion	5%				60,000	360,000	1,200,000	
	男装 Men's Fashion	5%				60,000	360,000	1,200,000	
	女士内衣/女士内衣/家居服 Ladies' & Men's Undergarment	5%				60,000	100,000	600,000	
	箱包/皮包/双肩包/男包 Ladies' and Men's bag	5%				60,000	100,000	600,000	
	女鞋 Ladies' Shoe	5%				60,000	100,000	600,000	
	旅行男鞋 Men's Shoe	5%				60,000	100,000	600,000	
	鞋类箱包 Bag & Shoe	5%				60,000	100,000	600,000	
	运动户外 Sports wear	运动服饰 Sports' Shoe	5%				60,000	360,000	1,200,000
		运动服/运动包/运动配件 Sportswear / sports bag / neck ring accessories	5%				60,000	360,000	1,200,000
电动车/电动车配件		2%				60,000	100,000	600,000	
山地/公路/休闲自行车		2%				60,000	100,000	600,000	
其他		5%				60,000	100,000	600,000	
运动/瑜伽/健身/体育用品 Sports equipment/stuff eg. Ball		5%				60,000	100,000	600,000	
户外/登山/野营/旅行用品 hiking & camping stuff		5%				60,000	100,000	600,000	
礼品/骑士车/眼镜 Gifts/骑士车/眼镜		5%				60,000	100,000	600,000	
高档手表/旅行手表 Watches		5%				60,000	100,000	600,000	
首饰/旅行首饰/时尚饰品 Accessories		5%				60,000	100,000	600,000	
珠宝配饰 Jewelry	黄金/五黄金	0.50%				60,000	100,000	600,000	
	铂金/PT	2%				60,000	100,000	600,000	
	其他	5%				60,000	100,000	600,000	
珠宝配饰 Jewelry	5%				60,000	100,000	600,000		
珠宝配饰 Jewelry	5%				60,000	100,000	600,000		
天猫经营大类	一级类目	二级类目	技术服务费费率	三级类目	技术服务费费率	技术服务费年费(元)	技术服务费年费(元)	技术服务费年费(元)	

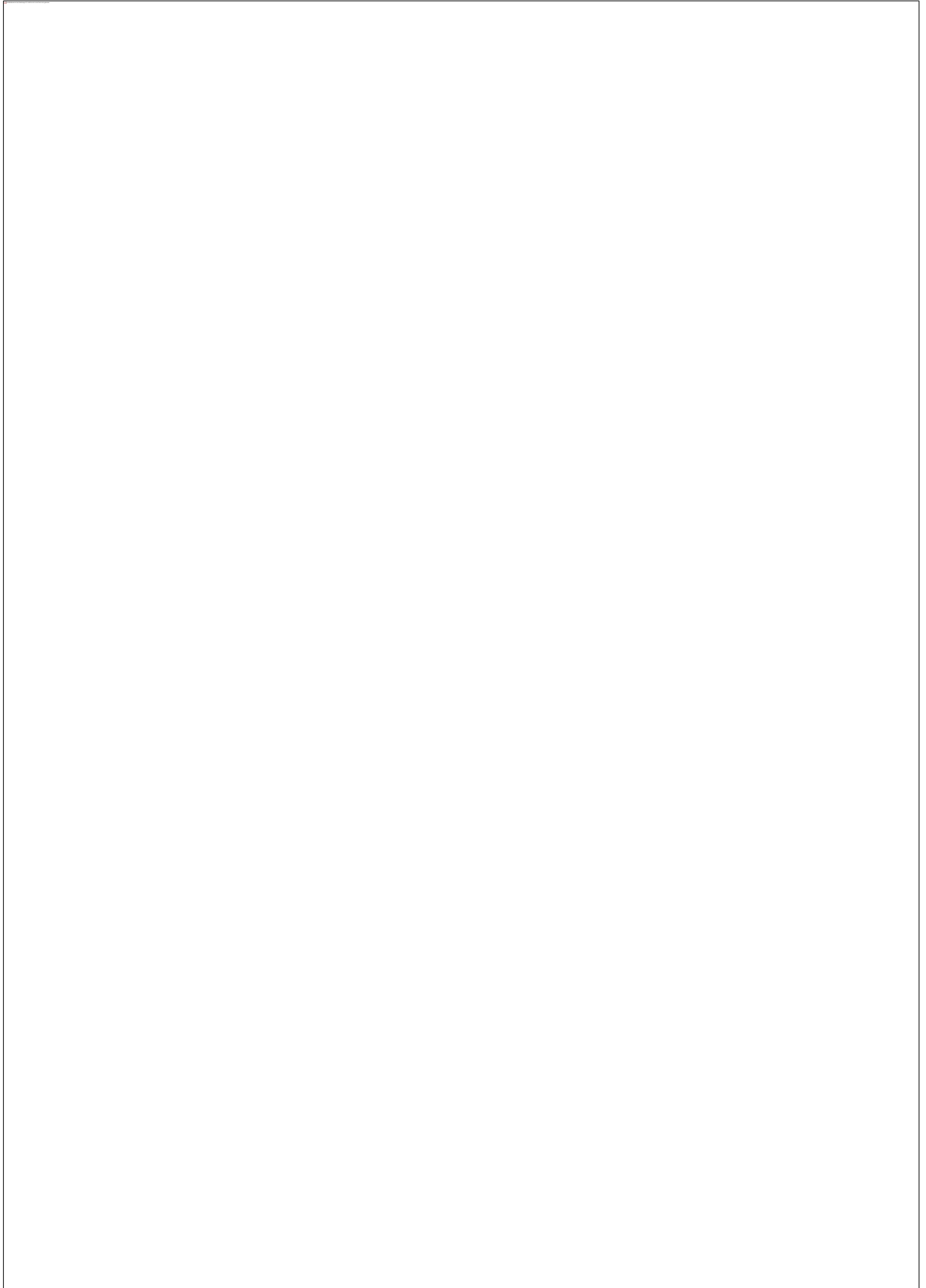
备注:

1) 涉及跨类目回佣费用缴纳及返还,全部参照相对高的类目的标准,即入驻时缴纳年费的金额参照商户选择经营的类目中对应年费金额的最高档;结算时参照有效月份内销售额占比最大类目对应的返还标准;

2) 由于类目划分较细,二级类目仅列出与一级类目扣点或固定年费不同的类目,各一级类目下完整的二级类目列表以商品发布页面为准。







一级类目	二级类目	技术服务费费率	技术服务费	三级类目	技术服务费费率	技术服务费	技术服务费费率	技术服务费	技术服务费费率	技术服务费
3C数码配件市场 3C digital accessories market	2%									
闪存卡/U盘/存储/移动硬盘 Flash card / U disk / storage / removable hard disk	2%									360,000
电视/配件/游戏/攻略 Video games / accessories / games / Strategy	2%									360,000
平板电脑/MID Tablet PC / MID	2%									360,000
办公设备/耗材/相关服务 Office equipment / supplies / related services	2%									360,000
电子词典/电子书/文化用品 Electronic Dictionary / electronic paper book / cultural goods	2%									360,000
影音电器 Audio and video appliances	2%									360,000
厨房电器 Kitchen appliances	2%									360,000
生活电器 Electric Appliance	2%									360,000
大家电 Large appliances	2%									360,000
个人护理/保健/按摩器材 Personal care / health / massage equipment	2%									360,000
家用电器 Household appliances	5%									360,000
网游及QQ Online games and QQ	0.50%									360,000
网络游戏点卡 Network game cards										360,000
腾讯QQ专区 Tencent QQ Zone	0.50%									360,000
移动/联通/电信充值中心 Mobile / Unicom / Telecom prepaid Center	0.50%									360,000
手机号码/套餐/增值业务 Mobile Number / Package / value-added services	3%									100,000
话费通信 Communication	1%									100,000
特价酒店/特色客栈/公寓旅馆 Special Hotel / Inn features / Apartment Hotels	3%									100,000
酒店预订/度假线路/旅游服务 Attraction tickets / holiday line / Tourism Services	2%									100,000
旅游 Travel	2%									100,000

Appendix 2 Basic Translation of Tmall's Regulations for Vendors (4)

Source:

<http://www.tmall.com/go/chn/mall/newguizedetail37.php?spm=3.361013.276491.6.fv2cOj>

《天猫 2013 年度招商标准》 Merchants standard

2012-12-13 出处：天猫

第一章 (Chapter 1) 入驻须知

第一条 天猫暂未授权任何机构进行代理招商服务，入驻申请流程及相关的收费说明均以官方招商页面为准。

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第三条 (Clause 3) 请务必确保您申请入驻及后续经营阶段提供的相关资质的真实性 { Be sure to ensure the authenticity of the application assigned to follow-up phase of the operation to provide qualified} (若您提供的相关资质为第三方提供，如商标注册证(trademark)、授权书等 (Power of Attorney)，请务必先行核实文件的真实有效性)，一旦发现虚假资质，您的公司将被列入非诚信客户名单，天猫将不再与您进行合作；

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第五条 天猫暂不接受未取得国家商标总局颁发的商标注册证或商标受理通知书的品牌开店申请 (部分类目的进口商品除外)，亦不接受纯图形类商标的入驻申请；

第二章 天猫店铺类型及相关要求

第六条 旗舰店，商家以自有品牌（商标为 R 或 TM 状态），或由权利人排他性授权，入驻天猫开设的店铺。

(一) 旗舰店，可以有以下几种情形：

1. 经营一个自有品牌商品的旗舰店；
2. 经营多个自有品牌商品且各品牌归同一实际控制人；
3. 卖场型品牌（服务类商标）所有者开设的旗舰店；

其中 2、3 两种类型旗舰店仅限天猫主动邀请入驻。

(二) 开店主体必须是品牌（商标）权利人或持有权利人出具的开设天猫旗舰店排他性授权文件的企业；

第七条 专卖店，商家持他人品牌（商标为 R 或 TM 状态）授权文件在天猫开设的店铺。

(一) 专卖店有以下几种情形：

1. 经营一个授权销售品牌商品的专卖店；
2. 经营多个授权销售品牌的商品且各品牌归同一实际控制人的专卖店；

其中第 2 点专卖店仅限天猫主动邀请入驻。

(二) 品牌（商标）权利人出具的授权文件除个别类目不得有地域限制，且授权有效期不得早于 2013 年 12 月 31 日；

第八条 专营店，经营天猫同一经营大类下两个及以上他人或自有品牌（商标为 R 或 TM 状态）商品的店铺。一个招商大类下专营店只能申请一家。

第三章 天猫申请入驻资质标准

第九条 天猫申请入驻资质标准详见《[天猫 2013 年度招商资质细则](#)》

第四章 开店入驻限制

第十条 品牌入驻限制，

(一) 与淘宝（包括但不限于淘宝网、天猫、一淘等）已有的品牌、频道、业务、类目等相同或近似；

(二) 以“网”、“网货”结尾的品牌；

(三) 包含行业名称或通用名称的品牌；

(四) 包含知名人士、地名的品牌；

(五) 与知名品牌相同或近似的品牌。

第十一条 店铺跨类目经营限制，

(一) 旗舰店、专卖店，

1. 持有商标注册证的品牌，可以申请其商标注册证上核定使用商品所包含的一级类目；
2. 持有商标注册申请受理通知书的品牌，不允许跨天猫经营大类。同一大类下可根据相应的商标注册受理通知书申请天猫一级类目；

(二) 专营店，不允许跨天猫经营大类。

第五章 (Chapter 5) 天猫保证金/年费/费率标准

第十五条 (Clause 15) 保证金 (Deposit) :

商家在天猫经营必须交纳保证金，保证金主要用于保证商家按照天猫的规则进行经营，并且在商家有违规行为时根据《天猫服务协议》及相关规则规定用于向天猫及消费者支付违约金。续约商家须在当年续签要求的时间内一次性缴纳次年度保证金；新签商家在申请入驻获得批准时一次性缴纳当年度的保证金。保证金根据店铺性质不同，金额如下：

(一) 品牌旗舰店、专卖店 (distributor): 带有 TM(with TM Trademark) 商标的 10 万元 (100,000)，全部为 R 商标(with R Trademark) 的 5 万元 (50,000)；

(二) 专营店 (Franchise): 带有 TM 商标(with TM Trademark) 的 15 万元 (150,000)，全部为 R 商标(with R Trademark) 的 10 万元 (100,000)；

(三) 特殊类目说明，

1. 卖场型旗舰店，保证金为 15 万元；
2. 经营未在中国大陆申请注册商标的特殊商品（如水果(Fruit)、进口商品(import goods)等）的专营店(Franchise)，保证金为 15 万元 (150,000)；
3. 天猫经营大类“图书音像”(Audio books)，保证金收取方式：旗舰店(distributor)、专卖店 5 万元 (50,000)，专营店(Franchise) 10 万元 100,000)；
4. 天猫经营大类“服务大类”(service) 及“电子票务凭证”(Electronic)，保证金 1 万元 (10,000)；
5. 天猫经营大类“医药”(Medical)，保证金 30 万元 (300,000)；
6. “网游及 QQ”、“话费通信”及“旅游”经营大类的保证金为 1 万元；

天猫经营大类包含的一级类目详细请参考《[天猫经营大类一览表](#)》

(四) 保证金不足额时，商家需要在 15 日内补足余额，逾期未补足的天猫将对商家店铺进行监管，直至补足。

第十六条 技术服务费年费（下称“年费”）：

商家在天猫经营必须交纳年费。年费金额以一级类目为参照，分为 3 万元或 6 万元两档，各一级类目对应的年费标准详见《[天猫 2013 年度各一级类目技术服务费年费一览表](#)》。

1. Annual Fees (attachment 1a)

(1.1) 不享受《2012年天猫商家扶持方案》的商家: (New Contract - 1st year)
根据类目不同分 3 万元或 6 万元两类 (According to different categories priced at 30,000 or 60,000 yuan two categories), 详见《天猫 2013 年度各类目技术服务费年费一览表》。

(1.2) 享受《2012年天猫商家扶持方案》的商家: (Renewal/continuous COntract)
A: 若您计划与天猫续签 2013 年合同 (If you plan to renew the 2013 contract with Lynx), 年费额度包含 2012 年第四季度年费 (The annual fee amount includes the fourth quarter of 2012, the annual fee) (参见《关于优化天猫商家扶持方案的公告》) 与 2013 年度的技术服务年费 (and 2013 annual technical service fee), 其中 2012 年第四季度年费按比例分摊后为 0.75 万元或者 1.5 万元 (in which the annual fee for the 4th quarter of 2012 has been pro-rated to 0.75 million or 1.5 million), 总计需要缴纳的年费分别为 3.75 万元或 7.5 万元 (total payable for the annual technical service fee is 3.75 million or 7.5 million)。

年费计算公式 (computation for the annual technical service fee): 对应年费金额的最高档 X (corresponds to the most high-end);

需缴纳年费 (annual fee) = ((2012 annual technical service fee / 12 months) * 3 months) + 2013 annual technical service fee

B: 若您计划 2012 年底不再与天猫续签 (if you intend to terminate the contract at the end of 2012), 或在 2012 年 10 月 1 日~2012 年 12 月 31 日期间退出天猫 (or at the last quarter of 2012), 或转到淘宝网继续经营 (or intend to conduct E-biz (business on Lynx website)), 天猫将免除您 2012 年度第四季度的年费费用 (you are not liable to pay for the technical fee for the last quarter of 2012)。

注 take note: 参加 2013 年度续签并已经续签成功的商家 (for contract entered in 2013), 若中途退出, 2012 年第四季度的年费正常结算 (if exercise early termination, the technical fee for the last quarter of 2012 is payable)。