Overview of the cross border e-commerce industry in China

Along with continuously increasing enthusiasm in overseas online shopping and loosening policy environment, cross border e-commerce industry has rapidly and strongly developed in China. During the recent two years, internet titans including Alibaba Group Holding Limited, JD.com, NetEase have entered the cross border e-commerce business one after another, and industrial capital also poured into the field, such as Tecent, COFCO Corporation, S.F. Express and so on. Experts believe that numerous titans intensively getting involved into the cross border e-commerce industry makes the market over-crowded with increasingly intense competition, which may prompt an industrial reshuffle.

To better grasp the trends in the rapid emergence of China as the global e-commerce leader and quick growth elsewhere, we have done intensive market research with exclusive interviews with industry experts and governmental officials. The following report will summarize our findings of the e-commerce development in China.

I Market profile

Changes brought by online shopping are happening in market transactions, distribution model of enterprises, and even people’s daily life. As domestic market develop, consumers armed with various devices and payment methods have become increasingly familiar with the mechanics and benefits of shopping virtually. In parallel, the Internet has raised awareness of new online shopping destinations. Online shopping users and the total amount of online shopping are showing strong growth momentum in China. According to data from China Internet Network Information Center, the number of online shoppers in China increased substantially by 125% in 2014 to 361.4 million compared with that of 2010. As we can see from [Figure 1], the growth rate of online shoppers in China has witnessed a stable increase from 2011 to 2014.

[Figure 1]
The online retail transaction totaled RMB 2.8 trillion in 2014, representing a 49.7% year-on-year growth compared to that of 2013. As [Figure 2] indicated, the online retail transaction posted a 96.9% increase in the year 2010, and it kept a gradually growing momentum since then.

For the past few years, rapid development of cross border e-commerce has already reached a certain transaction scale. According to data from China’s e-commerce research center, iResearch and the Ministry of Commerce (hereinafter the "MOFCOM"), China’s cross border e-commerce transactions has reached RMB 4.2 trillion in 2014, representing 16% of China’s total import and export trading volume. Based on global trade pattern report released by MOFCOM, it is predicted that China’s cross border e-commerce transactions amount will increase to RMB 6.5 trillion in 2016, with annual growth rate over 30%, representing 20% of China’s total import and export trading volume.
II. Cross-border e-commerce

1. Overview

In terms of the import flow of cross border e-commerce, producers/manufacturers can display the products via cross border e-commerce platforms where customer can order and pay directly. After the payment has been made by the purchaser, logistics companies will handle the delivery process of products sent by the e-commerce operators. Customs will go through the inspections when the products arrived which will then be sent to the purchaser via domestic logistics. Some cross border e-commerce operators cooperate with third-party comprehensive service platforms and entrust them with logistics, goods inspection and relevant procedures. [Table 1]

[Table 1]

2. Key market players

According to “2014 China’s data monitoring report” released by China’s e-commerce research center, Alibaba boasts an overwhelming share of China's ballooning e-commerce market, occupying 59.3% of the Business to Consumer (B2C) market with its online platform Tmall, while JD.com, its closest competitor in that segment, is a distant second with 20.2% of the B2C market. While Alibaba remains the unchallenged market leader, JD is undoubtedly standing out as the second largest Chinese e-commerce company. [Figure 4]

Alibaba’s business model is comparable to eBay Inc., as both companies provide platforms for third party sellers. Alibaba does most of its sales through Taobao and Tmall, but distribution centers and delivery trucks are generally operated by third parties. Similarly, JD is comparable to Amazon, as both e-commerce companies sell both third party products as well as their own merchandise on their platforms. JD gains an edge over its bigger rival since it can ensure efficient and speedy delivery to its Chinese customers as the company focuses on boosting its pick-up and delivery stations network nationwide.

Other major market players such as Suning, which focusing on selling household appliance and 3C products; Vipshop, a leading online discount retailer for brands considered as the largest flash sale
website; and Jumei, a top online retailer of beauty products, are gaining popularity and resulting in fierce competition in the sector. Investors considering tapping the e-commerce market in China, are advised to identify suitable joint venture partners (if required) or carefully choose which business models are the most suitable for planned investment.

Source: “2014 China’s data monitoring report” released by China’s e-commerce research center [Figure 4]

3. Regulatory update

On Aug 29, 2013, the MOFCOM, in collaboration with eight other ministries and departments, released an "Opinion on Implementing Relevant Policies for Supporting cross border E-commerce Retail Exports" (hereinafter “the opinion”) to boost e-commerce retail exports and address regulatory gaps. The opinion innovated new e-commerce export customs supervision mode which enabled related department to work together and share data with companies in e-commerce, payment and logistic sectors. 5 pilot cities including Shanghai, Chongqing, Ningbo, Hangzhou, Zhengzhou were selected to conduct the customs reform. Since October 2013, the reform expanded in other cities in China which are usually logistics centers or port cities such as Guangzhou, Shenzhen, Qingdao, Haerbin and Xian, etc, pursuant to respective guidelines announced by General Administration of Customs of China (hereinafter “GAC”).

In terms of cross border e-commerce import, new import mode such as bonded import were approved in pilot cities. Currently, there are 9 cross-border e-commerce import services pilot cities in China – namely Shanghai, Hangzhou, Ningbo, Zhengzhou, Chongqing, Guangzhou, Shenzhen, Fuzhou and Pingtan – where new cross-border e-commerce import modes can be conducted.

On July 23 2014 GAC released the “Announcement on the Supervision of Entry/Exit Goods in cross border e-commerce (GAC Announcement [2014] No.56)” (hereinafter “Announcement No.56”) to better regulate the cross border e-commerce industry in China, which took effect on August 1, 2014. Announcement 56 detailed the customs clearance procedures for qualified e-commerce companies, please refer to below [Table 2] for reference.

<table>
<thead>
<tr>
<th>Items</th>
<th>Provisions of Announcement No.56</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customs procedures declaration</td>
<td>• A covered enterprise shall submit a declaration list for import/export goods under cross-border ecommerce businesses for goods verification and release purposes, and complete the customs declaration for import/export goods under cross-border ecommerce businesses on a</td>
</tr>
</tbody>
</table>
Under the consolidated declaration mode, covered enterprises or their agents are required to complete a declaration list for goods according to the electronic data related to the order, payment, storage and logistics, which were transmitted to the Customs beforehand.

Within 10 days of each month, covered enterprises or their agents are required to compile declaration lists for goods imported/exported upon custom clearance for the previous month according to a prescribed order to work out import/export customs declaration forms for customs declaration purposes.

Covered enterprises, e-payment service companies, operators and involved logistics companies shall transmit electronic data related to the transaction, payment, storage and logistics of import/export goods through the clearance services platform to the e-commerce customs clearance management platform.

Verification and customs clearance of import/export goods under cross border e-commerce businesses shall be completed in customs supervision areas.

The Customs in charge shall perform inspection on import/export goods under cross border e-commerce businesses. Covered enterprises, their agents and operators should cooperate for the on-site inspection performed by the Customs.

Announcement 56 specifies that covered enterprises engaging in cross-border e-commerce businesses through the cross-border e-commerce platforms, which is recognized by and connected with the customs, are supervised by the customs. This shows a stricter and comprehensive supervision mode adopted by the customs on cross-border e-commerce businesses. Also, it provided favorable treatment to covered enterprises as they are required to compile all declaration lists for the previous month within a prescribed timeframe to work out import/export customs declaration forms and declare with the customs in a consolidation manner at a monthly basis. This would help to expedite customs clearance processes, especially those with sizeable import/export transactions, and also cut down relevant administration costs.

### 3. New import mode comparison

Latest issuances of the policies explored new modes for cross border e-commerce in terms of custom inspection and logistics management. Currently, the import business of cross-border e-commerce platforms could be divided into two modes in the piloted cities: bonded import mode and direct purchase import mode.

<table>
<thead>
<tr>
<th>Import Mode</th>
<th>Direct purchase import</th>
<th>Bonded import</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operation</td>
<td>“Order first, delivery later” model</td>
<td>“Stock first, order later” model</td>
</tr>
</tbody>
</table>

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Consumers will place the order of goods overseas directly via a cross border e-commerce platform linked to the customs network. Goods will be shipped by international logistics provider and reach domestic consumer. Goods overseas are temporarily stored in bonded customs supervision areas after arriving in China. Upon an order is placed via a cross border e-commerce platform linked to the customs network, a real-time declaration to the customs will be conducted and the goods will complete customs clearance procedures within the bonded zone. Goods will be delivered to domestic consumers via local logistics provider.

<table>
<thead>
<tr>
<th>Delivery time</th>
<th>Within 7 to 1 month</th>
<th>Within 2 to 3 days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product category</td>
<td>Unlimited</td>
<td>Limited</td>
</tr>
</tbody>
</table>

**Duty**

- Postal tax (goods original price × postal tax rate) will be levied
  - *For imports under general trade, “customs duty + consumption tax (25%) + import VAT (17%)” will be levied;*
  - For the purchase of a number of products in a single order with the value less than RMB 1000, the products can go through customs clearance according to personal postal articles tax regulations
  - Imported products are for personal use only with a reasonable quantity for each transaction
  - Postal tax rate ranges from 10% to 50%* (please refer to Appendix for detailed postal tax rate of selected items)
  - Postal tax will be exempted if the postal tax amount is less than RMB 50

Particularly, under bonded import mode, customs clearance procedures have been greatly simplified. As indicated in [Table 3], a third party e-commerce comprehensive service provider (so called “TP” as Taobao Partner) can handle the submission of payment information, transaction data, logistic and storage data to China’s Customs data system, also it provides services such as branding strategies, personnel training, network marketing, after-sales, etc. for the partner company. Investors can choose different TP to outsource the whole or partially business based on their business models in China.

[Table 3]

1 Variable depend on circumstances
2 The value less than RMB 800 for purchase of products from or sending to Hong Kong, Macau and Taiwan

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4. Diversified products provided by cross border e-commerce platforms

Products provided by cross border e-commerce platforms extend from easily-transported products including apparel, 3C (Computer, Communication and Consumer) products, household, etc. to products with large size like furniture and automobile. Apparel and accessories, baby products, and cosmetics tend to be among the most popular products purchased online. As we can see from [Table 4] according to a report on different categories of products from key e-commerce platforms in China by VennData, Fast Moving Consumer Goods (FMCG), which are more connected with people’s daily life, are the most favored by consumers and e-commerce platform providers. Also, the data shows the best performing business sectors of key market players respectively in providing varieties of products.

<table>
<thead>
<tr>
<th>Category</th>
<th>Tmall</th>
<th>JD.com</th>
<th>Vipshop</th>
<th>Yiahaodian</th>
<th>Suning</th>
<th>Jumei</th>
<th>Amazon.cn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apparel, shoes, bags, jewelry</td>
<td>33.5%</td>
<td>2.4%</td>
<td>2.6%</td>
<td>0.2%</td>
<td>-</td>
<td>-</td>
<td>0.2%</td>
</tr>
<tr>
<td>Household appliance</td>
<td>13.1%</td>
<td>51.9%</td>
<td>0.6%</td>
<td>1.4%</td>
<td>9.5%</td>
<td>-</td>
<td>0.5%</td>
</tr>
<tr>
<td>3C products</td>
<td>10.4%</td>
<td>54.8%</td>
<td>0.1%</td>
<td>2.6%</td>
<td>4.1%</td>
<td>-</td>
<td>7.4%</td>
</tr>
<tr>
<td>Cosmetics</td>
<td>23.4%</td>
<td>7.9%</td>
<td>1.6%</td>
<td>0.8%</td>
<td>0.2%</td>
<td>11.8%</td>
<td>0.3%</td>
</tr>
<tr>
<td>Personal care</td>
<td>22.4%</td>
<td>25.6%</td>
<td>0.5%</td>
<td>15.4%</td>
<td>0.5%</td>
<td>2.9%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Baby products</td>
<td>34.6%</td>
<td>13.0%</td>
<td>0.1%</td>
<td>2.0%</td>
<td>0.8%</td>
<td>-</td>
<td>0.4%</td>
</tr>
<tr>
<td>Foods</td>
<td>33.1%</td>
<td>5.2%</td>
<td>-</td>
<td>12.4%</td>
<td>0.2%</td>
<td>-</td>
<td>0.3%</td>
</tr>
</tbody>
</table>

[Table 4] Best performing business sector of key market players

All these platforms are supported by the local government. And rules that permit the establishment of an e-shop by international producers and sellers are unique to each city. For instance, Kuajingtong in Shanghai requires that the international producer can open an e-shop on www.kuajingtong.com, but they must entrust a Chinese company to handle all online trading data and after-sales service under the supervision of the local authority. However, Ningbo has a different rule. kjb2c in Ningbo requires that only a company registered in Ningbo's bonded zone may open an e-shop on www.kjb2c.com. Therefore, individual analysis is required for cross-border e-commerce platforms in each city to find out what requirements are imposed on international producers and sellers.

III Case study

"Bonded import” mode, in which goods are imported and stored in bonded warehouses in China and delivered to the consumer directly after an order is placed, is entering a period of explosive growth. It is expected to seize half of the import e-commerce market. To better understand the concept and actual practice, we made a visit to Kuajingtong, a cross-border ecommerce platform within the China (Shanghai) Pilot Free Trade Zone (hereinafter “PFTZ”) to offer customers lower prices for imported products, such as fruits, luggage and handbags, health products, baby products; skincare and cosmetics, apparel, etc.

1. Concept

Maintained by state-backed Orient Electronic Payment Co. for the online purchasing of imported goods in China, Kuajingtong allows buyers to avoid the import duties that would otherwise apply to
their purchases. Products can only be listed on the site after the vendor has been cleared with the GAC, resulting in a safer, more reliable channel for Chinese consumers to purchase imported goods.

2. Practice

According to the representatives from Kuajingtong during our visit, Kuajingtong provides a platform for individual e-commerce stores to list their wares and charges a commission on each sale. Under existing laws, there are strict limitations on foreign investors establishing online stores in China, requiring that they set up a legal entity beforehand. In the PFTZ, however, foreign e-commerce operators can directly set up an online store on Kuajingtong and customers will be redirected to the operators’ overseas online store by clicking on the products displayed via Kuajingtong website. Imported products will be stored in 2 of their bonded warehouses, one located in Shanghai Pudong international airport, the other one in Waigaoqiao bonded zone area. Both of the warehouses will be monitored and managed by Kuajingtong’s unified electronic system and conduct real-time data sharing.

Because products offered on Kuajingtong are dispatched via bonded warehouses, the related domestic logistic time will be significantly reduced. Generally, according to personnel of Kuajingtong, product deliver to Shanghai, Zhejiang and Jiangsu, will be fulfilled within 1 day; and for nationwide, product delivery time will be within 72 hours.

When touring around the warehouse of Kuajingtong in Waigongqiao bonded area of Shanghai, it is obvious that the warehouse was systematically managed and supervised. For example, certain procedures are being conducted in separate areas such as “import product storage” area, “completed inspection and waiting for release” area, and “packing for delivery” area, etc. Local customs and inspection and quarantine bureau are located just neighboring the warehouse for easy and fast clearance. Also for products entry or exit the warehouse, only declaration list will be verified by authorities and postal tax levied on the products will be calculated on a monthly basis. This would significantly simplify the clearance procedures and increase efficiency.

According to existing customs regulations, however, there are still restrictions imposed on the total amount a consumer can spend and the quantity of products a single consumer can purchase via Kuajingtong. Also, as local authorities require overseas companies shall entrust Orient Electronic Payment Co. to handle all online trading data and after-sell service if registered with Kuajingtong, this might be a concern for overseas investors. However, the site is well-situated to eventually claim a larger portion of China’s cross border e-commerce market, owing to its unique channels for direct access to Chinese consumers.

III Comments

China’s e-commerce boom is driving by technology progress and economy growth, underlying huge development potentials. When considering to tap the sector, logistic cost, advertising and marketing cost, commission cost to major platforms shall be taken into account. Also, as the quality of third party agencies vary and there are already a great number of TP agencies with their respective strengths in different stages of the e-commerce flow, it is important to identify a suitable business partner. However, in the e-commerce era, security of different online payment system, in addition to convenient, still remains a big concern when a considerable volume of documents and transactions were digitalized and exchanged online. And some e-commerce platform providers have been struggling with accusations of counterfeit goods or fake transactions. As the Chinese government devotes significant efforts to develop the sector with policies to better regulate the industry, it is expected an orderly development of e-commerce can be achieved with more opening up to overseas investors in the future.
The interpretation and actual implementation of e-commerce development in China should be worthy of attention. The up-to-date information will be provided continuously by our bank.

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Appendix

Rate of Personal Postal Articles Tax on Selected Personal Articles

<table>
<thead>
<tr>
<th>Product Category</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food, beverage</td>
<td>10%</td>
</tr>
<tr>
<td>Textiles and articles thereof</td>
<td>20%</td>
</tr>
<tr>
<td>Leather garments and accessories</td>
<td>10%</td>
</tr>
<tr>
<td>Luggage and footwear</td>
<td>10%</td>
</tr>
<tr>
<td>Domestic Medical, fitness and beauty devices</td>
<td>10%</td>
</tr>
<tr>
<td>Kitchen, bathroom products and small electoral appliances</td>
<td>20%</td>
</tr>
<tr>
<td>Stationery and toys</td>
<td>10%</td>
</tr>
<tr>
<td>Bicycles, tricycles, children’s cars and accessories and parts thereof</td>
<td>10%</td>
</tr>
<tr>
<td>Luxury watches, golf and golf equipment</td>
<td>30%</td>
</tr>
<tr>
<td>Cosmetics, alcoholic beverages, tobacco</td>
<td>50%</td>
</tr>
</tbody>
</table>

Source: GAC, Mar 2015