

Revisiting Cross-border Import E-commerce

- Latest developments

Asia Distribution and Retail
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Cross-border import e-commerce has been expanding rapidly over recent years. Cross-border e-commerce (CBEC) platforms are highly popular among Chinese consumers and have become one of the major channels to buy authentic foreign products. For many brands and retailers, the CBEC channel is a good starting point to test the China market. In the past year, increasing numbers of e-commerce operators and traditional retailers have set up their own CBEC businesses.

The government has been very supportive toward the development of CBEC. It has rolled out a number of favourable policies since 2012 to regularize CBEC, and set up comprehensive e-commerce pilot zones that are designated exclusively for the development of CBEC industry. As of August 2018, there are 35 CBEC comprehensive pilot zones across the country. In March and April 2016, the government introduced new policies for CBEC to facilitate further growth and development of the CBEC market and balance the impact of CBEC on traditional importers and existing sales channels. The new policies set forth new tax rules for CBEC businesses and new supervision regulations covering new operation procedures, a positive list of permitted imported goods, etc. CBEC operators have been given a transition period until the end of 2018 to adjust their operations and business strategies in relation to the new supervision regulations on CBEC imports.

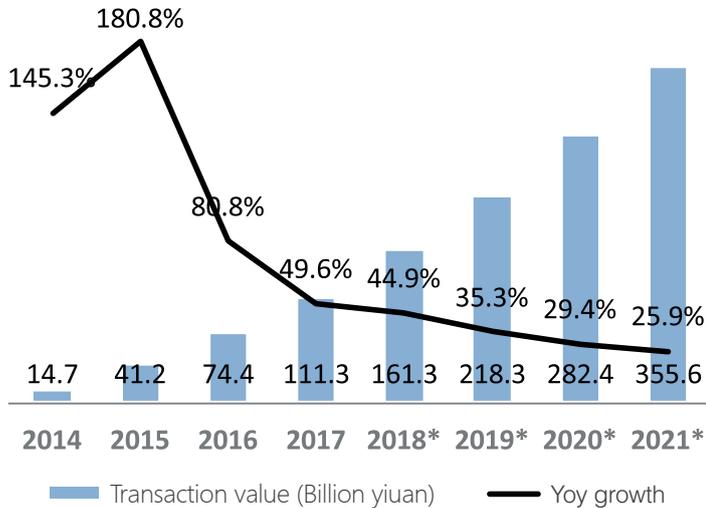
I. Market overview

1. CBEC maintains stable development, while growth pace slowing down

China's CBEC (import) market has maintained stable development in recent years, fueled mainly by individuals upgrading their level of consumption. Chinese consumers are increasingly buying higher quality and unique overseas products via approved CBEC platforms. According to iResearch, the transaction value of the CBEC (import) retail market increased by 49.6% year-on-year (yoy) to 111.3 billion yuan in 2017 and is expected to balloon to over 350 billion yuan by 2021 (Exhibit 1).

Hectic though growth has been for China's CBEC (import) market, the pace has, in fact, slowed over the past three years. This might be attributable in part to the launch in late March and early April 2016 of new CBEC tax policies and a positive list for permitted imported goods, which might pose uncertainties for the future development of cross-border trade. Also, as the base becomes larger, growth rate would not be as rapid as in previous years.

Exhibit 1: Transaction value of CBEC (import) retail market, 2014 – 2021 (estimates)



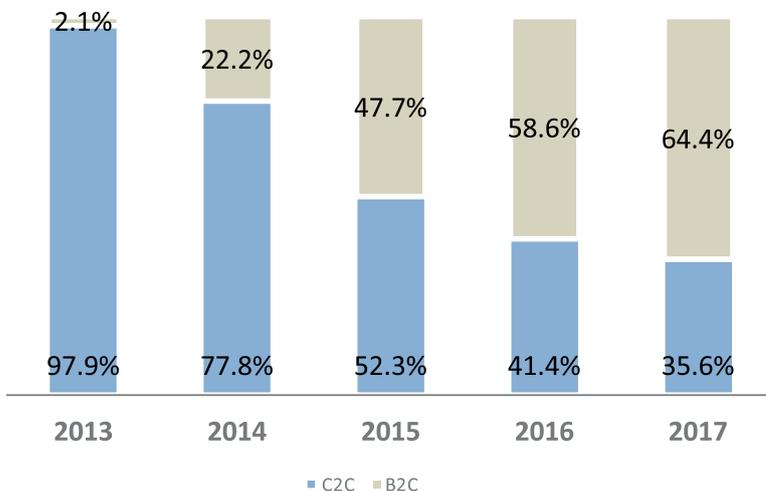
Source: iResearch; compiled by Fung Business Intelligence

* Note: Estimated figures.

2. B2C model accounts for the largest share of total CBEC (import) market

CBEC (import) business can be grouped into B2C and C2C models. According to Moda Data, B2C has exceeded C2C to become the most significant CBEC import model in China. It is estimated that the B2C model accounted for 64.4% of the total CBEC import market in 2017 (Exhibit 2). The B2C model enables regulators to monitor the activities and transactions on the platforms and take the appropriate actions imminently if required.

Exhibit 2: Share of B2C and C2C of CBEC (import) market, 2013 – 2017



Source: iiMedia Research; compiled by Fung Business Intelligence

3. Two major types of CBEC (import) platforms: integrated and vertical platforms

Currently, cross-border B2C players usually sell on two major types of platforms – integrated CBEC platforms in the form of marketplace platforms, self-operated platforms and hybrid platforms or vertical CBEC platforms which are often a combination of marketplace and self-operated platforms. The former sells a large variety of categories of products, while the latter focuses on a few specialized categories. Selected major CBEC platforms and their major operating models are shown in Exhibit 3.

Exhibit 3: Selected major CBEC platforms and their operating models

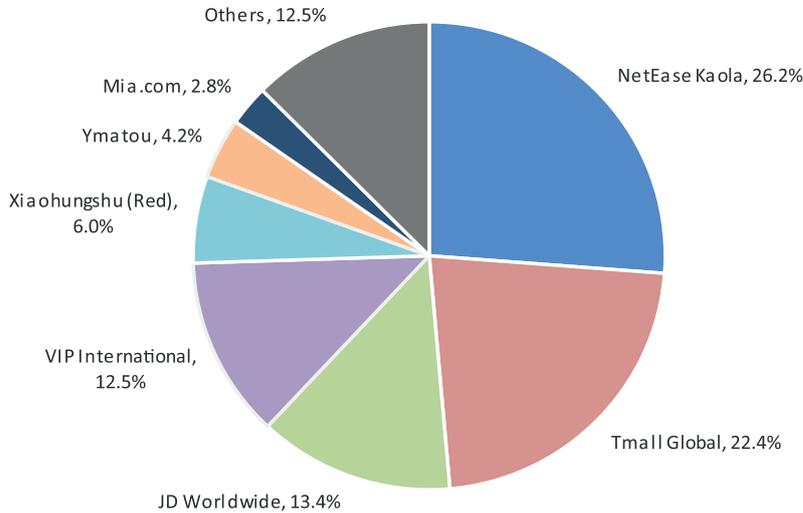
	Integrated CBEC platforms			Vertical CBEC platforms		
Player	Tmall Global	JD Worldwide	VIP Global	NetEase Kaola	Xiaohongshu (Red)	Mia.com
Operating model	Marketplace	Marketplace and self-operated	Self-operated	Marketplace and self-operated	Marketplace and self-operated	Marketplace and self-operated
Core competencies	Wide product choices	Good logistics services	Good after-sale services	Mainly self-operated; authentic products	Content-based and community nature	Specialized in baby and maternity products

Source: iResearch; modified by Fung Business Intelligence

4. NetEase Kaola, Tmall Global and JD Worldwide continue to top the list among CBEC (import) players

According to domestic consulting agency iiMedia Research, NetEase’s CBEC arm Kaola ranked first in the CBEC market in terms of transaction value with 26.2% market share in 1H18, followed by Tmall Global with 22.4% market share and JD Worldwide with 13.4% market share (Exhibit 4).

Exhibit 4: CBEC (import) players by market share, 1H18

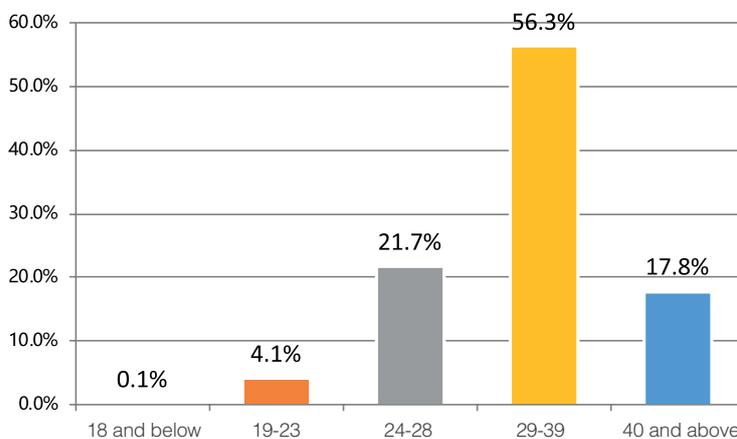


Source: iiMedia Research; compiled by Fung Business Intelligence

5. Consumers aged 29–39 and those living in coastal regions are core CBEC shoppers

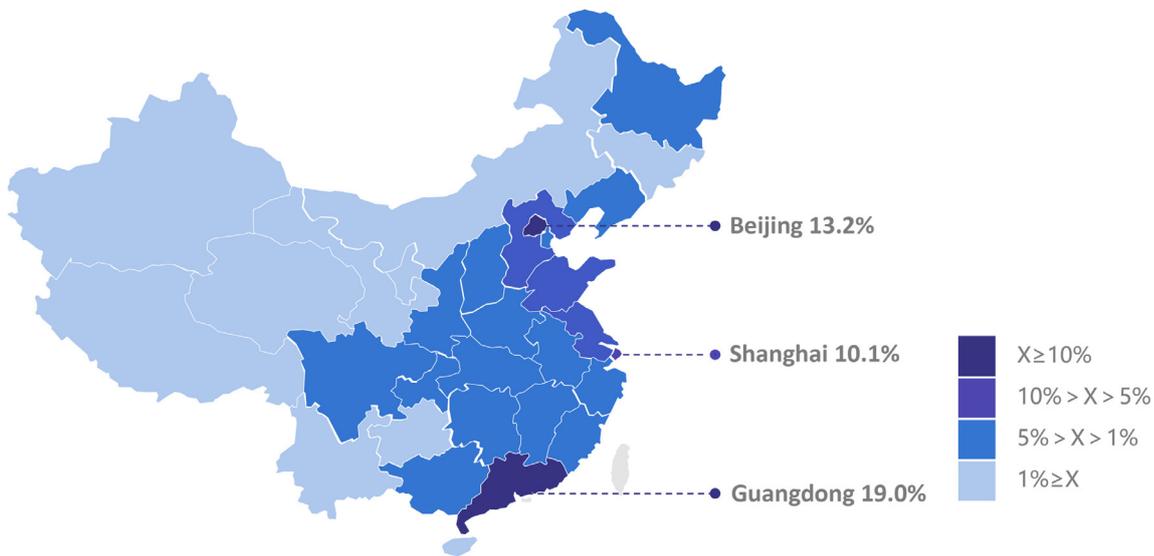
According to a survey released by iResearch in March 2018, more than half of the surveyed CBEC shoppers are aged between 29 and 39 (56.3%); 21.7% of are aged between 24 and 28, and 17.8% are aged 40 and above (Exhibit 5). As shown in Exhibit 6, the majority of CBEC shoppers live in coastal areas. 13.2% of the surveyed shoppers live in Beijing, 10.1% live in Shanghai and 19.0% in Guangdong. Many CBEC shoppers are frequent buyers, with 69.1% make more than one purchase per month.

Exhibit 5: CBEC (import) shoppers by age, March 2018



Source: iResearch; compiled by Fung Business Intelligence

Exhibit 6: CBEC (import) shoppers by region, March 2018

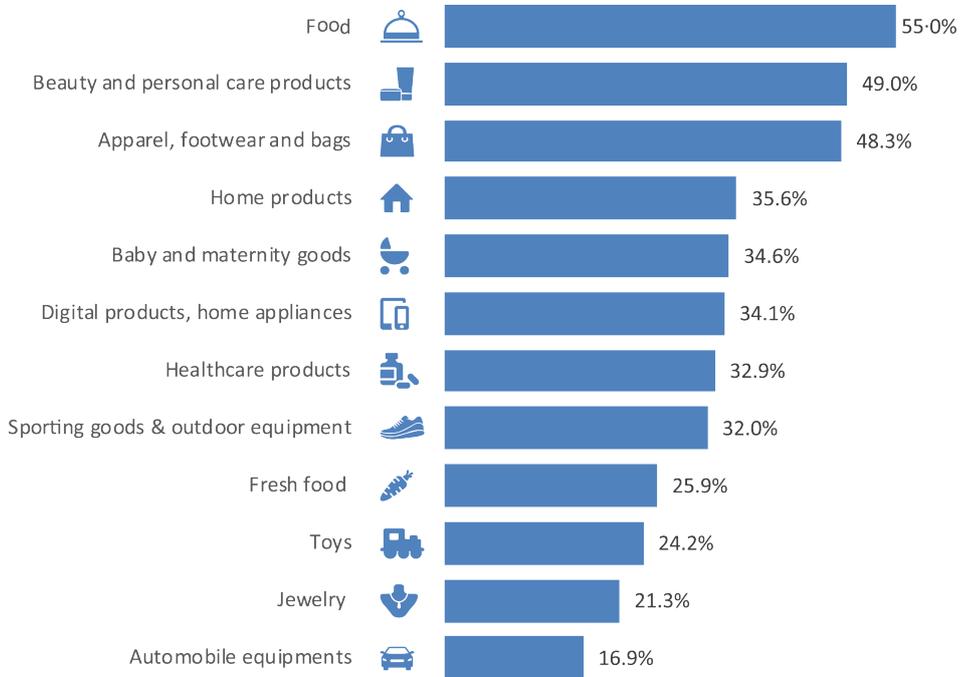


Source: iResearch; compiled by Fung Business Intelligence

6. Food, beauty and personal care products, and apparel, footwear and bags are the best-selling categories for CBEC (import) market

Chinese consumers' concerns about product safety have driven the demand for imported products which are generally perceived as having better quality than domestically produced goods. Exhibit 7 shows the categories of products purchased by CBEC shoppers on CBEC platforms during March 2017 to March 2018. Food (55.0%), beauty and personal care products (49.0%) and apparel, footwear and bags (48.3%) were mostly purchased by CBEC shoppers during the surveyed period.

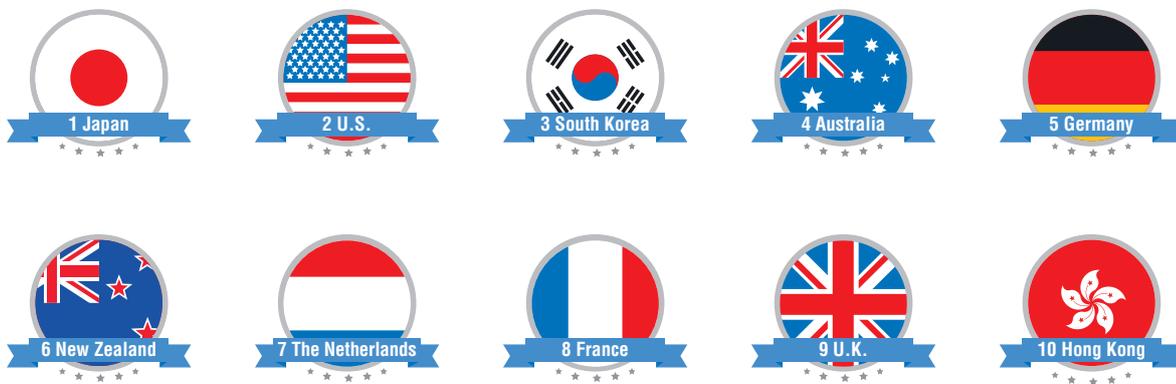
Exhibit 7: Categories of products purchased by CBEC shoppers on CBEC platforms, March 2017 – March 2018



Source: iResearch; compiled by Fung Business Intelligence

As shown in Exhibit 8, CBEC shoppers bought mostly from Japan, the U.S. and South Korea.

Exhibit 8: Top countries/regions of cross-border online shopping, 2017



Source: Ebrun; compiled by Fung Business Intelligence

II. Key trends and developments

1. Government establishes more pilot zones for CBEC

Since 2012, the government has rolled out a pilot program and established pilot zones for CBEC import business. These pilot zones take the lead in setting new standards for CBEC transactions, payment, logistics, customs clearance, exchange settlement, inspection quarantine, etc., and facilitate the development of the CBEC import business. As of August 2018, China has 35 CBEC Comprehensive Pilot Zones (Exhibit 9); 22 of which were approved by the State Council on 7 August, 2018, including pilot zones in Beijing, Hothot, Shenyang, Changchun, Harbin, Nanjing, Nanchang, Wuhan, Changsha, Nanning, Haikou, Guiyang, Kunming, Xian, Nanzhou, Xiamen, Tangshan, Wuxi, Weihai, Zhuhai, Dongguan and Yiwu. The State Council has also urged relevant government departments to support innovation and development in the CBEC Comprehensive Pilot Zones, including streamlining logistics processes and custom clearance procedures, enhancing information sharing, promoting effective regulatory innovation, and pushing forward with international trade liberalization, facilitation and business innovation.

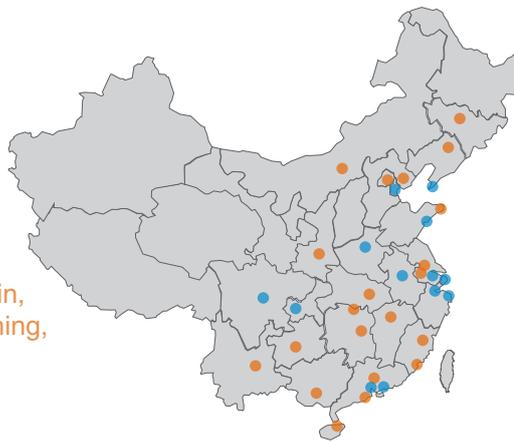
Exhibit 9: CBEC comprehensive pilot zones, as of August 2018

1st batch

Hangzhou, Ningbo, Tianjin, Shanghai,
Chongqing, Hefei, Zhengzhou,
Guangzhou, Chengdu, Dalian, Qingdao,
Shenzhen, Suzhou

2nd batch

Beijing, Hothot, Shenyang, Changchun, Harbin,
Nanjing, Nanchang, Wuhan, Changsha, Nanning,
Haikou, Guiyang, Kunming, Xian, Nanzhou,
Xiamen, Tangshan, Wuxi, Weihai, Zhuhai,
Dongguan and Yiwu



Source: iResearch; compiled by Fung Business Intelligence

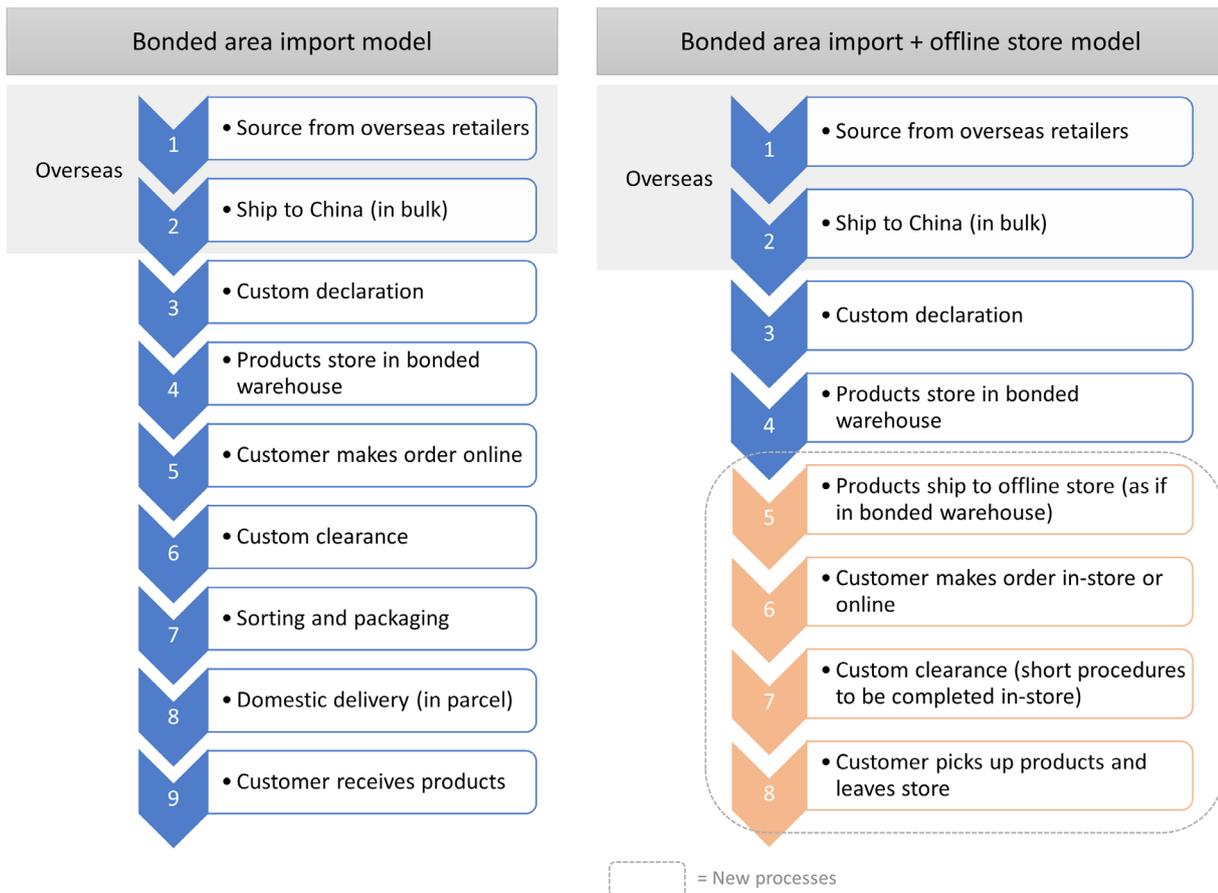
5. CBEC players set up new form of offline stores to sell bonded imported products

In recent years, some CBEC operators have set up offline experiential stores to display overseas products sold on their website and provide a physical touchpoint for customers to see and feel the products before placing orders. Customers still need to buy products online via authorized CBEC platforms and the imported products will be sent to their home by courier.

More recently, some CBEC players, after gaining approval from relevant authorities, have opened a new form of offline stores where customers can purchase and pick-up the bonded imported products directly in the stores (the “bonded area import + offline store” model). The bonded imported products go through customs clearance only after the customers have placed the orders. In February 2018, Kaola.com opened its first offline store in Hangzhou; it then opened the second store in Zhengzhou in August 2018. Customers can purchase bonded imported products directly in the store. After choosing the products they want to purchase, customers can go straight to the cashier, provide their ID card number and telephone number and settle payment; the customs clearance process will then be processed immediately. The process reportedly will take around 4 minutes. Customer will receive a SMS notification if the customs clearance is successful. After showing the cashier the SMS, customers can pick-up the goods directly in the store without the need to wait for the products to be sent to their home.

The offline store is de facto an extension of the bonded area import model whereby overseas products in the bonded warehouse in China can be sold in the approved experiential store, and they will go through customs clearance only after customers have placed orders in-store or via the CBEC website. Exhibit 10 compares the flow of CBEC products via the bonded area import model and the “bonded area import + offline store” model.

Exhibit 10: Flow of CBEC products, bonded area import model vs. “bonded area import + offline store” model



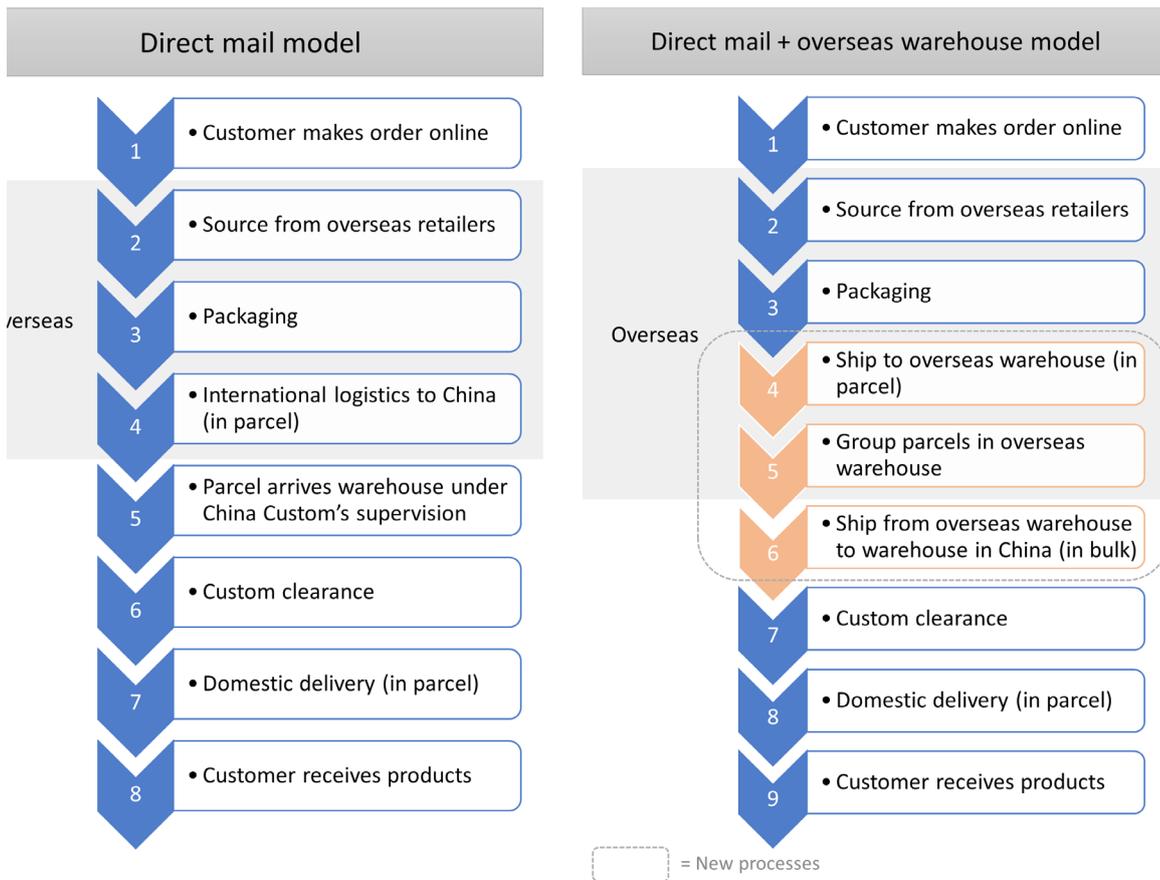
Source: Fung Business Intelligence

3. Building overseas warehouses to improve logistics efficiency

Some leading CBEC players such as JD.com, VIP.com, NetEase Kaola and Xiaohongshu are ramping up efforts to build overseas warehouses to facilitate cross-border shipping. For example, in May 2018, VIP.com announced that its CBEC arm VIP International will cooperate with JD Worldwide in operating CBEC supply chain and overseas warehouses. VIP.com will provide overseas warehousing and logistics services to JD Worldwide, including 12 overseas warehouses (of which eight of them are self-operated by VIP.com). This allows VIP.com to better utilize its overseas warehouses as well as its shipping services, while reducing costs and improving logistics efficiency.

Indeed, the setting up of overseas warehouses by CBEC operators can be regarded as a modification of the direct mail model (Exhibit 11). After customers place orders on a registered CBEC platform, overseas retailers will ship the products to the overseas warehouse instead of sending them directly to the warehouse in China. The CBEC operator will collect and store the parcels in the overseas warehouse before shipping them in lots to warehouses in China. For customers, a major advantage of using overseas warehouses is that logistics costs will be cheaper than that of the direct mail model as more recipients (customers) can share the logistics costs. However, shipping time will be longer than the direct mail model. For CBEC operators, setting up overseas warehouses involve substantial investments. They also need to spend some time to understand and adapt to local practices. Exhibit 12 shows the advantages and challenges of using overseas warehouses.

Exhibit 11: Flow of CBEC products, direct mail model vs. “direct mail + overseas warehouse” model



Source: Fung Business Intelligence

Exhibit 12: Advantages and challenges of using overseas warehouses

Advantages of building overseas warehouses	Challenges of using overseas warehouses
<p>a. Lower logistics costs for consumers – By grouping parcels from sea freight and air freight to overseas warehouses first before sending to China warehouses reportedly can save 30-50% logistics costs compared with the traditional direct mail model.</p> <p>b. Better after-sales service – Consumers can send back the goods to the overseas warehouses for repair and return, which can increase their stickiness towards the platform.</p>	<p>a. Local policies – The setting up of and operations of overseas warehouses are affected by local government policies. Any changes in local policies will affect the operations of the warehouses.</p> <p>b. High investment and operation costs – the costs of setting up overseas warehouse as well as the day-to-day operation costs are high.</p> <p>c. It takes time for overseas warehouses operators to fully understand, localize and adapt to local practices.</p> <p>d. As CBEC platforms build and use their own overseas warehouses, brand owners/ retailers need to deal with different warehouses when selling on different platforms. This is not convenient for brand owners/ retailers.</p> <p>e. Longer delivery time – The delivery time of CBEC goods is longer compared to the direct mail model.</p>

Source: Fung Business Intelligence

4. Putting more emphasis on product tracking system

To provide better user experience, some leading CBEC platforms are applying various ways to track and trace the movement of CBEC goods. Blockchain technology is becoming increasingly popular among CBEC operators as a method for tracking products. Some CBEC players are also cooperating with relevant industry associations and government departments to make the movement of CBEC goods more transparent to consumers. For example, in August 2017, Tmall Global launched the Global Product Traceability Project. Facilitated by blockchain technology and big data, product information including origin of production, logistics, custom clearance, inspection and quarantine details are made available for public use. China Certification & Inspection (Group) Co., Ltd., China National Institute of Standardization, National Monitoring Center for Cross-border E-commerce Security Risk have reportedly joined the project.

Going forward, it is expected that blockchain technology for product traceability will widely be adopted in the CBEC sector. With this technology, leading CBEC platforms can collect, integrate and display product information to consumers in a more transparent way, thus gaining customer trust and loyalty.

III. Major challenges

1. Potential policy changes may affect business operations

Currently, one of the biggest challenges facing enterprises engaging in CBEC business is the changing government policies. In late March and early April 2016, the government announced several new policies to ensure sustainable tax collection and foster fair competition. The new policies set forth new tax rules for different CBEC models, new tax rates for personal postal article tax as well as new supervision regulations covering new operation procedures, a positive list of permitted imported goods, etc. These may create new challenges for companies engaging in CBEC business, such as a higher tax burden, product entry, more complicated custom clearance procedures, and quality compliance issues. The transition period for the implementation of the new policies has been extended several times to end-2018 as the industry is not ready for the changes. Enterprises need to be alert to the policy changes and adjust their strategies accordingly.

2. China-U.S. trade war pose negative impact in long-run; import tariffs cuts narrow the price gap between general imports and CBEC goods

The China-U.S. trade war is likely to last much longer than originally thought — extending well into the second half of 2019; this may hinder China's economic growth and pose a negative impact on people's willingness to consume. This in turn may affect the business of CBEC operators in the medium to long term.

In the past year, China has been keen to increase imports amid the rising tension with the U.S. It has taken bold steps to increase imports by reducing import tariffs. Earlier in July 2018, China reduced import tariffs on a range of consumer items including apparel, cosmetics, home appliances, and fitness products. In September 2018, the Ministry of Finance of the PRC announced further cuts on import duties on nearly 1,600 products including textile products starting 1 November, 2018. The overall tariff level will be reduced to 7.5% in 2018 from 9.8% in 2017. Indeed, promoting imports has been a major priority of the Chinese government; the price gap between general imports and CBEC goods is set to further narrow against this backdrop.

IV. Concluding remarks

China's CBEC business has been growing rapidly over recent years, while competition in the market has become more intense. Customers increasingly demand high quality and authentic products, but they also like to compare prices across different CBEC platforms. It is expected that less competitive players who cannot survive the competition will eventually leave the market. CBEC operators are advised to put more focus on streamlining cross-border supply chains, improving sourcing capability and increasing the variety and quality of products they offer.

Going forward, despite the potential negative consequences of the China-U.S. trade war, we expect the CBEC market to continue to thrive as Chinese consumers demand for good quality foreign products is set to remain strong and continue to drive the demand for CBEC products. New CBEC operation models will emerge as operators seek to differentiate themselves from their peers. The government is expected to further roll out new policies to better regulate the CBEC market, promote the growth of the sector, and build synergies among different players. Also, China's first E-commerce Law, approved in September 2018 and will come into effect on 1 January, 2019, is set to improve regulatory efficiency and optimize the supervision process for CBEC in customs declaration, tax payment, inspection and quarantine, etc.

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