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# Mizuho Economic Outlook & Analysis

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## *E-Commerce creating new business opportunities and challenges in the Chinese economy*

### < Summary >

- ◆ In China, the e-commerce market is growing rapidly. The B-to-C market in 2016 showed China expanding its e-commerce market more than two-times higher than in the United States and more than ten-times higher than in Japan to become the largest in the world, with e-commerce giant Alibaba emerging as a major growth driver.
- ◆ Behind this rapid growth is the Chinese government's focus on e-commerce promoting potential consumption as a measure to control excess production capacity in the manufacturing industry. China's development of logistic networks and smartphone payment systems is boosting e-commerce growth.
- ◆ Cross-border e-commerce is highly expected to provide Japanese companies with market opportunities in China. The keys to boosting e-commerce trade between the two countries are cooperation of e-commerce platform businesses and a Japan-China logistics partnership.

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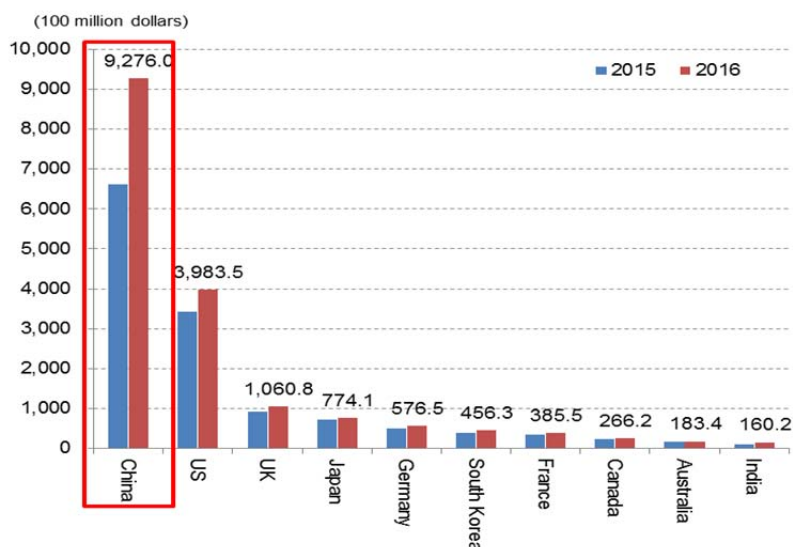
## 1. Introduction

China is experiencing explosive growth in the e-commerce market. For Japanese companies exploring the Chinese market, one promising choice is e-commerce, which does not require opening physical stores and has the potential for developing markets all across China. This report examines the overall trends of China's e-commerce market and the prospects for cross-border e-commerce based on the research findings of "E-commerce creating business opportunities and challenges in the Chinese economy" entrusted to the Chinese Academy of International Trade and Economic Cooperation (CAITEC) by Mizuho Research Institute in 2016.

## 2. Current conditions of China's e-commerce

China's e-commerce market has already overtaken the United States to become the largest in the world (**Chart 1**). CAITEC lists six factors for China's success as the world's leading e-commerce market: a growing need to stimulate demand to control overproduction in the manufacturing industry; a vast land area preventing the spread of store networks and rising incomes in farming villages; the advent of digital natives; improvements in communications and logistics infrastructures; emergence of giant e-commerce corporations; and leadership by the government. The combination of all these factors apparently has propelled China's e-commerce market to a top position in the world.

**Chart 1: EC (B to C) market size of major countries (top ten in 2016)**



Source: Ministry of Economy, Trade and Industry, *Japan's Infrastructure Development for a Data-Driven Society in FY2016 (E-Commerce Market Survey)*.

### **3. E-commerce as an effective way to solve structural problems**

China's e-commerce development is characterized by structural problems in the country's domestic economy and the government's powerful political backup. China has struggled to handle excess production capacity in the manufacturing industry, while slow development of retail stores and channels in rural areas and farming villages across the country's vast land area has hindered potential consumption growth. To overcome these difficulties, the Chinese government looked to e-commerce as an effective way to remove such constraints, and spurred on by the spread of smartphones, China's e-commerce attained explosive growth in the 2010s. Thus, China has made a nationwide effort to support e-commerce to resolve its structural problems.

As a specific measure to promote e-commerce, China introduced its "Internet Plus" policy in its 12th Five-Year Plan (2011-2015). The country especially focused on promoting "Internet Plus Logistics" to drive consumption growth, leading to the successful expansion of the e-commerce market. In the following 13th Five-Year Plan (2016-2020), China is aiming to build a "digital China" with the policy goal of addressing the global challenges also facing developed countries, including the Internet of Things (IoT), a sharing economy, and big data applications. In this field, considering competition created by market size and data accumulation, China's innovations are expected to advance and outperform developed countries.

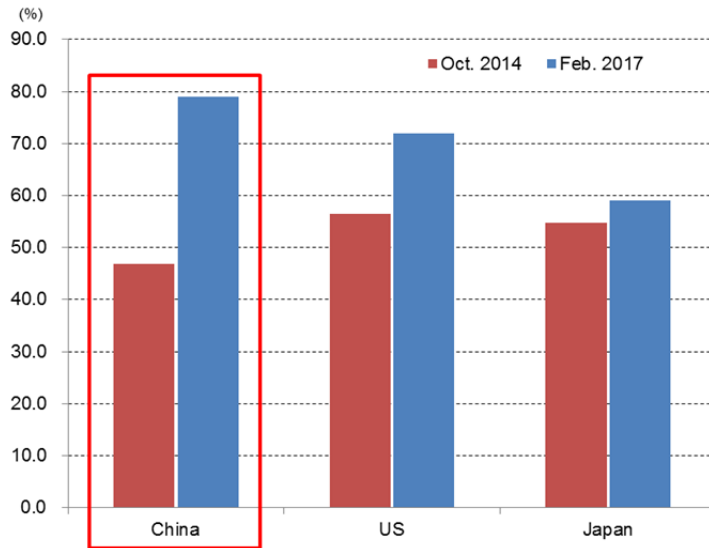
### **4. Bottlenecks in e-commerce development already eliminated**

Insufficient development of logistics networks and payment systems bottlenecks the efficient use of e-commerce. Products cannot be delivered smoothly without improving the logistics infrastructure, and payments cannot be collected efficiently without an adequate payment system infrastructure.

China's logistics infrastructure, however, has laid the foundation for an e-commerce boom with its expressway network already extending throughout the country. The government's active investment in infrastructure has led to China's success in promoting e-commerce.

China's payment systems have also advanced considerably with the spread of smartphones. In response to the soaring number of smartphone users in China (**Chart 2**), businesses quickly introduced online payment systems, and this rapid progress in electronic payment has helped eliminate the other bottleneck.

**Chart 2: Percentage of smartphone users (Japan, US and China)**

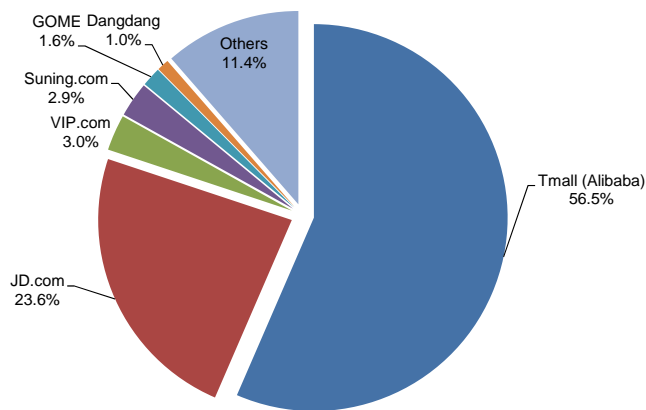


Source: Made by MHRI based on press releases by AUN Consulting, Inc. (November 12, 2014 and March 17, 2017).

In addition, Alibaba and JD.com have served as driving forces behind China's e-commerce market (B to C), dominating roughly 80 percent of the e-commerce market (**Chart 3**) and actively expanding their businesses to local areas. On the other hand, e-commerce ventures offering new services, such as deliveries, housekeeping, and real estate brokerage, have also flourished in recent years. This trend suggests that China's e-commerce is evolving as a service industry in a wide range of fields.

Therefore, the elimination of the above bottlenecks and the emergence of giant e-commerce corporations providing comprehensive services have helped facilitate further development of China's e-commerce.

**Chart 3: EC (B to C) market share (Jan-Mar in 2016)**



Source: Made by MHRI based on Analysis Ltd.

## **5. Challenges facing China's e-commerce**

While China has witnessed remarkable growth in e-commerce, it is also facing numerous challenges. Compared with traditional stores, e-commerce is considered lucrative not only because of low operating costs but also tax exemptions and no direct involvement with consumers. On April 8, 2016, the Chinese authorities introduced a new system for practically restricting e-commerce retail imports in the name of correcting unfairness to ordinary trade.<sup>1</sup> However, issues involving stricter e-commerce tax rules, after-sales services, and consumer protection need to be addressed first before exploring ways to realize fair competition and co-existence between traditional retail stores and e-commerce.

Moreover, China's domestic e-commerce is confronted with overseas competition. The country's domestic e-commerce websites are lagging behind their overseas counterparts, with counterfeit products found on some Chinese websites and their promotions, including product appeals and bonus points, regarded by many consumers as less attractive than those on overseas websites. Thus, Chinese e-commerce companies need to improve their reliability and promotional strategies, in addition to enhancing user-friendliness through comprehensive services.

## **6. Keys to expanding cross-border e-commerce trade between Japan and China**

According to a report by Japan's Ministry of Economy, Trade and Industry, e-commerce trade (B to C) between Japan and China in 2016 revealed Japan's huge trade surplus, with 1036.6 billion yen (up 30.3 percent year-on-year) for exports from Japan to China and a mere 22.6 billion yen (up 7.9 percent year-on-year) for imports to Japan from China. These figures reflect the continued popularity of Japanese products in China.

On the other hand, CAITEC indicates that despite their strength of high quality products, many Japanese companies are backing away from the Chinese market due to obstacles involving buying channels, logistics, customs clearance, and after-sales services. In other words, if Japanese companies are able to properly utilize cross-border e-commerce, they can overcome these challenges and seize a new opportunity to enter the Chinese market.

CAITEC also points out that the keys to expanding cross-border e-commerce trade

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<sup>1</sup> Before introducing the new system, China had relaxed its import tax rules with low-priced products accepted as duty free; but the government has tightened the tax rules and limited the number of duty-free products in the name of correcting unfairness to ordinary trade. Cross-border e-commerce imported items are now controlled on a positive list, with the upper limit of transactions set at 2,000 yuan per import and 20,000 yuan yearly to gain tariff exemptions.

between Japan and China are platform business cooperation and a logistics partnership. E-commerce platform firms provide credit information about participating retailers and infrastructure, including payment systems. Therefore, Japan-China cooperation of e-commerce platform companies will play a leading and integrated role in building collaborative relationships among other service providers.

Furthermore, it is worth noting that to form a Japan-China logistics partnership, CAITEC suggests expanding distribution volumes using chartered flights, accelerating the customs clearance and quarantine processes, and establishing cross-border electronic logistics parks (warehouses). With consumption trends expected to continue shifting from traditional stores to e-commerce, logistics will undoubtedly hold the key, and in this sense, these suggestions from the Chinese side are worthy of attention.

## **7. Conclusion**

As far as e-commerce is concerned, China deserves to be positioned as a pioneer. The lifestyle using a smartphone to buy products and enjoy services through cashless e-commerce is becoming increasingly common in China's urban areas. Supermarkets, department stores, and specialty stores are all facing competition with e-commerce, with some consequently forced to close their doors.

While rules and consumer protection are still slow to respond to the expanding e-commerce market, it is highly likely that its accessibility will help the Chinese e-commerce market advance in its own unique way. With China's position evolving from the world's factory to the world's market, it should be noted that China is also transforming into the world's most advanced e-commerce nation.

Japanese companies aiming to enter the Chinese e-commerce market will need to think more seriously about working in partnership with Chinese e-commerce and related businesses conversant with these trends and issues. If sales shift from traditional stores to online shopping, it will affect not only logistics and payment systems but also marketing strategies. Japanese companies recognized in China for their strong product appeal still have a chance to catch up as long as they respond flexibly while acknowledging China's advancement in the e-commerce market.