

# Cross-border EC Business in South China: Current State and Future Prospects

Milly Cheung

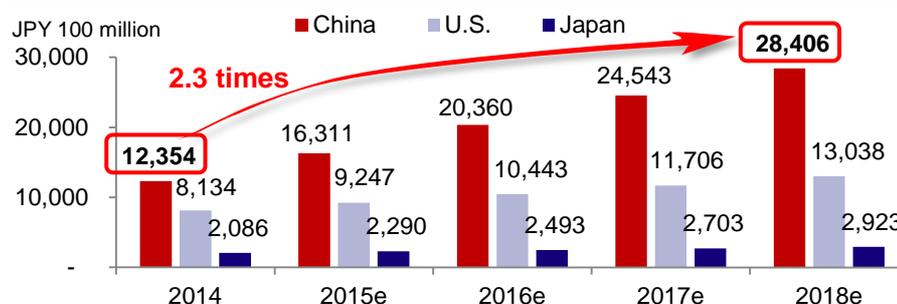
China ASEAN Research & Advisory Department,  
Hong Kong Corporate Banking Division No.1  
Mizuho Bank, Ltd.

In China, where the Internet population is steadily growing, the market of cross-border e-commerce (EC), which allows consumers to purchase high-quality foreign-made products at bargain prices, is rapidly expanding against a backdrop of strong consumer confidence. Especially, in the Guangdong Pilot Free Trade Zone (Guangdong FTZ) in South China, recently, cross-border EC malls have been opened one after another by utilizing FTZ bonded systems, and they are gaining popularity among consumers by realizing the purchase of foreign-made items at cheaper prices without the need to travel to Hong Kong. This article examines the current state and prospects of cross-border EC, which is expected to serve as a new sales channel for companies aiming to sell their products to China.

## The booming cross-border EC market

According to a survey, the scale of China’s cross-border EC market (performance-based) will reach JPY 2.8 trillion by 2018, increasing by 2.3 times from JPY 1.2 trillion in 2014. In 2018, China’s cross-border EC market is expected to be nearly 10 times the size of that in Japan. (Fig. 1)

Fig. 1: China’s cross-border B to C EC market size, estimations and breakdowns



Note: The figure only counts the total amount of purchases in each of the three countries through cross-border EC from the other two countries.

Source: Ministry of Economy, Trade and Industry of Japan “Results of the FY2014 E-Commerce Market Survey” (May 2015)

In Guangdong Province, “couriers” who purchase overseas products from the bordering Hong Kong and resell them in mainland China used to meet the demand of consumers in mainland China for safe foreign-made products. However, the “courier service” became so rampant and caused shortages in some necessities such as the baby formula, as to start affecting local consumption in Hong Kong. To address the situation, the authorities imposed a once-a-week limit on multiple cross-border visits to Hong Kong by Chinese citizens since April 13, 2015.

In order to capture the yet strong demand in mainland China, with the political support from the Chinese government, a new sales scheme of offline display and online sales of foreign products in bonded cross-border EC malls has rapidly expanded centering the Guangdong FTZ.

For example, on July 28, Hong Kong-based major jewelry chain Chow Tai Fook acquired the rights to develop and operate (for 10 years) a shopping center for the display and sales of imported goods, mainly Hong Kong-brand products, in the FTZ of Shenzhen’s Qianhai district. The mall is planned to open by the end of this year. Meanwhile, China Merchants Group, a Hong Kong-based state-owned corporation, has also announced a construction plan of shopping malls featuring high-end goods organized by country in the same district, and some of these malls have already started partial operations.

### **Advantages of cross-border EC**

The reasons for the boom in cross-border EC can be summarized as per the following advantages.

For consumers, the benefit lies in the 20~30% price cut of foreign-made products. Purchases made through cross-border EC are dealt with as private imports by consumers on which the lower personal postal articles tax is imposed instead of the tariffs, value-added tax, and consumption tax on general trades.<sup>1</sup> (Fig. 2)

**Fig. 2: Comparison of cross-border EC and general trade**

	General trade	Cross-border EC (B to C)
Definition	Trade across national borders	Online trade across national borders
Form of import	General trade	Private import
Characteristics	Multiple mediators such as agencies and retailers exist	Using an online platform to sell products without having several mediators in the middle
Products	Dealt with as trade goods	Dealt with as postal articles or hand baggage
Tax	Tariffs, consumption tax, value-added tax	Personal postal articles tax

Source: General Administration of the Customs of the People’s Republic of China, etc.

<sup>1</sup> There are restrictions for the application of the personal postal articles tax, such as that the purchased goods should be used for personal purposes and that the amount should be within a reasonable range. In addition, the tax will be applied to each purchase up to RMB 1,000 per person, with the annual ceiling of RMB 20,000.

Further, purchases through cross-border EC are subject to preferential tax treatment (tax exemption for a tax amount of RMB 50 or cheaper). For example, in the case of the widely-demanded baby formula, for which the personal postal articles tax is 10%, if the purchase amount is RMB 500 or cheaper, the tax amount which is RMB 50 or below shall qualify the tax exemption and no tax needs to be paid. (Fig. 3)

**Fig. 3: Comparison of tax rates by product**

Product	General trade			Cross-border EC
	Tariff (most favored nation)	General trade value-added tax	Consumption tax	Personal postal articles tax
Cosmetics	10%	17%	30%	50%
Luxury watches	11%	17%	20%	30%
Suitcases, bags	20%	17%	-	10%
Shoes	15%	17%	-	20%
Clothing	14–17%	17%	-	20%
Electronic items	10%	17%	-	10%
Baby formula	10%	17%	-	10%
Accessories	10%	17%	-	10%
Personal exercise equipment	12–14%	17%	-	10%
Overseas specialties	10%	17%	-	10%

Source: General Administration of the Customs of the People's Republic of China, etc.

There are also benefits on the side of enterprises. For sales through cross-border EC, as the product order and import is conducted by individuals, there is no need for a foreign company to establish a local subsidiary or to obtain relevant sales approvals or licenses in order to directly sell foreign products to Chinese consumers. In addition, by making use of bonded warehouses, foreign companies can export in advance a certain amount of popular products in bulk to the bonded warehouses, which can reduce costs and increase customer satisfaction. At the same time, as the delivery of goods from bonded warehouses can be quickly arranged in accordance with orders from consumers.

### **Business strategy options in China's cross-border EC business**

As mentioned above, the development of the cross-border EC business in China has the potential to aid foreign companies in developing new markets in China, while it can also become a new sales channel for foreign companies to expand sales opportunities and their own brands in the country. Furthermore, the Chinese government politically supports cross-border EC, aiming to introduce a political and management system that will enhance the optimization of customs clearance procedures, development of measures related to inspection and quarantine, and normalization of export and import

tax systems, in seven model areas for cross-border EC across the country, including Shenzhen and Guangzhou.

Then, what options are available to foreign companies regarding their business strategies for the cross-border EC business in China? The business models are compiled in Fig. 4.

### **1. Direct sales to cross-border EC operators in China**

For foreign companies, the most simple and quick approach is to sell products to Chinese cross-border EC operators. In this case, a company simply sells products to the operator of a cross-border EC website, and then the relevant Chinese operator will keep the products as inventory in their bonded warehouses in bonded areas and dispatch the products throughout China upon receipt of an order. To the foreign companies, this method spares them the procedures to establish a locally incorporated company in China and reduces inventory risk, which lowers a hurdle in business. Therefore, this business model shall be beneficial to small and mid-sized companies with limited power and financial resources or for the marketing of new products.

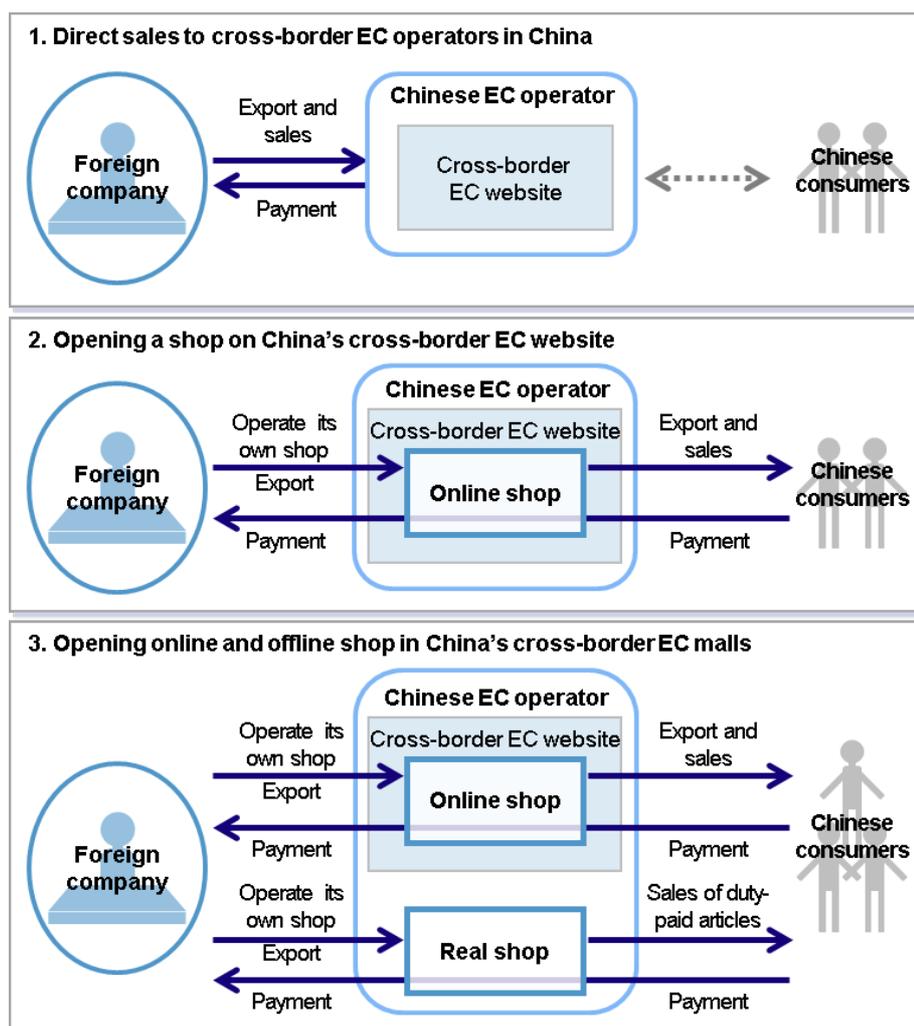
### **2. Opening shops on China's cross-border EC websites**

The next possible option is to open the company's own virtual shop on China's cross-border EC websites. This business model could be suitable for relatively large-scale companies with brands of a relatively high profile and attractiveness. At their own online stores, these companies will be able to craft a consistent brand image and take flexible response in accordance with their own sales strategies, as well as collect customer data. On the other hand, the business model will set a somewhat higher hurdle than the business model described in Section 1 in such areas as operating cost and inventory risk.

### **3. Opening online and offline shops in China's cross-border EC malls**

As introduced in the beginning of this article, recently, the most noteworthy business model is an O2O (Online-to-Offline) cross-border EC scheme where companies open shops both online and offline in cross-border EC malls. Such scheme aims to produce synergy effects by combining displays at real shops and sales at online shops. In terms of online sales, this scheme operates in the same way as explained in Section 1 and 2, while offline shops both sell imported items for which tariffs and other taxes have already been paid (duty-paid items) directly to customers and exhibit bonded items (that are purchasable only on the Internet). For duty-paid articles, customers can make a direct in-store purchase and bring them home at the spot. However, as these items were imported as general trade items, customers can not enjoy the tax reduction. Meanwhile, for bonded items, in exchange for a tax advantage, customers are required to order the items online as private import and wait for delivery at a later date. Companies can enter this scheme by consigning sales to mall operators or by opening their own shops in such malls.

Fig. 4: Three options for business strategies



Of course, it is worthwhile to note that even though the cross-border EC business is expected to expand and develop further, the base of the business is still under development, and it is definitely necessary to pay attention to the Chinese government's possible moves to regulate the business. In the meantime, the business schemes described above are merely simplified models, and there are actually many more ways to conduct cross-border EC business depending on the forms of contracts between foreign companies and cross-border EC operators. When examining the cross-border EC business, it shall be important for foreign companies to carefully organize the advantages and disadvantages of each of these cross-border EC schemes and combine with their own management policies and other factors, to work out with the best way of marketing in China through EC.

**Disclaimer & Confidentiality**

1. Legal and accounting advice: The information contained herein does not incorporate advice on legal, accounting or tax issues. You should obtain your own independent professional advice on the legal, accounting and tax aspects of this information.
2. Confidentiality: The information contained herein is given for general informational purposes only and shall be kept strictly confidential. This information is intended for your company's internal use only, and the disclosure to any third party is strictly prohibited.
3. Copyright: The information contained herein is, as a general rule, the intellectual property of MHBK, and may not be copied, duplicated, quoted, reproduced, translated, or lent, in whole or in part, in any form or by any means for any purpose whatsoever without prior consent.
4. Limitation of liability:
  - (a) The information contained herein was obtained from information sources deemed reliable by MHBK but in no way is the accuracy, reliability or integrity of such information guaranteed. MHBK disclaims any liability whatsoever for any damage arising out of or relating to this information. Moreover, the analysis herein is hypothetical and is not intended as an indication of the certainty or completeness of the results thereof.
  - (b) Please note that information to be disclosed hereafter, appraisals, the opinions of credit rating agencies, and/or changes in the system and/or financial environment may necessitate substantial modification to the relevant processes and/or schemes, which may have the effect of rendering the analysis herein ineffectual. Further, this information is not intended to be an exhaustive statement of the risks to which your company is exposed.
5. The information contained herein does not constitute a solicitation or offer by MHBK to buy or sell any financial instruments or to provide investment advice or service.