Testimony of Richard Cant, Asia Counsel of ADX Net Inc.

Before the U.S.-China Economic and Security Review Commission Hearing on US Access to China's Consumer Markets

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Russell Senate Office Building, Room 188
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Senator Dorgan, Commissioner Hubbard and esteemed members of the Commission. Thank you for inviting me to testify before the Commission. It is a great honor and I appreciate the opportunity to appear before you today to discuss the issue of US companies' access to Chinese consumer markets with particular emphasis on e-Commerce and logistics.

1. INTRODUCTION

My name is Richard Cant and I am an Australian attorney & CPA that has been working in international business for over 30 years. Currently I am the Asia Counsel for a US mid-market technology company based in Minneapolis MN. This company has business interests in a number of Asian countries including China.

Prior to this I was the North America Director for an Asia based consulting company, Dezan Shira & Associates, which is one of the larger companies advising US and other businesses on how to do business in China and other Asian countries. In 2015 I established an office for Dezan Shira in Boston MA to primarily advise mid-market and smaller US businesses on how to establish and operate businesses in China and the rest of Asia. Prior to establishing this office, I lived in China for over 10 years. During that time, I have established my own and others businesses, worked for a Chinese finance company, consulted to Western businesses and headed up Dezan Shira's Shanghai office for about 6 years where I came into daily contact with US and other foreign companies and individuals wanting to establish businesses in China, operating existing businesses in China and wanting to expand their businesses in China.

During this testimony I have referred to and cited a number of sources. I'd particularly like to acknowledge the resources of China Briefing (www.chinabriefing.com) which is the publications subsidiary of Dezan Shira & Associates, and the White Paper produced by the Stanford University's Business School: 'U.S.-TO-CHINA B2C E-COMMERCE: IMPROVING LOGISTICS TO GROW TRADE' in August 2016 (https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/vcii-white-paper-us-china-ecommerce-imrpove-logistics-grow-trade.pdf) which is an excellent resource.

2. CURRENT STATE OF CHINA'S ECOMMERCE MARKET

The online retail sector in China continues to attract the world's attention for its headline growth and transformative effects on the country's business environment and social fabric. It seems that every day we read more superlatives and bigger number coming out of China in relation to this area.

Exemplifying this growth, China's biggest business-to-consumer (B2C) platform, Tmall, operated by Alibaba, created the popular Singles' Day on 11 November 2009. With much anticipated discounts on offer, subsequent Singles' Days have broken consecutive world sales records for a single day. On 11 November 2016, the total gross merchandise value of goods sold on its marketplace on Singles Day was $17.8 billion, compared with $14.3 billion in 2015. The 2016 sales figure is about four times what the worldwide Black Friday sales are expected to be this year.

Just this month Alibaba, one of the world's largest tech company announced that it is very bullish on the future of China ecommerce sector. They predicted revenue growth for next year to exceed 40%. That's on top of 2016 growth of 56%.

China's ecommerce industry is experiencing massive growth-online sales topped USD622 billion in 2015, a 33% increase on the prior year. Previous YoY growth has been around the 50% mark since 2010.

For 2016, the figure is $752 billion representing 26.2% growth from 2015—more than double the growth rate of overall retail sales. Total retail sales amounted to $4.98 trillion in 2016, up 10.4% year over year. In comparison, online sales in the United States were close to $342 billion in 2015.6 China's e-commerce market is projected to reach a transaction value of $1.56 trillion by 2018.7. Even with dark clouds over the Chinese financial landscape, retail sales (both traditional and online) show tremendous growth. Compare this with the flat or no growth in the US and other Western economies.

The Chinese online marketplace is by far the biggest in the world. It is estimated that by 2020, the size of the Chinese online market will overtake the combined US, UK, France and Japan markets with an estimated 750 million online shoppers.

This growth trajectory is only forecast to continue-online shopping for goods and services is a social mainstay of urban, upwardly mobile classes of (especially) young consumers (see Appendix 1). This is driven in part by urbanization, better payment systems and technologies, better logistics, higher wages, and more competition and choice.

There is a fundamental difference between the Chinese ecommerce model and the more traditional model found in the USA. The Chinese marketplace is dominated by online marketplaces like Taobao, TMall, JD.com and the like. I will discuss these later. These marketplaces (think Amazon and EBay) dominate up to 90% of the entire Chinese online market. Contrast this with the USA where independent merchant sites have approximately 75% of the market. Amazon currently holds about 15%, Walmart 4% and a range of retailers like Costco, JC Penny, Target, Kohls, Sears, etc. holding 1% or less. (Statista 2017)

The uptake of e-commerce in China is significantly different to its evolution in other markets. In China it is driven not by PC shoppers but by consumers using mobile devices. More than 40 per cent of Tmall's transactions are made by mobile consumers. According to the Chinese authorities, 520 million Chinese access the internet via a smart phone, from a total population of 632 million internet users. The Chinese Government's target is to connect 1.2 billion people – 85 per cent of the population – to 3G or 4G mobile internet by 2020. Mobile technologies play, and will play, an important role in this growth. There is almost a 15% increase in 2015 in the percentage of online shoppers which will utilize mobile technologies. There are over 600 million smart phone users in China and an increasing number are using those smart phones to shop online.

It's not just B2C that is booming. Business-to-business (B2B) e-commerce is also growing rapidly due to its low costs and accessibility of information. In 2013, sales in China's online B2B market reached RMB 7 trillion (US$1.2 trillion) with a year-on-year growth rate of 19.7 per cent. Alibaba's 1688.com remains the prevailing platform for such transactions, spanning 16 industries including food, raw materials, clothing and accessories, and furniture. The site controls over 40 per cent of the B2B market, followed by Global Sources (a Hong Kong-based B2B media company) and HC360 (a comprehensive B2B platform covering more than 70 industrial clusters).

Cross Border Ecommerce (CBEC) is also an emerging trend and of most interest to US businesses. As the growth of the consumer revolution emerges in China, there is increasing interest in foreign goods and services. It has recently been estimated that CBEC amounted to an estimated $40 billion in 2015, more than 6 percent of China's total consumer e-commerce, and it's growing at upward of 50 percent annually. A number of the Chinese ecommerce market places has established dedicated sites that cater to international ecommerce-TMall Global, JD Worldwide (discussed later).

The Chinese consumers are buying from countries such as the USA, Canada, Japan, South Korea, Australia, New Zealand and Europe in increasing numbers. The reasons driving this are numerous but generally center on higher quality, lower prices due to better logistics, brand awareness, unavailability in local markets, lack of trust in local brands, etc.

Foreign brands have a strong appeal to Chinese consumers (e.g., US brands like Apple, Nike, Gap, Disney, Starbucks, Buick, etc.; Asian brands like SK, Panasonic, Sony, and Samsung; European brands like Mercedes, Chanel, etc.).

Foreign products though are expensive even when purchased through legitimate cross border ecommerce routes. VAT, consumption tax on luxury goods and import duty can mean that foreign goods can cost up to 40-100% more in China.

This booming demand for foreign goods but not having to pay the steep import taxes has led to a 'underground' import channel which is so called parallel or gray importing. Chinese consumers who do not buy products abroad themselves or through friends have a number of options for ordering goods online. Purchasing agencies, or *daigou* agencies, buy products abroad on behalf of consumers for a fee, provide assistance on payment and delivery, and allow consumers to pay in Chinese Renminbi (RMB). However, the process may take a long time to complete, agencies may not be reliable, and they may import goods illegally.

Chinese consumers may also buy products directly from overseas shopping websites. This is a more reliable and legal process, but consumers may face language barriers and need to settle payment in foreign currencies. Both models described above are likely to avoid import taxes, since packages enter the country as personal items with low declared values, resulting in low or no tax liability.

MAJOR CHINESE MARKETPLACES

See generally Appendix 2 for a representation of the major players. The Ecommerce industry in China is dominated by two large players, **Tmall** and **JD.com** all with different focuses and orientations affecting their prospects for foreign sellers:

Tmall:

- Market share: 55-60%
- Online Mall
- Focus: General merchandise
- Estimated number of users: 407 million
- Shipment and delivery: Third party delivery outsourcing
- Ownership: Alibaba Group listed on NYSE
- Suitable for: Large international brands with demonstrated potential to achieve a large volume of sales or high revenue

JD.com

- Market share: 25.1%
- Hypermarket
- Focus: General merchandise
- Estimated number of users: 132 million

- Shipment and delivery: In-house delivery and logistics
- Ownership: Publicly listed on NASDAQ
- Suitable for: Dominates the home, appliance and consumer electronics categories in China and therefore favors 3C products

Both market places have established dedicated platforms for international transactions: Tmall Global and JD Worldwide (discussed later). The reason for this is that, as we will see, the Chinese marketplaces are primarily established for Chinese sellers and buyers. They are not an appropriate platform for foreigners due to a number of factors including Chinese government policy and regulatory issues, cultural and the platforms' own internal regulations. In fact the operators actively discourage foreigners from participating on these platforms. I'll discuss this in more detail later.

Let's take a look at the current ways foreigners can sell products to Chinese consumers.

Different Investment Models for Foreigners to Access China's e-Commerce Market

Model 1: Selling directly from a website hosted outside of China

Under this model, Western businesses simply adapt their existing website to suit Chinese consumers. This appears to be the easiest as it does not require a Chinese entity or website to be registered. However, it is not recommended and usually fails for the simple reason that Chinese consumers will have difficulty finding your site even if there is a Chinese language version. Then there is the problems of how to pay the retailer. Most Chinese consumers don't use traditional Western forms of payment (credit cards, PayPal) and most Westerners don't accept Chinese forms of payment (China Union, AliPay, WePay).

Furthermore, under this model the consumer has to organize to get the goods through Customs and pay any Import and Value Added Tax (VAT) which is a burden they are not generally willing to take on. There are also issues as to who will arrange the shipping, and how the consumer will return the products and get a refund.

Model 2: Selling via a self-owned website in China

In order to set up your own website in China which sells your own products, you need first to establish a subsidiary in China. This has all the advantages of selling through Model 1 but avoids delivery and customer support issues. Also payment can be made in local currency and via local payment systems.

However, the entity must be a trading company which is authorized to buy and sell goods, and import products into China. This means going through the tortuous and long (and expensive process) of establishing a Chinese Wholly Owned Foreign Enterprise (WOFE) which can take up to 6 months. It also requires an Internet Content Providers filing which can be burdensome. There are also ongoing compliance, operational and other expenses of maintaining an entity in China and also issues finding good staff to maintain it.

There's also a requirement that you establish a physical retail store which sells the same products as the online store. This can be very expensive and usually the reason a foreigner sets up an online store is to avoid the need for a retail store.

Probably the biggest issue is the continuous investment in digital marketing and search engine optimization that is required to attract consumers to your online store. This can be a major expense with no guarantee of success particularly if the foreigner is a new player to China and doesn't really understand Chinese consumer behavior which is vastly different from Western consumer behavior.

Over the years I have seen many Western companies attempt and fail to penetrate the Chinese market via this method. It takes a lot of time and capital, and a great Chinese marketing plan, to have success with this model

Model 3: Selling through a third party B2C platform within China

We briefly touched on two of the largest platforms: TMall and JD.com. Opening a shop or placing products on these platforms is an effective way to reach and sell to Chinese customers. They have a ready-made audience, logistics, and payment platforms and are established in the ways of Chinese consumer behavior. Furthermore it avoids a foreigner having to go it alone and spend large amounts of capital on entities and operations.

The problem is that the marketplaces do not really encourage Western companies to go onto the platforms. As said previously, they are Chinese platforms designed to sell Chinese products to Chinese consumers. There are tens of thousands of sellers and millions and millions of consumers and products. In many ways there's simply no room for smaller foreign companies and brands. Whilst international foreign brands are encouraged, smaller ones are not.

Consequently the Chinese marketplaces have developed their own internal rules for entry by foreign businesses onto the platforms. These rules set very high barriers to entry (entity, capital, trading history, IP registration, etc.). They also impose very high fees like consumer protection fees (in the case of trade mark and counterfeit disputes of up to $50,000) and commissions of up to 5-6%. Taken all together the effect is to keep out the smaller Western players

TMall Requirements

- Companies must be an established business entity in China and hold a Chinese retail business license.
- Companies must already have on-the-ground operations in China and store merchandise in the country. Tmall strongly prefers companies that have had a presence in China for a minimum of three years, and if not, they must prove that they have enough capital to penetrate the Chinese market.
- Companies are required to prove they have the capabilities to ship orders within 72 hours of placement, and be able to track shipments.
- Merchants must provide customers with the option to return a product for a full refund with no questions asked within seven days of receipt.

JD.Com Requirements

As is the case with Tmall, JD requires that merchants be registered companies in China. To qualify for JD, companies must be registered for at least a year and have a registered capital of at least RMB 500,000. Companies must also present a product quality check report and a customs inspection declaration for any imported goods, both dated within a year from the date of application.

International Platforms

Because it is so difficult for foreigners to participate and succeed on the Chinese platforms, both Tmall and JD.com have launched international gateways namely **Tmall Global** and **JD Worldwide.**

The **Tmall Global** requirements are not easy and can be onerous.

The ideal Tmall Global partner has been operating for at least two years, has annual sales over US $10 million, and has had a presence in China between zero and two years. Tmall Global prefers engaging with brand owners who sell their own products.

Tmall Global enforces strict entry requirements for overseas companies seeking to create a storefront on the platform. To build up a reputation for product trustworthiness and quality, Tmall Global established an invitation and third-party application system to filter out counterfeiters and disreputable companies. A third-party (TP), also known as a Tmall Partner or Trusted Partner, is an agency that offers international companies lacking physical presence in China access to Chinese e-commerce platforms, particularly Tmall Global. Prominent brands are either directly invited by Tmall to open a storefront or have easier access if they express interest. Other brands must enlist a TP certified by Tmall Global to lobby the platform to allow them to create a storefront.

The search for an appropriate TP and the potential fees can be overwhelming. Any investor expanding into China must budget for the extensive costs of entering a new market. Alibaba promotes Tmall Global as a "fast track into China", and many companies see e-commerce as a way to test drive products in a new market before fully establishing a physical presence. However, investors often underestimate the costs of establishing an e-commerce storefront, and the costs associated with engaging a TP are often overlooked entirely. Indeed, in many cases, companies are unaware of the need to enlist a TP in the first place.

TPs generally charge sales commission in addition to quarterly service fees as incentive to provide effective service. Engaging a TP costs upwards of RMB one million (US$154,000) per year, and often several times that amount depending on the kinds of services provided and the amount of commission made. TPs have different rates depending on their size, reputation, services offered, and uniqueness of their expertise. This is in addition to the costs of using each individual e-commerce platform. For instance, Tmall Global requires a US$25,000 security deposit, a US$5,000 annual fee, and a 0.5-5 percent commission depending on the product category. Success on these platforms is not guaranteed either: the Wall Street Journal reports that about 70 percent of stores on Tmall Global have "almost no volume".

JD International is a little better. These are some of their requirements:

A foreign company is required to be an overseas legal entity with qualifications for retailing and trading overseas. Companies on JD Worldwide need to provide a location for returns in mainland China, provide product information in Chinese with metric units, and offer Chinese speaking customer service staff. JD Worldwide prefers companies with previous e-commerce experience and proven success. The following documents are required for JD Worldwide:

- Proof of company registration
- Bank account certificate
- Brand authorization
- Proof of supply chain capabilities

- Legal representative's ID
- Company introduction

Model 4: Selling through cross border pilot platforms (CBEC)

Model 4 selling through cross border pilot programs, is a relatively new but promising option for tapping into the ecommerce market. Available in major cities such as Shanghai, these programs allow for 24 hours customs clearance services and tax incentives.

Cross border e-commerce (CBEC) is a special import channel which allows products to be sold directly online sale to consumers (B2C). The channel has temporary exemptions to tariffs and other regulatory requirements which apply to conventional international trade (B2B). It was established in 2014. There are 13 pilot CBEC cities including Shanghai, Hangzhou, Ningbo, Zhengzhou, Shenzhen, and Guangzhou.

This measure led to a boom in China cross-border e-commerce which was dramatic and exponential.

As the Stanford white paper states:

Operating through the pilot zones is very beneficial to all parties involved. A benefit for sellers is a much less rigorous screening and verification process for imported goods.47 Benefits to consumers include:
• Lower customs duties: China Customs levies import duties on these orders at the rates applicable to personal items, which are usually lower than tax duties for general trade.
• Better customer support: Language challenges associated with shopping on a foreign website are eliminated. Merchants are also required to set up a customer service channel in China, with service in Chinese, to handle returns and customer complaints.
• Payment in local currency: Customers can pay in RMB, and third-party payment service providers (e.g., Alipay, Tenpay) will convert the money to foreign currencies.
• Shorter delivery time: When goods are delivered from the bonded areas, customers benefit from a shorter delivery time compared to shipments from abroad

It has led to strong share price growth of brands that have been particularly favored by Chinese consumers. But it also led to distortions in the market and it was always clear that the Chinese authorities would at some stage seek to better regulate cross-border e-commerce. As of 2016, the policy was substantially revised and extended by the Chinese authorities until at least May 2017 when we expect further reform and changes. The area is still in flux.

3. REGULATORY REGIME FOR CHINA'S ECOMMERCE MARKET

Above I have described the Chinese ecommerce landscape for US businesses attempting to sell products and services into the Chinese marketplace.

There is a further major obstacle that impacts on US companies doing business in China particularly in ecommerce and other technology based industry segments. Historically under China's Foreign Investment rules, non-Chinese companies are generally prohibited from operating businesses in the telecommunications industry and thus many businesses that utilize the internet to do business like ecommerce platforms. This is part of the severe restrictions on foreign technology companies doing business in China. The Panel will note that most if not all Western tech companies are prohibited from entering the Chinese market in any meaningful or direct way. The reasons are essentially protectionist but there is also a desire to ensure that Chinese consumers and internet users are not subject to 'unfiltered' access to Western information and data.

This is part of a wider prohibition on foreign companies providing services to Chinese consumers and businesses. Currently it is generally illegal for foreign companies to conduct business in the key service areas like telecommunications, financial services, education, healthcare, transportation, entertainment and similar service areas. Interestingly these are the industry areas that foreigner businesses, particularly American companies, do very well. It represents the next great potential wave of foreign investment into China. The Chinese authorities have promised reform to allow investment into these industries but the pace of reform is glacial. I'll discuss this further below.

A number of very complicated legal arrangements (namely Variable Interests Entities or VIE's) have been constructed to get around the prohibitions and have tacitly been approved by the Chinese authorities. It is interesting to note that all of the major players in the Chinese internet and technology scene (Alibaba, China Telecom, Sina, Baidu, JD.com, Tencent, etc.) are in fact foreign companies as they are listed in either New York or Hong Kong (a foreign country to China). Theoretically then, they should be prohibited from operating in China. But by dint of questionable VIE arrangements they control huge swathes of the Chinese telecoms and internet market. The Chinese authorities give their tacit approval to these arrangements.

Whilst the future of the VIE arrangement is currently unsure, the arrangements are really only open to large foreign companies. The complexity and cost of establishing such arrangements for smaller companies is prohibitive. For this reason smaller foreign tech companies tend to stay out of the Chinese market because it is too hard, do business with China from outside China (which has its own operational problems) or enter into gray or possibly illegal business activities in China.

The Chinese authorities have promised to reform this area as part of a broader reform of the ability for foreign companies to provide services to the Chinese consumers and businesses. A key component of this was the establishment of the Shanghai Free Trade Zone (SFTZ) in 2013 and the subsequent expansion of the FTZ concept to a number of other locations.

Essentially the SFTZ was, amongst other things, to be a testing ground for the liberalization of the policies that prohibit foreigners investing into the service sectors noted above. Great promises were made but very little has been practically delivered. Probably the area in which the most progress has been made has been financial services but in a very limited way.

For many years the Chinese authorities have theoretically allowed foreign companies to invest into the Chinese telecoms and internet sector but only as a minority shareholder with a Chinese partner. However, even if a US company found an appropriate Chinese partner (which is difficult), as a rule it was impossible for that joint venture to obtain the necessary operating (Value Added Telecommunications Service (VATS), Internet Content Provider (ICP) etc.) licenses to enable it to operate. I only know of a few joint ventures that secured such licenses in the last 10 years or so.

Only recently has it been allowed that foreigners can fully own a Chinese subsidiary that can establish and operate an ecommerce platform. Firstly it was only in a Free Trade Zone like SFTZ. Then they extended it to the whole of China. However, despite the 'opening up' of this sector to foreigners, the first ever VATS license that is required to operate was only issued in April 2016 to a Japanese company. I'm aware of a number of applications by foreign owned Chinese companies that have yet to be approved.

Despite all of the above, I'm quite positive that the industry barriers will eventually be removed but it will take a long time.

It should be noted that some US tech companies are making inroads in China although often through indirect methods. Amazon has recently introduced its popular Amazon Prime service. Walmart now fully owns the successful fresh food and grocery site YiHaoDian, and also owns nearly 10% of JD.com. And of course Uber made a tactical retreat from the Chinese market (after spending billions on a questionable Chinese strategy) by essentially leaving China and taking a 17.7% stake in Chinese rival DiDi Chuxing. All eyes are currently on AirBnB and their latest Chinese push.

Suffice to say that the above are some of the largest tech companies in the world with unlimited resources. As you can appreciate a smaller foreign company really has no or little chance.

4. BIGGEST CHALLENGES FOR US COMPANIES

I have discussed above the Chinese ecommerce regulatory and operating environment and the technical and practical difficulties it presents tor US and other foreign businesses.

I'll now touch on a range of issues that also present challenges for US and other foreign businesses. These range from external factors (government policies, HR, tax, etc.) which are widely known and discussed to internal factors (management, marketing, strategic, etc.) which are not so widely discussed.

China is for Chinese: China is a huge self-contained market place that is essentially conducted by the Chinese in Chinese for Chinese consumers. Foreign participation (whether products, brands or businesses) is tiny other than in certain specific areas like cars. Western businesses tend to assume the Chinese marketplace is similar or a copy of the Western model. Nothing could be further from the truth. From the layout and 'feel' of Chinese websites to Chinese consumer behavior patterns, the Chinese marketplace is vastly different. Often it seems like there is not a place for Westerners in this model.

Chinese Government Policy: As discussed above, Chinese government policies and procedures do not actively encourage foreign investment in the ecommerce sector or the sale of Western products other than through Chinese ecommerce platforms which in themselves can be difficult to penetrate. The policies are often protectionist, arbitrary, ambiguous and subject to unilateral change.

Tax System: The Chinese tax system is a work in progress particularly in operation and practice. At times it is arbitrary, ambiguous and regionally diverse. Often it appears it is used as a protectionist trade tool against foreign companies operating in China. Chinese and foreign companies do not operate on an even playing field when it comes to the implementation of the tax laws as it seems that Chinese companies can 'get away' with a less than optimal adherence to the tax laws.

High import duties like customs duty, consumption tax and import VAT also make importing goods into China very expensive.

Chinese Ecommerce Platforms: As discussed above, these platforms do not make it easy for foreigners to participate in a transparent and easy manner. Furthermore, there is an implicit and practical moratorium on foreigners operating ecommerce platforms in China

Competition: The Chinese marketplace is the most competitive in the world. The Europeans, the Japanese, the Koreans and the North Americans and not to mention the Chinese (and the Taiwanese, the Singaporeans and the Hong Kongers) are all battling for the hearts, minds and purses of the Chinese consumers in the most dynamic, fastest moving and innovative marketplace in the world. Quite frankly many US businesses are not ready for such levels of intense competition having grown complacent in their relatively moribund domestic market.

IP & Counterfeit Issues: The Chinese IP registration and protection landscape is a work in progress to say the least. It is getting better, but progress is slow.

Foreign businesses still are very slow to make the requisite TM and other IP registrations in China. And then cry foul when a Chinese business 'appropriate' their mark or brand. Chinese see this as a business opportunity not IP theft.

Ecommerce Payment Platforms: Because the US and foreign financial institutions and credit card companies have been excluded from operating in China, China has evolved its own unique payments system particularly in ecommerce. There is no PayPal, checks, Amex, Visa or Mastercard. In its stead there's Union Pay, WePay and AliPay, the latter that work via QR codes which are virtually unknown in the USA. It is almost practically impossible to transplant a western business with its inherent payments systems into the Chinese context. Chinese consumers simply cannot pay for the goods unless payment methods are localized.

The large US and multinational banks have been very slow to integrate with the Chinese payment systems largely because they have been excluded from the Chinese banking and financial system. The Chinese banks have not integrated with the western systems largely because they are not 'international'.

The situation is changing and slowly being remedied largely due to the large number of Chinese tourists travelling to the West.

Logistics & Supply Chain: Whilst the supply chain logistics for products moving from China to the West is well established, the reverse has never been that smooth particularly when the products land in China. Problems with Chinese Customs and internal delivery logistics have caused numerous headaches over the years. The Chinese Government has made tremendous improvements to these areas and now the situation is much better particularly if a CBEC channels are used.[1]

Human Resources: Despite the size of the Chinese labor market, for a variety of reasons it is difficult for foreign businesses to find good Chinese staff and partners, and retain them. China is running out of workers and Chinese professionals who speak English and understand Western business practices are in high demand and have no loyalty as a rule. In many cases, suitably qualified Chinese staff would rather work for a Chinese firm. There is also a wage growth explosion happening in China which has made the costs of retaining great Chinese staff even harder and costlier.

Without great local staff, Western businesses are at a disadvantage in competing and understanding the Chinese market.

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[1] Please see an excellent discussion in the Stanford Business School Ecommerce Whitepaper note above: https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/vcii-white-paper-us-china-ecommerce-imrpove-logistics-grow-trade.pdf.

Lack of Overall & Marketing Strategy: As a general proposition, I believe that many US and other foreign businesses are often ill prepared for establishing and operating businesses in, and with, China. There is a lack of cultural awareness that borders on arrogance. There is a lack of understanding of the Chinese market place and consumer. There is a lack of appreciation that Chinese business is conducted in a completely different manner from Western business. There is a belief that a successful an longstanding Western business model and marketing approach and strategy is adequate for China and will be able to be successfully executed with a modicum of localization like translating a website or marketing materials.

There is a reluctance to spend capital on an overhaul of the foreigners marketing approach which acknowledges that China is a distinct consumer market with its own unique traits and that it is constantly changing. There is often a lack of flexibility when it comes to adapting to the ever changing Chinese market.

Impossible Goals & Over Expectation: I think there is a tendency to overplay the potential success of a China 'adventure' and downplay the risks, cost and timeframe of success. Time and time again I have seen only very rudimentary business plans which play to this over expectation. These business plans often display unachievable and wildly ambitious revenue, sales and profit targets.

Lack of Capital: China is much more expensive than most Western businesses think. To succeed in China even in a modest way takes much more time and money that is expected. US businesses regularly underestimate the amount of capital it takes in China. There also seems to be a reluctance by headquarters of Western businesses to commit the required amount of capital and finance to adequately fund a Chinese business.

Sources of capital and finance are in short supply. Because of the foreign exchange restrictions imposed by China, foreigners are not freely able to transfer foreign exchange (like USD) into China. Even if a subsidiary is established, the amount of capital to be invested must be approved by the Chinese authorities, and any subsequent transfer of capital must similarly be approved. It is almost impossible for Western owned Chinese businesses to borrow money in China. Furthermore, most Western banks will not lend money to mid-market and smaller Western businesses looking to establish a China business. Hence, most capital that is earmarked for a China business is the companies own money. This too leads to a reluctance to spend and fund adequately.

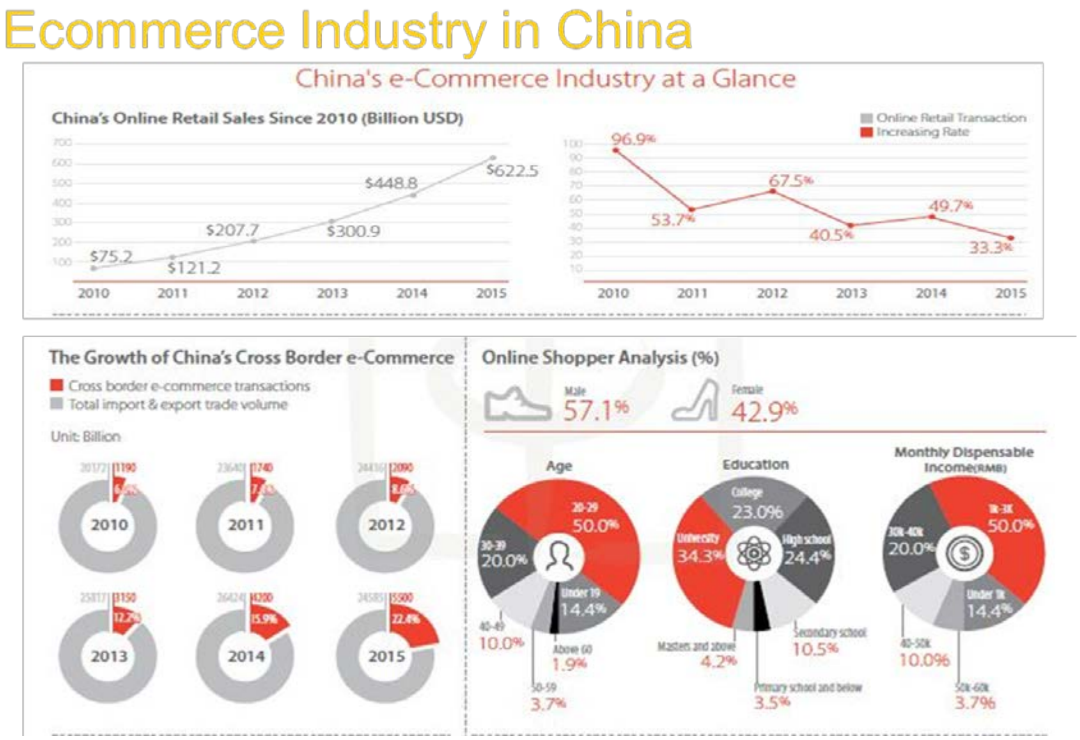
5. RECOMMENDATIONS

a. On a macro level, I think it would be a great step if the Bilateral Investment Treaty could be concluded with China. This Treaty could go a long way to resolving a number of outstanding issues regarding foreign investment into both China and the USA by companies of each country.

b. USA to agree to be a part of the Trans Pacific Partnership. Although China is not a party to the TPP, the Treaty represents the 'gold standard' of trade treaties and would be a huge step forward in liberalizing and simplifying trade and investment amongst the Pacific nations. If implemented, many other nations (including China) would in time seek to become a part of it. This would be a huge step to liberalizing and reforming the ability to do business with, and in, China.

c. The international trade and investment arm of the Department of Commerce, the US Commercial Service, should be boosted and tasked with a program to educate mid-market and smaller US business on accessing the Chinese ecommerce market. The USCS currently does a tremendous job in assisting US exporters and others that are doing business in China and other places in the world. I believe a unique targeted campaign on the practical ways US businesses can engage in trade with China via ecommerce platforms and other methods. The respective trade and investment offices of Canada, Australia and New Zealand have recently undertaken such targeted campaigns with excellent results.

APPENDIX 1



APPENDIX 2