

Testimony before the U.S.-China Economic and Security Review Commission

U.S. Access to China's Consumer Market

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Part One – Introduction

China by the numbers: 800 Million Consumers – 650 Million E-commerce Shoppers – 450 Million Alibaba Customers.

In October of 2014 the book I co-authored “*China’s Super Consumers: What 1 Billion Customers Want and How to Sell It to Them*” was published by Wiley. The book’s central thesis was that China’s consumer class is now the largest and fastest growing in the world and the most important and powerful since the rise of the “American Super Consumers” of the mid-late 20th century. We posited that the fate of brands, retailers, technology companies and service providers from around the world will, in many ways, depend on successfully engaging and serving 800 million, soon to be 1 billion Chinese consumers.

When asked by Wiley to write a book about China (subject matter of my choosing) I reflected on my extensive business and cultural experiences in, and the accumulated knowledge I gained, over 15 years of advising American and global companies, brands, retailers and investors on opportunities for engagement in China, there was no doubt in my mind that *the* story was the journey China and Chinese citizens made from a closed, planned economy with little more than the bare essentials of life for sale to the second largest economy in the world and the most important emerging consumer class on Earth.

We called them ‘Super Consumers’ because of their sheer numbers (800 million), spending power and insatiable appetite to buy everything from locally produced commodities and necessities to the best products and services from the West, to luxury products and services.

The questions that needed to be answered were: How did China progress from Feudalism to Fendi? From Sandpaper (used on ladies’ faces due to make-up not being available) to Sephora? From Chairman Mao to Chairman Ma (Alibaba founder Jack Ma)?

Over the last twenty years we can track the growth of China’s consumer market in three stages.

Phase I - “The First Consumers” 1994-2000 – The first significant wave of Chinese entrepreneurs, executives and white collar workers realize success in business, especially in the manufacturing sector, and are able to spend disposable income on foreign products and brands. The Chinese government encourages foreign brands and retailers to enter the market by relaxing and in some cases eliminating laws and regulations that had previously hampered retail operators. The majority of early non-Chinese products and

retailers are in the luxury space. During this phase, there were roughly 100 million Chinese consumers with significant disposable income.

Phase II - The Consumer Boom - 2000-2012 – The second and third waves of consumers with significant disposable income developed during this period. Spending on luxury, foreign restaurants, fashion and technology spreads beyond first tier cities like Beijing, Shanghai and Guangzhou to vast stretches of the Eastern and Southern coastal areas. E-commerce, once a novelty with little impact, is introduced to the market on a mass scale. Alibaba, who previously was known for its manufacturer/buyer B2B service Alibaba.com turns its attention to consumer products, first with its EBay like ‘Tao Bao’ and then its digital mall ‘Tmall.com.’ Consumer appetite for foreign brands, products and retail experiences expands rapidly and hundreds of non-luxury multinational companies enter the market. During this phase, there were 300-400 million consumers with legitimate disposable income.

Phase III – The Age of the Super Consumer – 2012 to Present – Fueled by government directives to realize economic growth through consumption (detailed in the 12th and 13th 5 Year Plans) the rise and ubiquity of E-commerce; rising urban incomes; 300 million people out of poverty; a rapidly expanding urbanized middle class; millennials supported by the 4-2-1 family (four grandparents, two parents, one child); and 150 million outbound travelers per year, the age of the China Super Consumer/ “China Global Consumer Demographic” begins and matures rapidly.

There are now 800 million Chinese consumers with varying, but substantive, levels of disposable income. They run the gamut from rural villagers who can now afford mobile phones, automated farming equipment and Western personal care products to urban middle/upper middle class consumers eating out at American restaurants, drinking French wine and buying luxury apparel and homewares, to the very wealthy who can afford all of the luxury products and experiences the world has to offer.

While American companies have been, with varying levels of success, addressing the Chinese consumer market on a mass scale for more than ten years, the opportunity is now bigger than most realize, but the rules of engagement and keys to success have changed dramatically. The upside to engagement has never been higher, but the competition has never been fiercer.

It is my opinion, informed by 24 years of experience in international business, technology/e-commerce and China that the three key realities that American companies must embrace to succeed in China and thus globally are:

- E-commerce ubiquity and the new cross-border e-commerce model.
- The effects that Globalization 2.0 and China’s role in the new paradigm has had on all aspects of global business and the need to reset “make it-move-it-sell-it” strategies and operations for China and beyond.
- The emergence of a “Global China Consumer Demographic” that American companies must address in order to engage, connect with, and sell to Chinese speakers. They are “mobile and mobile” (e.g., Chinese consumers are traveling the world, investing abroad, being educated and entertained abroad and participating in the global economy at every level) and live their lives

through mobile phones. Simply engaging Chinese consumers within the borders of China itself is not sufficient anymore.

The opportunities for American companies to grow and prosper through engagement with China and China's Super Consumers as a whole are numerous and widespread.

Part Two – The Digital World and Globalization 2.0

From roughly 2000-2014 the foundations of the digital business, commercial and lifestyle paradigm and the seeds of E-commerce ubiquity were laid. It is critical that U.S. businesses understand that the key to future growth and prosperity in retail, consumer products and branding is through the “New Retail” model.

Globalization 1.0 spanned the period from roughly the early 70s to 2010. Globalization 2.0 began around 2010 and the three megatrends it produced were:

- The reemergence of China as a Global Economic, Cultural, Consumer, Supply Chain and Manufacturing Power and the emergence of “China's Super Consumers” as the largest and most important new consumer class in the world.
- The emergence of tech driven, efficient and cost effective Global, Regional, Local and Hyper-Local supply chains and logistics that has made it possible to sell and ship from anywhere to anywhere in both the B2C and B2B.
- The maturity of E-Commerce and the beginning of a digitally (not IT) driven business world.

In this model, E-commerce is a set of channels within a larger framework for sales, distribution, customer engagement and loyalty, and operations. Building the model for global consumer product and retail success includes the following steps:

- Transition to digital strategies, operations, tactics and tools and to become a **Digital Company**.
- Transition to a **Multi-Channel/Uni-Channel** model whereby digital operations connect all sales channels, customer experiences, internationalization, branding and marketing.¹ Employ all or some combination of the **5 major E-commerce models** as tools for sales, distribution, marketing, consumer relationship management, and supply chain.

Part Three – Chinese Consumer Trends

It has been accepted wisdom in tracking China's rapid evolution in consumption, technology and logistics that changes are counted in dog years as compared to the West. Business models, consumer trends, technologies, and infrastructure build-out changes that would take 7 years in the West happen in 1 year in China. While this might be a slight exaggeration, in many important ways it is only slight.

There is no arguing however that changes in Chinese consumer trends, tastes, and activities regarding what they want to buy, where they want to buy, how they want to buy and from who they want to buy from has

¹ There is no longer a battle between E-commerce and bricks and mortar retail. The companies that survive and prosper over the next 5-10 years must employ stores and E-commerce in conjunction. The biggest names in E-commerce are now heavily investing in bricks and mortar operations. While it is true that thousands of retail stores are closing, the long term reality is that thousands more will open. The winners and losers will be separated not by E-commerce vs. bricks and mortar, but by who creates a uni-channel experience that employs both models in tandem.

seen massive changes and overhauls over the last five years. The following are some of the most important new trends to emerge recently and which are most likely to have the greatest impact on American company's engagement with China.

- E-commerce – By far the most important development in Chinese commerce is the near ubiquity and importance of E-commerce across almost all categories, demographics and income levels. As Alibaba's Jack Ma once said, "In the U.S., E-commerce is dessert. In China, it's the main course." China's retail environment remained largely underdeveloped in most of the country (with exceptions being the biggest 3-4 cities) throughout the boom in consumption in the 2000s. As a result there were few legacy systems, infrastructures and industry leaders to overcome, so China largely jumped straight to digital commerce/E-commerce. This phenomenon is similar to China's rapid and complete adoption of mobile communications in skipping over land lines.
- Interactivity/Shopping As Entertainment – Chinese consumers view shopping as entertainment/sport/competitive activity. Digital tools and E-commerce deliver all of these experiences to consumers and as a result drive higher engagement/spending than other markets.
- Mobile – Chinese consumers are now, on average, making 80% of their E-commerce purchases on mobile devices. The convergence of E-commerce ubiquity and mobile living has created a perfect storm of consumption enablement.
- American Products – Chinese consumers' desire for American products and brands has never been higher and this demand is on track to grow exponentially over the next ten years. Chinese consumers appreciate the brand story, lifestyle implications, quality assurance, authenticity and safety of American products.
- Personal Care – Spending has shifted away from products in the luxury sector (although luxury is growing) to experiences and a focus self and wellness. As a result demand for American vitamins, supplements, foods, beverages, medical products and high quality apparel is soaring. If it goes in and on the body Chinese consumers will spend more on foreign products.
- Grocery is a rapidly expanding category for online shopping and U.S. food and beverage companies and farmers have a great opportunity to sell in the medium.

Part Four – E-commerce Trends in China

E-commerce in China is no longer just about buying and selling products and services – rather it has become a part of the fabric of life in China. This is largely due to:

- E-commerce filling the space for consumption and retail that was largely underdeveloped at the time when E-commerce was maturing in the West and being introduced in China.
- Chinese citizens adopting the mobile phone as their primary tool of communication, consumption, entertainment and socialization.
- Alibaba and JD.com developing ecosystems that combine retail, supply chain, data/technology and entertainment. These two companies dominate almost every aspect of E-commerce in China. Alibaba accounts for approximately 72% of all E-commerce transactions, JD.com for about 22% and the remainder split among specialty marketplaces, big brand standalone sites and digital native sites.
- Mobile based shopping has become dominant in China. Alibaba reported that 82% of 11-11 Singles Day holiday sales were made through mobile devices

- Augmented Reality – Adding digital images/video over real life camera view images to “gamify” shopping
- Virtual Reality – Using VR headsets to shop virtual stores or stores that are hundreds or thousands of miles away. In November 2016, I used VR to shop Macy’s NY flagship store from Shenzhen China.
- Unichannel Commerce and “The New Retail Model” – Chinese internet/E-commerce companies are investing heavily in bricks and mortar commerce. The “New Retail Model” is “Uni-Channel”—providing customers seamless integration and experiences that combine all online/offline buying, entertainment and returns. It is now accepted that online and offline must be a single experience connected by digital operations and channels.
- Entertainment/Sports – Chinese E-commerce and technology companies are integrating entertainment and sports into all aspects of the E-commerce experience. In China, shopping IS entertainment and entertainment drives sales. The same can be said of sports. Sporting products, teams and lifestyle is a major new avenue for brands, retailers and teams in Chinese E-commerce. The NFL, NHL, NBA and major European soccer teams are now all integrating their products and messaging across all E-commerce channels in China.
- Social Commerce – China is home to many of the most robust social media platforms in the world. In particular Tencent’s We Chat is central to the lives of its 700 million users. We Chat has launched mobile payments, electronic malls and a wide array of marketing vehicles to serve customers who research and buy through mobile device based/social media enabled retail.

Part Five – China’s E-Commerce Landscape

The total global retail E-commerce market is estimated to reach US\$ 2.5 trillion in 2017, maintaining a double-digit growth pattern established over the past 5 years. China and the Asia Pacific region are the largest retail markets in the world and have and will continue to contribute the highest growth in the E-commerce and will maintain its leading position in the retail E-commerce market with almost 60% share of total worldwide revenue.

China for example already has an estimated 700 million internet users and 650 million E-commerce shoppers. Both numbers represent only about half the population of China so the runway for growth is incredibly long. In Southeast Asia, there are currently about 500 million online consumers and penetration is only 40%, again presenting a long runway for growth.

Accelerating internet penetration, the rise of a digital business, consumer and retail ecosystem, and eager online shoppers, as well as increasingly large Asian middle class, led by China, India, and Indonesia and their corresponding disposable income, have fueled the China/APAC growth.

Unlike the U.S. and Europe where there is a mature middle class and high internet E-commerce penetration, APAC is still in “adolescent” mode and the growth opportunities are huge. By 2020, there will be over 300 million new Chinese online shoppers for a total of almost 950 million, 3x the total population of the United States, the 3rd most populous country on Earth.

China, fueled by Alibaba maintains its top position in the retail E-commerce market, currently accounting for about half of worldwide sales which are estimated to double by 2020. Having the largest internet population in the world (680 million active users in 2016) and the largest pool of future middle-class

consumers (338 million households worth US\$ 6.5 trillion in 2020), China is poised to continue driving E-commerce development in Asia and globally.

As Amazon dominates in the U.S. and Europe, China is dominated by Alibaba; with over 80% of all transactions touching an Alibaba owned or affiliated business. However, unlike western countries where web based and desktop based shopping is dominant, Chinese online shoppers overwhelmingly connect online and shop through mobile devices. On Alibaba's Singles Day in 2016, 82% of sales (\$18 billion USD in GMV) were made through mobile.

The Single's Day festival was pioneered by Alibaba – a 24 hour shopping marathon where discounts and promotions are made available on over one thousand product categories; it is now considered to be the largest online shopping day of the year with a sales record of US\$ 17.8bn within 24 hours on November 11, 2016. Mobile is not only the most common purchase medium, it has also become one of the most popular payment methods/tools, where the largest payment platforms such as: Alipay and Tenpay are made available.

E-commerce growth in China is not only taking place domestically but on a cross border E-commerce basis, growing over 60% growth in the past 3 years; The US, Japan, and South Korea are the top 3 destination countries for cross border purchases. With somewhat slower but stable market growth in the next 3-5 years, the following trends are expected in E-commerce in China and by extension East Asia:

- Movement towards greater growth in B2C (vs. C2C) in China where Tmall will be the key platform, followed by JD, and Suning
- Upsell and premiumization where average spend per transaction, by product and by category, is gradually increasing - up 20% annually the last two years.
- Stricter regulations and demand for higher quality products as consumers become more sophisticated
- Rapid expansion of product category coverage and participating brands (especially international brands)
- Faster growth in luxury goods and larger size/ticket items
- Diversification in consumer engagement models (e.g., use of E-commerce satellites for agricultural sector, where online E-commerce can promote high quality crop products such as fruits or vegetables based on the cultivation and harvesting data, or emerging social commerce, where online shoppers can do transaction with sellers via social media platform post receiving friend's recommendation or reading / watching targeted ads / news)
- Food and beverage; cosmetics and personal care; mother and baby products, and healthcare-related products will continue to be fast growing and important categories

While China's E-commerce market offers attractive opportunities for foreign companies, many international marketplace/platform players have not been able to survive in the Chinese market. Companies like Amazon and eBay are now irrelevant in the Chinese market, regardless of the amount of investment and sound strategic moves they made to support their businesses. Hence foreign retailers and brands must work with the dominant local players (e.g., Alibaba and JD) to conduct e-business in the Chinese market.

Macy's, for example, decided to open its Chinese online store through Alibaba's Tmall for a faster, more cost effective, and meaningful entry. Even Amazon was forced to open an Amazon store on Tmall. This is the equivalent of Target admitting it cannot compete with Walmart and opening mini Target stores inside Walmarts.

Part Six – E-commerce in China vs. the U.S.

There are two major differences between E-commerce in the U.S. and China:

- In China, 90% of all transactions take place on marketplaces. Marketplaces are the electronic malls where thousands of brands have their stores set up. Less than 10% of all sales happen on a company's owned and operated .Com or .CN site.
 - In the U.S. Amazon is the dominant marketplace, accounting for about 50% of all new E-commerce transactions but 50% of all sales still occur on owned and operated .COM sites or 3rd party specialty retail sites.
 - Chinese E-commerce is dominated by two companies, Alibaba and JD.com, who account for almost 90% of all transactions.
- In the U.S., aside from Amazon, transactions are split between 3rd party retailers, digital native brands, and owned domains. In China the vast majority of transactions take place on mobile devices. In the U.S. less than half of transactions are made on mobile devices.

Part Seven – Alibaba – The Company That Touches 80% of All E-commerce Transactions in China

Alibaba is not only the largest E-commerce, technology, data, and marketing company in China, and Asia, it is one of the most dynamic, innovative and ambitious companies of any kind in the world today. They are a perfect result of, and key driver of, a Globalization 2.0 World.

As I said in a recent *Financial Times* interview, "If Globalization 2.0 got pregnant and had twin boys they would be named Jeff Bezos and Jack Ma." In China, Alibaba's tentacles reach into almost every aspect of life: shopping, finance, chatting, healthcare, entertainment and news. You can go for weeks in China without cash, swiping your phone to pay for coffee, clothing or utility bills. Alibaba is responsible for *one-tenth of China's retail sales* and has the biggest money market fund (Yu'e Bao has Rmb1.14trn under management). It is the company that chased eBay and Amazon out of China and bested Yahoo, acquiring its operations there in 2005.

Alibaba has built a dynamic, efficient, scalable and comprehensive ecosystem of platforms, services, technologies and business enablers for China, for Asia, and now for the world.

Alibaba has 450 million customers in China, and it is expected they will reach 750 million in the next five years. They are pursuing the SEA, Indian, and NE Asian markets aggressively. They also have a comprehensive system in place to enable European, American and South American companies to sell to Chinese consumers across a number of domestic and Cross-Border platforms.

Engaging with Alibaba is a must for a robust China E-commerce consumer play; especially China's fast growing 20-50 year old premium and luxury consumers. As Alibaba transforms the entire retail, distribution, consumer and logistics models to a new "current state" and resets the shopping experience

across all categories in China, it becomes clear that it is impossible to be successful in China without them, online and off.

Engaging with Alibaba with the right strategies and right operations (it is easy to get it wrong by pushing structure before strategy, relationships and win-win narratives) not only opens the door to the future of China, but also provides a clearer path to success in all of Asia and eventually in Africa, South America and the developed economies of the West.

For example, Alibaba is making a major push to become a major player in the global wine and spirits business and in many ways has a significant head start on Amazon and other marketplaces and tech companies from around the world.

Finally, Alibaba is committed to enabling the success of others. They do not compete with or harm in any way the brands, retailers and service partners they engage with.

Alibaba's business units are categorized into A. Core Commerce B. Digital Media & Entertainment C. Local Services/Marketing Services—and all are powered and driven by the company's:

- **Alicloud Technology/Cloud Computing** – Alibaba's data collection, analysis, and deployment capability; commercial enabler; smart device/life enhancer - The core of the company's ecosystem.
- **Cainiao Logistics Network** – Alibaba's outsourced supply chain and logistics arm that makes it possible to run a massive domestic and cross-border commerce business efficiently and cost effectively.
- **Alipay** – The world's largest e-payment system. Alipay is owned by Alibaba leadership and outside investors. It was spun off from Alibaba group prior to the company's 2014 IPO and is central to the growth of E-commerce in general in China and beyond.

Alibaba is aggressive, innovative and strategic in the development of its own technologies and business enablement systems and has invested heavily in making Alicloud one of the largest cloud systems in the world.

Payment is not only a needed function for Alibaba's core Commerce activities but it helps open new markets and is a key to tying together its entire ecosystem.

Logistics is a key part of Alibaba's strategy to further their impact in China, the rest of Asia and globally. Importantly the Cainiao Logistics Network is being enhanced and scaled to be *the* key driver of Alibaba's cross border e-Commerce strategy.

THE ALIBABA ECOSYSTEM:



Alibaba’s mission statement is “to make it easy to do business anywhere”.

This mission statement has driven Alibaba to build its product and service offerings around buyers and sellers through an enablement approach. It created marketplaces as a platform that enables buyers and sellers to conduct transactions directly with each other and launched finance/payment units to facilitate payment for transactions made in their marketplaces. Their finance and banking arm, Ant Financial, offers funding for sellers to enable them to sell on marketplaces. Its smart logistics solutions enable sellers to deliver their products reliably, cheaply and quickly providing buyers with value-added customer delivery experiences.

The data collected from all of these operations is integrated into a system that helps sellers to better sell their products and buyers to gain better shopping experience. While each business seems to operate independently, they act as components that complement one another to create an end-to-end solution for both buyers and sellers across any B2B, B2C, C2C, B2B2C and O2O platforms.

The Alibaba ecosystem is central to the company’s success, profitability, dominance in market and coming globalization.

CORE COMMERCE BUSINESSES

Chinese consumers are eager to spend money—and they spend a lot of time shopping. In China, shopping is about more than just the transaction. It’s about entertainment, discovery, and social engagement with friends, celebrities, and internet influencers. On average, China’s consumers spend almost 30 minutes a day on Alibaba’s Taobao, the country’s leading E-commerce marketplace, nearly three times longer than an American consumer typically spends on Amazon. And they’re very brand conscious, if not particularly brand loyal. For instance, the typical Chinese teenager can recall 20 cosmetics brands while the average US teen can identify just 14. China’s young people are also the most “spend friendly” in the world: 42% feel the need to buy more things, compared with 36% in both the UK and the US.

Marketplaces

The core of Alibaba's consumer business model lies in providing sellers and buyers marketplaces along with affiliated platforms that:

- Enable entrepreneurs, small to medium sized businesses, mega brands, retailers and multinational companies to sell their products and services on a B2C, B2B, B2B2C and O2O basis
- Enable individuals and entrepreneurs to sell their products and services on a C2C basis
- Provide Chinese consumers with multiple platforms from which they can buy products from domestic and foreign sellers

Alibaba.com

Alibaba.com was Alibaba's first platform and first business model. Launched in 1999 Alibaba.com was and is the largest B2B platform in the world. The primary purpose of the site was to enable foreign companies, brands, retailers and entrepreneurs to find, contact, and do business with Chinese factories, manufacturers, agents and suppliers.

Alibaba.com also solved a massive problem for Chinese suppliers; how to find foreign customers for their products. Within a short time hundreds of thousands of Chinese suppliers signed up and listed their products, contact information etc. on Alibaba.

Huge companies like Softbank, Yahoo, and Goldman Sachs invested in Alibaba early and provided the capital for fast and comprehensive expansion. Alibaba had taken the first steps to becoming a major player in China's internet and manufacturing industries.

Taobao

Taobao is Alibaba's C2C marketplace where Chinese netizens and small business sell and buy with each other. Taobao was the company's first foray into the consumer products world. Taobao was launched in 2003 after, and as a response to, U.S. Auction and C2C giant E-Bay bought China's leading auction site at the time "Eachnet".

E-Bay experienced initial success in China but Alibaba quickly reacted by offering free listings, instant chat (important to Chinese consumers) and other local features. Perhaps most important to Taobao's success was the introduction of 'Alipay', Alibaba's financial payment platform, which proved to be a hit with Chinese consumers because as an escrow service, it provided trust and assurance that they would not be victims of fraud.

Eventually a number of E-Bay missteps, Alibaba's innovations, and Ebay's difficulties with the government forced it to abandon China.

Soon after, Taobao became the most popular and important E-commerce platform in China. To this day it still generates the majority of Alibaba's core Commerce revenue. According to internet ranking company ALEXA, Taobao is the 10th most visited web site in the world. Taobao has more than 400 million shoppers and almost 800 million product listings at any given time.

The Taobao platform, while C2C, is the main gateway that connects Alibaba's users with its other marketplaces. Users can search in Taobao, but get results or suggestions for products on all of the Tmall

platforms. This was a smart way to educate users about Tmall when it first came out since everyone were already using Taobao, which is now a one-stop platform for shoppers online.

Alibaba is trying to build its brand globally and burnish its reputation and for this reason the significant problem with counterfeit items on Taobao is a major concern, prompting Alibaba to invest hundreds of millions of dollars in anti-counterfeiting measures. As of today, Taobao is, somewhat unfairly, listed on the USTR blacklist.²

Taobao, as a C2C marketplace, is becoming less significant as Tmall continues to grow and dominate in China and beyond. However it is still important to note that Alibaba started with Taobao and:

- Alibaba aims to ensure more US and global products on Taobao and Tmall via its June event in Detroit
- Taobao is still an important Gateway to all of Alibaba's platforms and services for Chinese consumers
- Alibaba is dedicated to eliminating fakes on Taobao. In May 2017, they sued the maker of fake Wuliangye spirits for RMB 123,000. This is part of a bigger civil and criminal prosecution effort to remove fakes from Taobao and replace them with only real products.

Tmall

Tmall is Alibaba's major B2C retail marketplace in China (and soon to be in other markets) that "caters to consumers looking for well know branded consumer products, luxury products and a premium shopping experience". It is also the biggest and most dominant B2C retail marketplace in China accounting for 56.6% of all retail E-commerce sales- Competitor JD.com trailing behind at 24.0%. The estimated gross merchandise value (GMV) of B2C E-commerce in China totaled USD \$707.5bn in 2016, which is up 23.9% from USD \$572bn in 2015.

Tmall is the primary platform for high profile international brands and retailers to sell directly to Chinese consumers.

It was originally launched as an offshoot of Taobao, called Taobao Mall. When it was officially spun off from Taobao it was renamed Tmall.

Foreign brands and retailers can establish a "Flagship Store" on Tmall. The store is the official presence for the company with Alibaba.

The store is usually built and managed by a specialty company called a "Tmall Partner" or "E-Commerce Service Provider" (ECSP). The ECSP handles listings, merchandising, customer service, logistics and relations with Alibaba's Hangzhou based category and product managers.

Having a flagship store on Tmall is crucial for global brands hoping to succeed in China because:

- It is the most important online retail channel to sell directly to Chinese consumers

² For more on Alibaba's efforts to deal with the sale of counterfeit and pirated goods on its platforms, see Michael Zakkour, "U.S. Agency Puts Tao Bao on Notorious Markets List—Here's Why They're Wrong," Forbes.

- The name and tagline of ‘Official Flagship Store’ is also meaningful to Chinese consumers because it is an assurance that purchasing there means the product is 100% genuine and safe.
- It is essentially a certification/acknowledgement that the brand is big and notable.
- Flagship stores are the most popular vehicle for established global brands. Having an official flagship store on Tmall, or not, is often a benchmark for consumers on whether a brand has a true and real presence in China and is committed to the market and to serving their wants and needs.

The Tmall marketplace is of vital importance to brands and retailers, consumers, and Alibaba

For Brands and Retailers

Brands and retailers benefit from Tmall not just through sales, but by raising brand awareness in China as a whole. To wit: Through Tmall, “Bosch is able to efficiently showcase all of its consumer products and engage a great number of consumers”. Companies like Bosch are also able to leverage Alibaba’s position as a data company to use big-data-based digital marketing, engage in China’s Internet of Things (IoT), and to establish Uni-Channel/O2O retailing.

An industry example is Napa Valley winery Robert Mondavi, who has been running their Tmall flagship store for over six months. Mondavi found that “data provided by Tmall – if analyzed and acted upon– provided detailed demographic insights and enabled the brand to target customers at multiple price points and segment its market”. The testimonial from Mondavi reveals that “Tmall is not just simply a transaction platform... working with Tmall, what we have learned the most is the power of collecting all this data, so we understand who is buying our wine”. Mondavi is able to determine their consumer profile for all China retail through Tmall data.

Tmall is not afraid to innovate with its client brands and tries to cooperate and develop customized strategies that work. For Bosch, Alibaba launched a “cross-category flagship store, the first of its type on Tmall, to sell all Bosch-branded products and build a holistic brand profile”.

A major attraction of Tmall for international and Chinese brands is the ability to exercise full control over their own branding and merchandising by operating their own storefront with unique brand identities. This is especially important for luxury brands wishing to control identity, pricing, experience, messaging and exclusivity as well as their intellectual property.

As Alibaba Group President, Michael Evans, stated that, “brands maintain control over the entire consumer experience” including pricing, branding and merchandising; delivery and returns; and data that supports all critical-decision making on Tmall. Examples of such successful Flagship Stores include Apple, Burberry, and Estee Lauder”.

For Consumers

To Chinese consumers, Tmall is the epitome of the fine online shopping experience in China. Chinese consumers associate Tmall with sophistication, quality, authenticity, superior service, and the best brands in the world. Tmall provides Chinese consumers with experience, selection, price, and convenience.

Convenience is a key in winning the hearts of Chinese E-commerce consumers. If one can purchase the same goods as at the department store or street level store with a click on the phone and later delivered to their door, why not? This is why it comes as no surprise that 2016’s “Single’s Day” data shows online

shoppers prefer mobile to computers (82 percent of all transaction made were mobile, rising from about 70 percent last year) as people can reach into their pockets and buy on the go.

China has the necessary infrastructure to support an ecosystem like this, but more importantly, it fits tightly with the lifestyle of Chinese consumers as mobile shopping is perceived to be trendy, fashionable, and technologically savvy.

In addition, the promise that consumers are buying 100% authentic goods from Tmall also defines the Tmall shopping experience. In China, counterfeit items are not uncommon. As the lifestyle of the average Chinese improves with the rise of the middle class, people are increasingly cautious about fakes and WANT - genuine goods – in no small part to “show-off” status symbols in front of families, coworkers, and friends. Hence, the Tmall promise that all goods sold on the platform are legitimate attracts many buyers around the nation. This fact is also a driver toward ‘premiumization’ as consumers are assured that the luxury goods that they buy are guaranteed by both Alibaba and individual brands and retailers.

Lastly, the reliable service from Tmall is also something consumers value greatly and appreciate. The 7 day unconditional return policy is unique to the Tmall platform. Returning purchased goods in China, unlike in the West, is usually a major hassle.

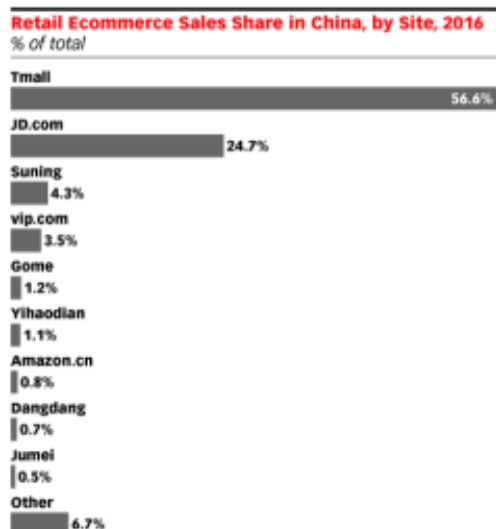
However, with the Tmall 7 day return policy, consumers are given extra incentive to explore and buy.

The combination of convenience, assurance of genuine goods, and implementation of excellent service, drives consumption on Tmall. The platform has become so pervasive in the lives of the Chinese that most people start searching on Tmall even if they decide to ultimately buy a product offline.

For Alibaba

As a platform itself, it generates revenue through commissions and advertising and marketing fees. Tmall is also the primary source of data on how businesses sell to consumers via Tmall Partners.

Tmall, in addition to being a sales and marketing platform works as a data collection and sharing platform enabled through Tmall Partners.



Tmall Global

Tmall Global was launched in 2014 as an extension of Tmall. It is Alibaba's primary B2C Cross Border E-Commerce platform. Brands and retailers set up Flagship Stores on Global just as they would on Tmall.com and the experience for the Chinese consumer is largely the same.

Tmall Global is primarily for big global brands and retailers who want to sell into China but who have not or are not ready to set up a fully realized business entity and operations in China. Tmall Global would not be appropriate for Moët Hennessy as the company already has a business in China.

Tmall Global shares many of the same characteristics as Tmall. For instance, Tmall Global also uses Taobao's infrastructure and payment system, Alipay (one of Alibaba's affiliated businesses), so "Chinese users are familiar with all the services, and the trust mechanism that they have been using for years."³

Trust has been driving success for Alibaba as customers are guaranteed products sold online are genuine since Tmall Global, like Tmall, only accepts verified brand and retail stores, which builds customer trust and ultimately conversion rates. Another advantage, which will be explored in greater depth in the Big Data section, is that "Tmall and Global have exceptional analytics tools... the daily update analytics and daily sales reports can help merchants make strategic decisions and compare data against peers in Tmall."⁴

While sharing many of the characteristics and traits of Tmall, Tmall Global differs from the operations of Tmall for brands and retailers, consumers, and Alibaba itself. Brands and retailers selling on the Tmall Global platform are foreign entities that don't have local operations in China, in comparison to Tmall, where all vendors need to be businesses with registered business licenses and trademarks. On the consumer side, "Tmall Global greatly simplifies the process for Chinese to purchase goods from overseas."⁵ This used to be a troublesome process that consumers had to go through as they had to speak a certain level of English and also possess a credit card with access to foreign currency, not to mention the long wait time for delivery that "would take up to 30 days or more, whereas products in Tmall Global are guaranteed to be delivered within 14 days from overseas or 2-3 days when brands store goods in a bonded warehouse in a FTZ (Free Trade Zone)."⁶

Finally for Alibaba, Tmall Global is the most important strategic asset for its cross-border and globalization initiative. Tmall Global allows Alibaba to further tap into the greater Asia markets through enabling cross-border e-Commerce businesses. This expansion towards globalization is pivotal to Alibaba's success in Asia and the rest of the world.

Part Eight – The Chinese Government's Role in E-Commerce Development

Government support for E-commerce, retail and consumption in general has been robust, consistent and ubiquitous in China.

³ Quoted from Misha Maruma's post on "China's Tmall Global: Everything You Need to Know"

⁴ Quoted from Misha Maruma's post on "China's Tmall Global: Everything You Need to Know"

⁵ Quoted from Misha Maruma's post on "China's Tmall Global: Everything You Need to Know"

⁶ Quoted from Misha Maruma's post on "China's Tmall Global: Everything You Need to Know"

In 2010, the Chinese government released its 12th Five-Year Plan. In it the Chinese government makes clear that the pillars of China's growth and prosperity over the first 30 years of the "Opening Up and Reform" era could not sustain China's continued growth for the next 30 years.

The key takeaways from the plan, in regard to consumption, and later reiterated and reinforced in the 13th 5 Year Plan (2015):

- Low value add manufacturing and exports will not support economic growth and higher standards of living over the next 30 years
- China's economy must shift to a consumption based model
- China's economy must shift to a services based model
- The government will support indigenous innovation in technology (in the form of support for technology and E-commerce companies)
- The government will support retail infrastructure
- The government will support the expansion of E-commerce and cross border E-commerce
- The government will support small and medium sized enterprises in E-Commerce and their efforts to sell their products and services to a global customer base

Additionally the government has supported the establishment of Free Trade Zones (FTZs) that encourage foreign direct investment, cross-border e-commerce and expanded retail activity.

The benefits of the FTZs for U.S. companies engaged in a number of business categories in China and especially with regard to cross-border E-commerce include:

- Choosing a virtual office instead of a real one;
- Procedures registering in a FTZ are much quicker and easier;
- Less – or no – (import/export) taxes;
- Easier conversion from RMB to foreign currencies;
- Special customs monitoring system:
 - Detailed customs clearance is only needed in a later stage;
 - Faster custom clearances of goods;
- No import tax when imported into the FTZ;
- Bonded warehouses;
- Broadening of investment horizons.

For cross-border E-commerce this means that U.S. brands and retailers can ship goods to a FTZ, and store them in a bonded warehouse without the goods having to pass through customs. When an online shopper orders a product from Tmall Global or JD Global, the third party logistics provider managing the distribution center picks and packs the product, fills out an individual customs forms and send the product to the customer.

Cross-border E-commerce and the FTZ's mean that small and medium sized businesses who want to sell to Chinese consumers do not need to establish a business entity in China, pay taxes in China, or hire employees in China.

Also, China does not charge customs fees on products/packages delivered via cross-border commerce into China with a worth less than RMB 800 (\$120).

Part Nine – Opportunities for U.S. Businesses to Sell to Chinese Consumers Through E-commerce

American companies, including those in the business to consumer, and business to business categories, are already engaged with selling to China via E-commerce. Many of them are realizing top-line and bottom line growth by doing so. Companies like NIKE, Apple, Gillette, Proctor and Gamble and COSCTO are all running successful E-commerce businesses in China by selling through Alibaba and JD.com platforms.

U.S. companies have only begun to scratch the surface of the opportunity that Chinese consumer and Chinese E-commerce represents. To date most engagement with Chinese E-commerce has been limited to only the largest U.S. companies. This was due to the cost, investment needed, and formerly restrictive legal and regulatory environment in Chinese E-commerce as well as the initial focus from Chinese E-commerce marketplaces on mostly multi-national companies.

This is no longer the case. Chinese consumers and Chinese E-commerce operations are now open to a wide array of companies across all categories. There is an entire ecosystem of technology, logistics, strategy, and software service providers in the U.S. and China focused solely on enabling U.S. companies to sell to Chinese consumer through E-commerce either in China or cross-border.

It is in the best interest of the United States and its businesses that further efforts are made at in the public and private sectors to help enable more U.S. companies to sell to Chinese consumers.

Chinese consumers are the most important new consumer class in the world. There are 800 million of them in China, and another 200 million living outside of China. Their preferred and primary channel of consumption is E-commerce. American companies can no longer consider themselves serious international players without planning for and engaging Chinese consumers through E-commerce.

Further, China's biggest E-commerce players are rapidly expanding into South East Asia, India and other developing markets. But engaging with these major players the door to not only China is opened but the entire developing world.

The following are key opportunities that U.S. companies should be taking advantage of with support from federal, state and local governments.

- Multinational U.S. companies should be selling on Alibaba's Tmall where they can manage and operate a flagship store. The Tmall flagship is the most visible online presence a U.S. company can have in China and is the key vehicle for sales, brand positioning and marketing.
- Multinational as well as small and medium sized enterprises should be selling on Alibaba's Tmall Global, the primary vehicle for selling cross-border and which allows direct access to Chinese consumers without the need for a Chinese business entity.
- Entrepreneurs, small businesses, farmers and agricultural concerns should sell to Chinese businesses and consumers through Alibaba's B2C and B2B platforms designed specifically for their needs.
- Multinational and small and medium sized enterprises should be selling on JD.com. JD operates on a more traditional wholesale/retail model. U.S. companies sell their products to JD and then JD owns, merchandises, sells, the products directly to Chinese customers.
- Multinational and small and medium sized enterprises should sell on JD Global for cross-border.

- B2B – Alibaba and JD, as well as others have launched several E-commerce platforms to enable B2B and B2B2C commerce between the U.S. and China. Taobao Global and Alibaba Direct Import are the two most prominent platforms.
- U.S. companies should transform their operations, strategies and expansion for a world where CHINA/DIGITAL & CROSS-BORDER/SUPPLY CHAIN/FINANCIALIZATION are the four major mega trends shaping all aspects of national and international business.

Challenges U.S. retailers and brands face in China’s E-commerce market:

- *Need for more consistent IP enforcement.* IP protection is the most common concern faced by multinational retailers and brands operating in China, including sales through E-commerce channels.⁷ While the Chinese Government has ample laws regarding IP on the books, enforcement efforts have at times been uneven. One bright spot is Alibaba’s massive effort toward solving IP issues on its Taobao C2C platform. IP issues are not a major concern on Tmall as the stores are owned and operated by the brands and retailers themselves. Alibaba’s TaoProtect program and its aggressive moves to bring civil and criminal charges against IP infringers are already showing results.

The key in fighting infringement in China can only be overcome by a coalition effort from government, marketplace and brand action. Jointly setting up policies and controls for copyright and trademark protection and ensuring early registration of patents and trademarks in China are key to ensuring brand and product integrity. One successful case study we can point to is the UK-China Copyright Protection effort. Twenty leading British brands have participated in the initiative which includes being involved in regular roundtable meetings with Alibaba and flash sales initiatives to promote the brand story and educate consumers towards product authenticity, etc.

- *Regulatory uncertainty.* In its effort to continually spur economic growth and to ensure stability in the country’s business and financial markets, the Chinese government is in a constant cycle of experimentation with laws and regulations. In my decade and a half in China this has been the number one frustration for the executives and companies I have worked with. Laws and regulations can change frequently and without warning. This makes long-term planning difficult at times. From population control and property ownership, to emerging trends such as E-commerce, the government is trying to stay ahead of and cope with change. There are upsides as well as downsides to uncertainty though.

As for e-commerce, while the regulatory development stage is still somewhat immature, there has been much positive movement from the government to increase cross border E-commerce with the aims of better regulating the marketplaces, improving consumer safety, and enhancing domestic consumption.

⁷ It should be noted that IP protection is a major concern for E-commerce the world over. A recent study showed that 1 in 4 of all movies and DVDs sold on Amazon are fakes and Nike and Adidas have had major issues on the big South American marketplace Mercado Libre.

Like many regulatory changes the recent regulatory upgrades in E-commerce (including the new “positive list”) are viewed as not only benefiting domestic cross-border E-commerce platforms like Tmall Global or JD.com but also to give time and room for the key supply chain stakeholders including the Chinese government to prepare and align themselves on standards and procedures, especially for products in need of greater health and safety regulation.

- *Hometown Heroes and Indigenous Innovation.* The Chinese Government has implemented a number of indigenous innovation policies in recent years that favor some domestic companies in regard to the development of new technologies, business models and market access. In addition the Chinese government is focused, as any government would be, on promoting best in class companies to be not only market leaders in China but globally. These issues must be navigated with delicacy, care and focus, especially in the new technology sectors.
- *Product specific issues.* To successfully sell in China requires a clear strategy of go global and go local (“glocal”). From labeling, spec detailing, to testing and product registration as well as branding and marketing, requirements can be very complex and costly. While selling to China through cross-border E-commerce does not require legal entity setup, U.S. brands and retailers who want to be successful in this regard require a dedicated team and focus to satisfy the requirements to successfully build a brand and sell it in China. Companies with long-term plans and focus in China have been successful and the rewards generally exceed the efforts and investment made in the long run.

U.S. companies now have greater access to the China market than ever before, but as stated earlier, the right strategy, and structure must be built before implementation. While some significant barriers to entry and success still exist there is more than abundant proof that with the right products(s), right strategy and right investment, China’s Super Consumers and the E-commerce channels they prefer to buy through present the greatest opportunity for expansion, growth and profitability for American brands, retailers and service providers on the international stage.

Increased private and public sector partnerships can and should play a key role in U.S. companies engaging Chinese consumers and integrating China into their global E-commerce structure. Some recommendations to help improve market access, awareness and deployment include:

- Initialize a high level round of negotiations on cross-border E-commerce between the United States and China to: 1.) Better define what barriers actually exist to greater market access to China via E-commerce and vice versa. 2.) Define new terms on trade rules, regimes and remedies that have not been adequately addressed since China joined the WTO almost 20 years ago. 3.) Define and negotiate new bilateral and regional trade agreements with a focus on E-commerce; cross border commerce; rules of the road for data and technology transfers; and intellectual property protection.
- Educate and empower national, state and local chambers of commerce to provide education, resources, grants and support for U.S. companies who need help in redefining themselves for Globalization 2.0/Digital Paradigm success and to promote the opportunities they have in selling to Chinese consumers, Asian consumers and developing market consumers via cross border commerce.

- Work with Amazon to better understand their ongoing globalization efforts and what they can do for U.S. companies seeking customers in China and beyond.
- Standardize product information and classifications for all key supply chain stakeholders in the U.S. and China markets – one example is the strategic cooperation between Alibaba and GS1 Australia through a signed memorandum of understanding to formalize, promote, and strengthen online trade between China and Australia
- Seamless cross-border E-commerce trade rules – a recent example being the Malaysia Digital Economy Corporation signing an MOU with Alibaba and the Hangzhou Municipal Government to establish an electronic World Trade Platform (eWTP). The platform offers SMEs easier access and easier procedures for customs clearance, inspection, and permit issuance for their cross-border e-commerce trade with China
- Support of the U.S. Country Pavilion on Tmall to support Chinese consumer education on American product quality and authenticity. For example, the Denmark Ministry of Foreign Affairs signed an MOU with Alibaba to help increase exports and strengthen cooperation on anti-counterfeiting as well as IP protection
- Work directly with Chinese marketplaces in a multipronged effort at combating fraud. Minimizing IP infractions will take a coalition effort by businesses, brands, marketplaces, and U.S. and Chinese government agencies.

Appendix of Graphs, Charts, and Visualizations

Figure A: The Four Current E-Commerce Models for International – All Overlaid by Cross-Border E-Commerce

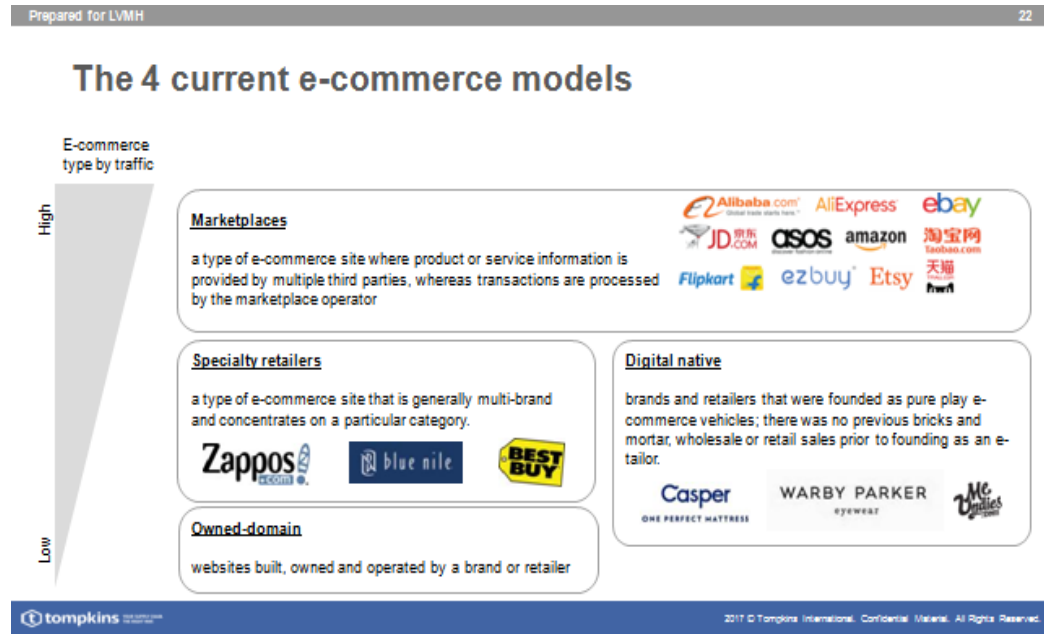


Figure B: Global E-Commerce Sales 2013-2017

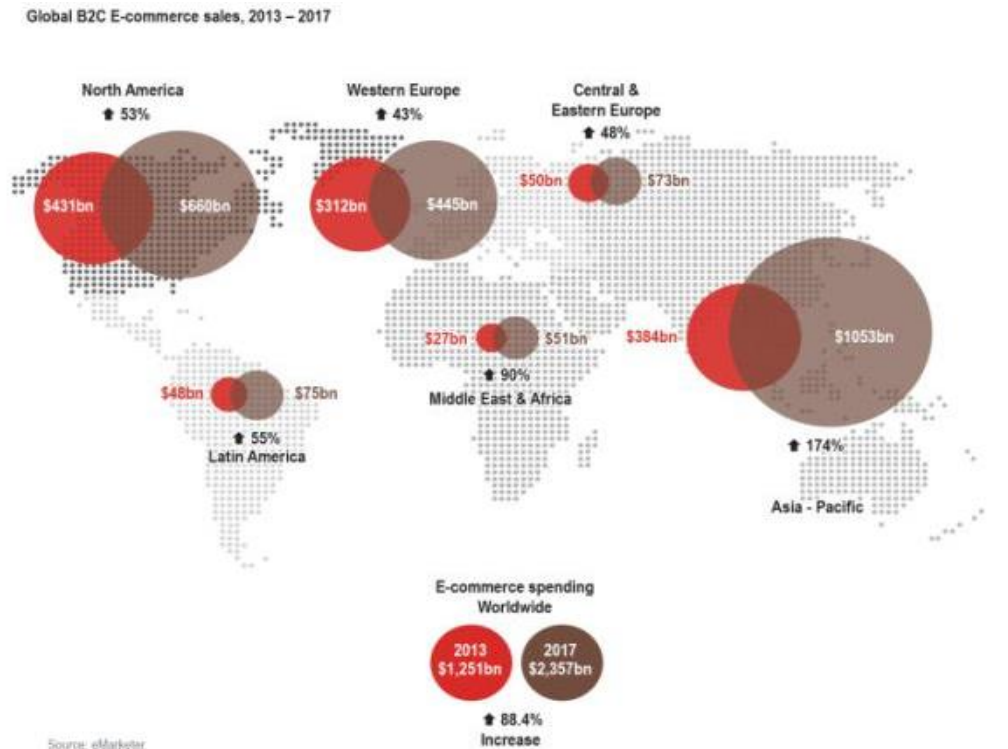


Figure C: Total E-Commerce Sales – U.S. and China

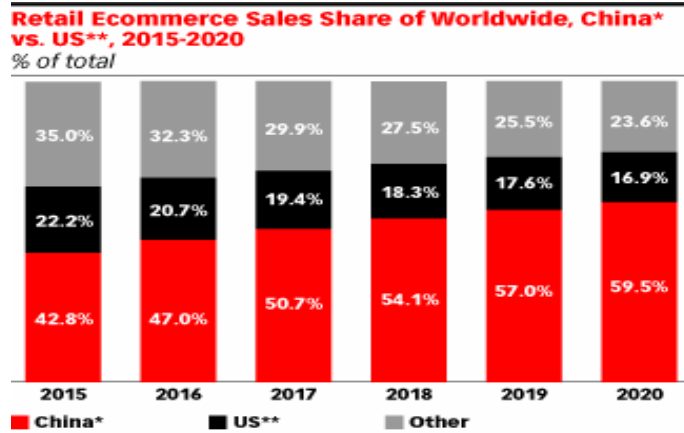


Figure D – Alibaba’s Businesses

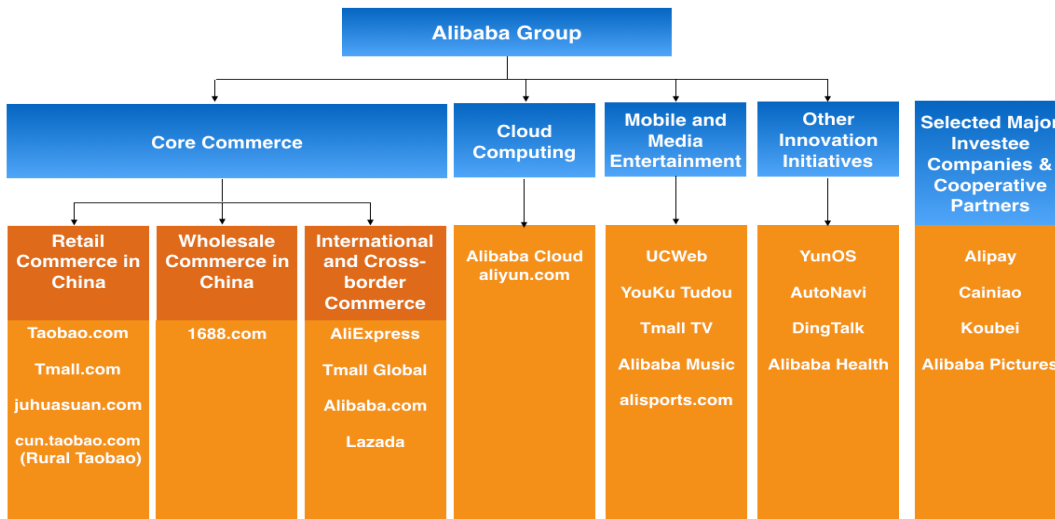


Figure E - Amazon Leads in Developed Countries through Local Presence and Operations

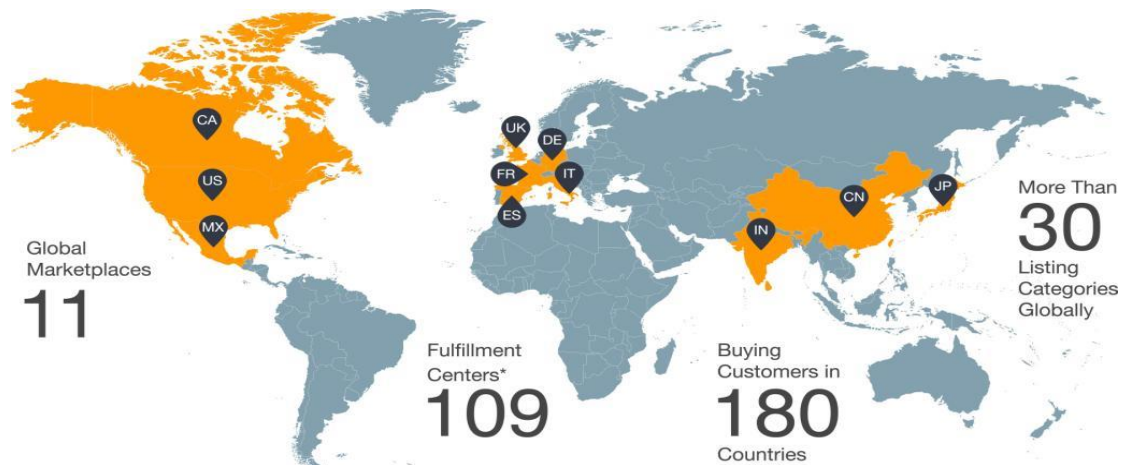


Figure F – Alibaba’s Business Units and Ecosystem

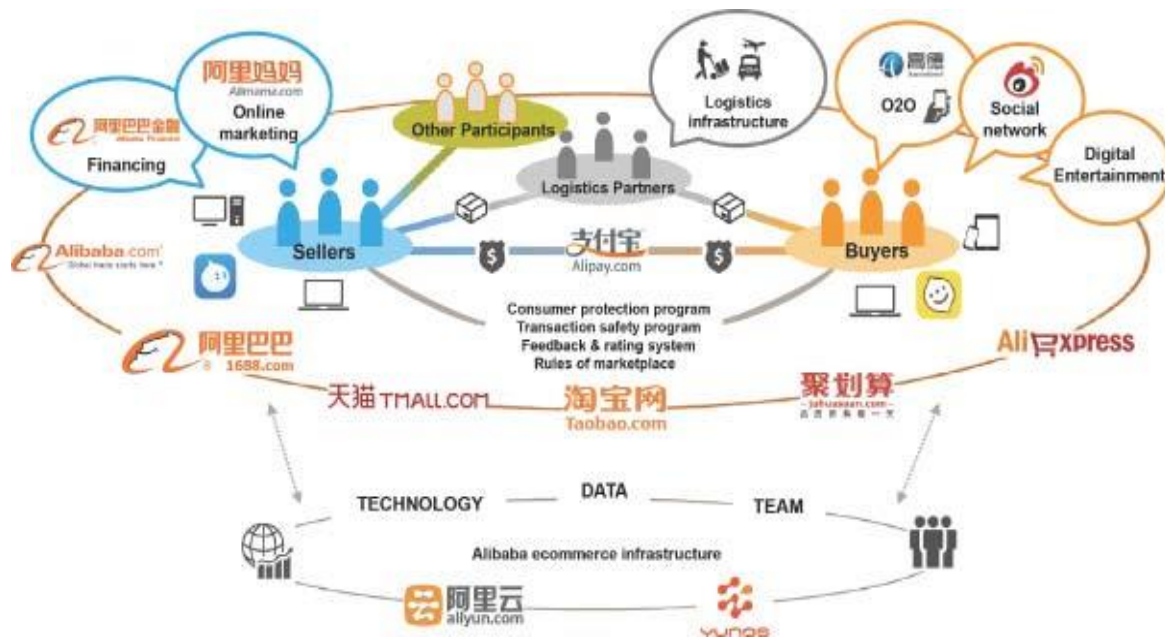


Figure G – Cainiao, The Largest Logistics Network in China

Cainiao – the largest logistics network in China

CAINIAO DRIVES SMART LOGISTICS

Alibaba's artificial intelligence network was founded in 2013 to create a logistic information platform that links a network of delivery providers, merchants and consumers to make package deliveries faster and more efficient.

Alibaba's business connect express delivery network fulfills more than 600 million parcels daily, rural logistics and cross-border logistics. By working with its partners, it serves 20 countries and regions around the world.

IN CHINA, CAINIAO CONNECTS...

- 6.1 million delivery routes
- 2 million couriers
- 40,000+ pick-up stations
- 3,000+ largest e-commerce companies
- 30,000+ rural villages
- 15 leading express delivery companies

CAINIAO USES BIG-DATA TECHNOLOGY TO...

RUN THE WORLD'S LARGEST LOGISTICS DATABASE

9 trillion parcels are processed a day

AVOID COSTLY DELIVERY ERRORS

81% of the shipping labels are digital, avoiding problems caused by handwritten mistakes and losing costs

PLAN DELIVERY ROUTES

70% of all shipments rely on algorithms to guarantee the fastest arrival possible

LOGISTICS IS GETTING SMARTER

CAINIAO PARTNERS ARE DEVELOPING ROBOTS TO SPEED

- ORDER FULFILLMENT
- WAREHOUSE SORTING
- LAST-MILE DELIVERY
- LOADING MERCHANDISE

WHAT'S NEXT

Offer smart supply-chain solutions to over **10,000** small and medium-sized brands

Expand **24-hour delivery** to cover China's Midwestern hinterland by applying smart inventory allocation system

Reach **500 million** customers with an extensive last-mile delivery network

Provide **cloud-computing services** and **affordable smart devices** to small and medium-sized logistics companies