

EASY ACCESS

Cross-border retail is changing the way China shops and has opened up opportunities for Western beauty brands, says **Annemarie Kruse**. But are the days of easy access to China numbered?

China is the largest e-commerce market in the world and one of the fastest-growing marketplaces. According to the National Bureau of Statistics of China, online turnover of consumer goods in 2015 reached Chinese yuan renminbi RMB3,242.4bn, an increase of 31.6%. And from January–August 2016, the online retail sector grew 25.5% to RMB2,434.7bn, a total that accounts for an 11.6% share of the entire retail market.

And few sectors within this marketplace are as successful as the B2C cross-border e-commerce channel. The cross-border model is comparatively new. Established in early 2015, an intricate system of so-called “bonded warehouses” located in special Free Trade Zones allows foreign/Western brands and retailers to sell directly to the Chinese consumer, without having to go through an official distributor or maintain a physical retail presence in mainland China.

Chinese consumers, on the other hand, can buy food, cosmetics, fashion and accessories directly from US and European manufacturers simply by logging on to marketplaces like T-Mall or JD.com. Western products are popular in China, not just because of their foreign allure but also because of perceived product quality and, most importantly, product safety.

SECOND-TIER CONSUMERS

For many Chinese customers based in so-called second-tier cities or rural areas there is an added incentive for purchasing through the cross-border model: buying directly from Western brands means less likelihood of accidentally buying counterfeited or fake products.

The tier system ranks Chinese cities according to their size and annual GDP: top-tier (first-tier or second-tier) cities are more urban and developed, tiers three, four

JD.com staff at the northeast China-based Gu'an warehouse

and five tend to be more rural. Originally this classification system was introduced to reflect urban development; today the concept is commonly used when talking about demographic development, social structure and consumer behaviour in mainland China.

In large cities such as Beijing or Shanghai (two of China's first-tier cities, with others including Shenzhen and Guangzhou), the big Western luxury brands are represented with official stores or brand counters in large department store chains. As a result, the chance of buying a fake handbag, wristwatch or face cream is comparatively small since the brands, their distributors and the retailers can make sure that only official merchandise is sold through these outlets.

In smaller cities, however, and especially in the rural areas, there is less control over product quality. Buying online from the actual brand is therefore considered safer than buying the same product from a local department store or other regional retailer.

HOW CROSS-BORDER WORKS

As a result cross-border online retail has become enormously popular over the last 15 months. According to US market researcher McKinsey, the cross-border e-commerce sector accounted for turnover of RMB259bn (US\$40bn) in 2015, more than 6% of the Chinese online retail market.

Considering that the actual retail channel

is not even two years old, these growth rates are even more remarkable. In March 2015, the Chinese government established a Free Trade Zone in Hangzhou in a bid to encourage cross-border e-commerce and bolster the flagging domestic economy.

Over the last few years the economy in mainland China – especially consumer spending – has slowed down and the government has been looking for ways to boost the domestic retail market, with a particular focus on the burgeoning Chinese e-commerce sector. With simplified customs formalities and preferential tax policies, the new cross-border retail model was developed to encourage Western brands to sell their goods in China. Among the first members of this new e-commerce project were Alibaba's T-Mall (the biggest e-commerce platform in Asia) and JD.com, the second-largest online retailer in China.

Mei Graefe is the Founder of Intergate, a Munich-based brand consultancy that specialises in marketing European cosmetics and lifestyle brands in Asia. Graefe explains how the cross-border model works: “The big Chinese online retailers, like T-Mall or JD.com, operate their own warehouses in these Free Trade Zones. Once the customers have placed their order through the respective online marketplace, the Western manufacturers dispatch the products directly to these ‘bonded warehouses’. The online retailer then informs the Chinese customs authorities,



giving them the requisite customer and order information. Once the customs authorities release the goods, the order is then picked up by a courier service and dispatched to the customers.”

Graefe says that although this process sounds complicated there is still less red tape involved than going through the official distributor route. And the pilot project turned out to be an enormous success. According to InterGate Consulting, more than 1.3 million sales orders worth a total of RMB290m (€40m) were registered in just one of three trade zone areas from March-August 2015.

In January 2016, the government established further Free Trade Zones and there are now 13 cities in mainland China with e-commerce zones, including Chongqing, Hefei, Zhengzhou, Chengdu, Dalian, Ningbo, Qingdao, Shenzhen, Shanghai, Suzhou Hangzhou, Guangzhou and Tianjin.

The cross-border e-commerce channel continued to grow by leaps and bounds over the following year until its success was threatening to erode the domestic retail market for luxury goods. In April 2016, the Chinese government took action: in an attempt to regulate the cross-border market, the state introduced a set of tighter tax regulations and raised parcel and customs fees for both retailers and consumers.

However, Chinese consumers are undeterred by these tax increases and the cross-border e-commerce retail channel is continuing to grow apace.

T-MALL CLASSIC VS T-MALL GLOBAL
E-commerce group Alibaba, whose Taobao and T-Mall marketplaces account for some 70% of all online purchases in China, is the biggest online retailer in Asia. The Alibaba group is enormously influential in China and its T-Mall site has been instrumental in

driving the success of cross-border retail.

There are two ways for Western brands to retail through T-Mall. T-Mall Classic is for companies who already sell their products in China, have bricks-and-mortar stores, sales staff and an official business licence. And T-Mall Global (which was launched in early 2014) is for brands that do not have an official product registration and are not retailed in mainland China yet.

For many FMCG brands, and especially for personal care manufacturers, T-Mall Global is an interesting option. Foreign beauty brands can find it difficult to enter the mainland China retail market: current legislation requires any non-Chinese cosmetics brand, no matter how many European or Western certifications it already carries, to undergo various product safety tests – including animal testing – in order to receive their official registration for the Chinese retail market.

For many European brands, especially for organic and natural cosmetics manufacturers, this is a major stumbling block: admitting to animal testing on their products – even if these tests are conducted outside of the European Union (where animal tests on cosmetics are strictly forbidden) – would mean damaging their credibility in their domestic markets and thus endangering their entire brand identity. The cross-border model, however, offers the opportunity to sell products without going through the official product registration procedure.

The new tax and customs regulations

from April 2016 also included a so-called ‘positive list’ of 1,200 product categories that could be sold through cross-border retail. And although the list still included cosmetics, it also required imported beauty brands to provide an official product registration at the customs point – de facto requiring these beauty brands to undergo the obligatory product safety tests, including animal testing.

After the first draft of this list was published, Graefe says, there were massive protests from the big online retailers, since cosmetics (especially organic beauty) is one of the most popular categories. The Chinese government then released a revised ‘positive list’, which specified a transitional period extending to July 2017. Until that date, beauty products can be sold through cross-border online retail just like before, without having to provide an additional product registration.

How the situation will develop after July 2017 is still uncertain. Graefe comments: “It is difficult to predict how the animal testing issue is going to develop. There are some positive signals that animal tests for foreign cosmetics brands might be abolished altogether at some point. But so far, there hasn’t been an official announcement about if and when this might take place.”

WESTERN RETAILERS ON T-MALL

However, the animal-testing issue only applies to the cosmetics sector. For food brands there are no such limitations and over the last year, many Western retailers have opened storefronts on T-Mall and T-Mall Global. One of the first Western companies on T-Mall Global was US wholesaler Costco, which started selling grocery products through T-Mall in late 2014. At around the same time, Korean manufacturer LG Household & Health Care began retailing six of its best selling beauty brands through T-Mall; Japanese drugstore retailer Matsumoto Kiyoshi opened a T-Mall store around a year later. And in March 2015, the UK’s Royal Mail postal and delivery service announced that it would open a storefront on T-Mall Global to sell typically British products from various UK companies.

Several European supermarket retailers have also jumped on the bandwagon, including Dutch food retailer Albert Heijn, UK supermarket chain Sainsbury’s and the German Metro group.

Sainsbury’s, the second-largest supermarket chain in the UK, launched its T-Mall store in September 2015. And business seems to be going well: Sainsbury’s recently announced that it would double the number of its own label products sold



Taobao and T-Mall owner Alibaba accounts for 70% of all online purchases in China



through T-Mall, with a particular focus on the categories British breakfast, drinks, organic foods and baby products.

German retail group Metro also opened a T-Mall flagship store last September. The German retailer already successfully operates 80 Metro Cash + Carry wholesales store in China. Metro's T-Mall store is currently offering some 100 food and personal care products, including dairy products, coffee, chocolate and tinned food from Metro's C+C (Cash & Carry) brand as well as own label C&T from Metro's Real supermarket chain.

However, Metro and Alibaba are already planning ahead. Metro has announced that the strategic cooperation with Alibaba will extend to helping other European retailers sell products through T-Mall. In early 2016, Alibaba opened its first German office in Munich, followed in June 2016 by an office in Amsterdam to serve the Benelux area.

GERMAN GROWTH

Interest among German retailers is growing strongly and not just because German foods and cosmetics are popular in China.

In July 2016, German retail trade publication *Lebensmittelzeitung* reported that German drugstore chain DM had began talking with Alibaba about a possible DM store on T-Mall. With some 1,800 outlets in Germany and an additional 1,480 stores in eleven further European countries, DM is the market leader in Germany's competitive drugstore retail channel.

DM's own label products have a very high reputation among its German and European customers, and they are popular with Chinese consumers, too.

The number of tourists from mainland China to Germany has increased rapidly over the last few years. According to the German Federal Ministry of Economic Affairs and Energy (BMWi), more than 2.5 million Chinese tourists (from mainland China and Hong Kong) visited Germany in 2015, an increase of 24.8% compared with 2014. Chinese tourists are also the largest visitor group in the domestic tax free business, accounting for 35% of the entire tax free retail turnover in Germany last year, says BMWI. And despite the fact that the ongoing terrorist attacks are currently causing a dip in the number of Asian tourists visiting Western Europe, industry experts do not expect this to have a lasting effect on tourist numbers.

DM's personal care brand Balea and supplements brand Das Gesunde Plus are in high demand among Chinese visitors, as are the retail brand milk powder and infant formula sold by DM and competitor chain Rossmann. Many Chinese tourists in

Germany buy these products in bulk to take them back home. In DM stores in Berlin or Munich, Chinese customers often buy up an entire shelf full of Das Gesunde Plus nutritional supplements or Balea's hyaluronic acid face creams.

Very often, these products end up on various Chinese e-commerce market places, sold by intermediary retailers or private individuals. According to market research company Azoya, Balea is one of the most top selling beauty brands in the cross-border business. And in September 2015, German financial magazine *Wirtschaftswoche* made headlines by publishing a photo, which showed what appeared to be an entire DM outlet, complete with company logo and slogan, built in a shopping centre in the Northern Chinese city of Shenyang.

DM is viewing this development with concern. Christoph Werner, head of DM's marketing division, said in a recent interview with *Lebensmittelzeitung*, that DM was looking at different strategies to prevent Asian intermediary retailers from buying up and selling such large amounts of DM own label products and retail brands through the grey market in China.

And there is another serious consideration for Western brands whose products are sold through unauthorised retailers. Mei Graefe says: "There is a strong risk of parallel brand communication. Private sellers on Chinese market places often use incorrect terminology when describing the product or brand they are selling; there might be wrong information about the brand, about what the product does or the ingredients it includes. In China, consumer goods or product properties are often described with words like 'magical' or 'divine' – and these terms are, of course, strictly forbidden in brand marketing. This unprofessional brand communication can have a

negative influence on the brand's image and even damage its reputation."

US beauty company Estée Lauder and French C&T giant L'Oréal are already present on T-Mall with individual shops for their luxury brands, as is German C&T manufacturer Beiersdorf, which is running an official Nivea T-Mall brand shop.

And *Lebensmittelzeitung* just reported that DM's competitor Rossmann is already trying out T-Mall. According to the article, Rossmann has just opened a test store on T-Mall shop for some of its own label products, including personal care brand Isana. The Rossmann shop will officially launch in early November to coincide with T-Mall's Singles' Day shopping event. And presumably, DM will not be far behind with its own store on T-Mall.

Although the Chinese economy is still lagging, Alibaba's sales have not been affected by the slowdown: on the contrary, in the second quarter of 2016, group turnover rose 59% to RMB32.15bn (\$4.84bn), driven by cloud computing services and online retail. E-commerce retail turnover alone grew 49% to RMB23.38bn (\$3.52bn) and three quarters of this turnover was realised through mobile revenue.

And there is still a vast potential in China's rural areas where there are few physical retail stores.

According to the Chinese Ministry of Commerce, there were some 186 million internet users living outside of the large cities as of summer 2015, 60% of which had never made an online transaction.

The big e-commerce companies have already started to improve their facilities in the rural areas. Alibaba, for example, is operating a 'Rural Taobao' online platform to encourage two-way trade between urban and rural China, making agricultural products available to urban customers while rural consumers get easier access to consumer goods. In addition, the company runs Rural Taobao service stations in some 14,000 villages to help purchasing and delivery services in rural China.

At the T-Mall Beauty Awards ceremony in February 2016, Alibaba announced that 29 Western brands and 37 Korean and Japanese brands were running storefronts on T-Mall, with a further 20 beauty companies planning to launch their own presence on T-Mall in 2016.

And the continuing growth of Alibaba and T-Mall also means the ongoing prosperity of the cross-border e-commerce market. **cb**



Western companies selling own brand goods using the China cross-border e-commerce model include the UK's Sainsbury's and German store DM