NRI Papers No. 163 June 1, 2011

Strategic Use of Online Sales Aimed at China's Rapidly Growing Consumer Market (Volume 2)

Hisao NAKAJIMA, Tomoyoshi KUZUSHIMA, Xiaoge Guan

Nomura Research Institute

NRI Papers No. 163
June 1, 2011

Strategic Use of Online Sales Aimed at China's Rapidly Growing Consumer Market (Volume 2)

Hisao NAKAJIMA, Tomoyoshi KUZUSHIMA, Xiaoge Guan

In August 2010, China's Ministry of Commerce published a circular that eased the regulations imposed on foreign investment. Based on this circular, it has become possible for Japanese manufacturers, their sales agencies and retailers to directly engage in their own online sales as extensions of their existing sales activities.

In China, "third-party payment platforms" offering an escrow function are widespread. These platforms are commonly used to collect payments for online sales. Accordingly, the collection of payments would not cause a major hindrance to Japanese companies entering the market. In the field of product delivery as well, the entry of private-sector home delivery companies into the market largely expanded the coverage of product delivery and improved quality of service.

China now has several companies that offer to undertake all of the operations necessary for online sales such as building and operating a shopping site, receiving orders, handling customer inquiries and processing returned goods. For Japanese companies, such outsourcing services provide an environment where they can promote online sales without increasing fixed costs.

The most important factor in achieving success in online sales is to improve recognition of the company's website. Recently, given their high cost effectiveness, the use of Internet communities has been attracting considerable attention in China.

When we look at recent tie-ups among companies, we see that it is very likely that online shopping markets will expand on a scale of all of Asia in the future. Japanese companies must be fully prepared by acquiring the expertise necessary for online sales in the Asian market, which is exhibiting remarkable growth in terms of both volume and momentum.

I Dealing with the Chinese Government's Regulatory Control of Foreign Companies

In NRI Paper No. 162, "Strategic Use of Online Sales Aimed at China's Rapidly Growing Consumer Market (Volume 1)," we looked at the expansion of China's middle-class consumer market from the coastal region inland, the reform of sales channels by Japanese companies in an attempt to respond to such expansion and some case studies on the strategic use of online sales. We also described China's rapidly expanding online shopping market and the moves of major companies in the online sales industry in China. In this paper, we will look at the challenges that Japanese companies are expected to face when moving into China's online sales market as well as the details of how best to address such challenges.

Foreign companies including Japanese companies face the following three major issues when moving into China's online sales market:

(1) Dealing with the restrictions that the Chinese government imposes on foreign investment
(2) Setting up a system of business operations that is suitable for the situation in China
(3) Implementing promotional activities that are tailored to the characteristics of Chinese Internet users

Of these, consideration is first given to Item (1), that is, how to deal with the restrictions that the Chinese government imposes on foreign investment.

1 Easing of regulations on foreign companies in August 2010

Until recently, China's government regulations made it difficult for companies with 100 percent foreign-owned capital to obtain permission to start online sales in China. The only means available was that a domestic company that has no capital relationship (i.e., a 100 percent Chinese-owned company) first obtain a license, and that a foreign company then enter into a contract with the domestic company to circumvent the regulations. For that reason, Japanese companies, which are very sensitive to issues of compliance, did not take a particularly positive approach to online sales in China.

However, on August 19, 2010, China's Ministry of Commerce published the "Circular of the General Office of the Ministry of Commerce, Shang Zi Zi [2010] No. 272" to clarify the interpretation of the current regulations. This circular states that "Sales via the Internet is the extension of corporate distribution on the Internet and foreign-invested production enterprises and commercial enterprises approved and registered by law may directly engage in online sales business." Accordingly, it has become possible for Japanese manufacturers, their sales agencies, retailers and so on to begin to undertake their own online sales. On the other hand, however, the circular also clarified that companies dedicated to online sales and companies providing online sales platforms (companies such as Japan's Rakuten) continue to be subject to the restrictions on foreign investment.

In the following section, we will look at the important laws and regulations that are applicable to online sales by foreign companies as well as the thinking of the Chinese government in order to have a better understanding of the background behind the above-mentioned easing of regulations. In China, laws and regulations are flexibly implemented based on the policy of the government at any given time. Therefore, it is important to fully understand the background behind and details of applicable laws and regulations.

2 Regulations imposed by the Ministry of Commerce and the Ministry of Industry and Information Technology

The important regulations applicable to online sales can be divided into the following two groups:

(A) Laws under the jurisdiction of the Ministry of Commerce in order to regulate foreign investment: "Measures for the Administration of Foreign Investment in Commercial Fields (promulgated by the Ministry of Commerce on April 16, 2004, and effective as of June 1)" and "Catalogue for the Guidance of Foreign Investment Industries (amended in 2007)"
(B) Laws under the jurisdiction of the Ministry of Industry and Information Technology: "Measures for the Administration of Internet Information Services (promulgated by the State Council on, and effective as of, September 25, 2000)" and "Provisions on the Administration of Telecommunications Enterprises with Foreign Investment."

Group (A) is designed to help promote domestic Chinese industries by limiting the ratio of investment that can be made by foreign capital enterprises, and classifies industries into the following three types:

- Encouraged foreign investment industries
- Restricted foreign investment industries
- Prohibited foreign investment industries

Previously, there had been confusion regarding online sales. Although selling via the Internet is included in the definition of the item of "Retailing," which was opened to 100 percent foreign investment enterprises in December 2004, Internet selling was still included in the above "restricted foreign investment industries."

However, the Ministry of Commerce Circular clarified this point. While those companies that are either dedicated Internet retailers or providers of Internet sales platforms are still subject to regulations, those that have acquired a "retailing" license are free to implement "sales via the Internet, etc." as an extension of their sales activities. However, a gray area still remains as to whether a company with a "retailing" license and having only a single physical store can be classified as a dedicated Internet retailer.

Moving on to Group (B), these laws are part of the laws that regulate the information and communications industry. These laws require a "commercial ICP (Internet Content Provider) license" to provide commercial Internet information services. To protect its own information and communications industry, China imposes strict restrictions on the operations of foreign investment companies. For example, operation of value-added peripheral communications businesses such as data centers and call centers for which foreign investment is 51 percent or more is not allowed in the Chinese market. Furthermore, even when the ratio of foreign investment is less than 51 percent, there are very few cases where businesses are actually authorized to operate.

Prior to the issuance of the Ministry of Commerce Circular, it was not clear whether online sales constituted "commercial Internet information services." According to the circular, business activities that offer a company's own network platform to other companies fall into "commercial Internet information services," for which a commercial ICP license must be obtained from the Ministry of Industry and Information Technology. However, when a company sells its own products via the Internet, this activity does not constitute "commercial Internet information services." What is required in this case is simply to apply for a "non-commercial ICP license" (the license needed to open a company's regular website).

The Ministry of Commerce Circular does not make mention of the sale of information and content via the Internet. According to Article 3 of the Measures for the Administration of Internet Information Services, however, "the term 'commercial Internet information services' means service activities such as compensated provision to online subscribers through the Internet of information services or website production, etc." Therefore, it is thought that while the sale of physical commodities via the Internet is now permitted, the sale of information and digital content is still subject to restrictions.

3 Regulatory control to be strengthened for new market entrants in the future

With the deregulation clarified by the Ministry of Commerce Circular, the Chinese government is hoping to increase tax revenues and protect consumers. As explained in Volume 1, most Internet transactions in China are currently between consumers (C2C transactions) through Taobao, etc. While the majority of these transactions are conducted by sole proprietors, the Chinese government cannot collect either corporation taxes or value added taxes because the proprietors are not registered as corporations. In addition, there is a need to protect consumers against untrustworthy transactions such as the offering of goods that are either counterfeit or are parallel imports without authorization.

Table 1. Laws and Regulations Related to Online Sales in China

1	Regulations on foreign-owned companies (Ministry of Commerce)	• Measures for the Administration of Foreign Investment in Commercial Fields • Catalogue for the Guidance of Foreign Investment Industries (Amended in 2007) • Circular of the General Office of the Ministry of Commerce, Shang Zi Zi [2010] No. 272 (promulgated on August 19, 2010)
2	Regulations on telecommunication business (Ministry of Industry and Information Technology)	• Measures for the Administration of Internet Information Services (promulgated on, and effective as of, September 25, 2000) • Provisions on the Administration of Telecommunications Enterprises with Foreign Investment
3	Regulations on advertisement	• Advertisement Law • Regulation on the Administration of Advertising; Detailed Implementation Rules for the Regulation on the Administration of Advertising • Provisions on the Administration of Foreign-funded Advertising Enterprises
4	Regulations on consumer protection	• Product Quality Law • Law of the People's Republic of China on the Protection of Consumer Rights and Interests
5	Regulations on publication	• Interim Provisions on the Administration of Internet Culture
6	Regulations on e-mail distribution	• Measures for the Administration of E-mail Service on Internet
7	Regulations on personal information protection	• Law on Personal Information Protection (draft is now under discussion)
8	Regulations on market research	• Measures for the Administration of Foreign-related Investigation • Catalogue for the Guidance of Foreign Investment Industries
9	Ordinance on industrial rules and standards	• Ordinance enacted by Beijing to promote information services

Source: Compiled based on material published by the Japan External Trade Organization (JETRO) and *Chugoku net business—Seiko heno point* (Online business in China—Points to success), Kosuke Okame, Nikkei Publishing Inc., 2008.

Behind encouraging the entry of new foreign investment in the market by clarifying the scope and subject of regulatory control imposed on foreign companies involved in online sales, the Chinese government expects to promote the "healthy development of the online sales industry" in addition to increasing tax revenues by collecting taxes from foreign companies. It is assumed that the government has a policy of building trust in online sales among consumers by encouraging foreign companies to sell genuine products online and by promoting healthy competition between enterprises in the industry. At the same time, the government intends to develop peripheral support service industries and to gradually eliminate sole proprietorships.

In the future, it seems likely that the Chinese government will impose greater restrictions on new entrants to the market in order to promote the healthy development of the online sales industry to ensure the protection of consumers. While the Ministry of Commerce Circular clarified the scope of deregulation, it also specifically set out rules and procedures that companies must observe to protect consumers such as the need to explicitly display a commercial ICP license. Moreover, because the actual performance of online sales is subject to many laws and regulations such as those related to advertising, consumer protection, e-mail distribution and the protection of personal information (under discussion as of January 2011), participating companies must be aware of these laws and regulations (Table 1).

In China, there are many cases in which a law is suddenly promulgated and immediately enforced on a certain day. Therefore, enterprises must pay close attention to any changes in regulatory control. Furthermore, rather than laws and regulations themselves, how such laws and regulations are actually applied is more important in China. Even if the enactment of a law is straightforward, the application of the law is often on a case-by-case basis. While this uncertainty is likely to be a source of headaches for foreign companies, flexible responses are very important for them to operate business in China.

II Setting up a System of Business Operations that is Suitable for the Situation in China

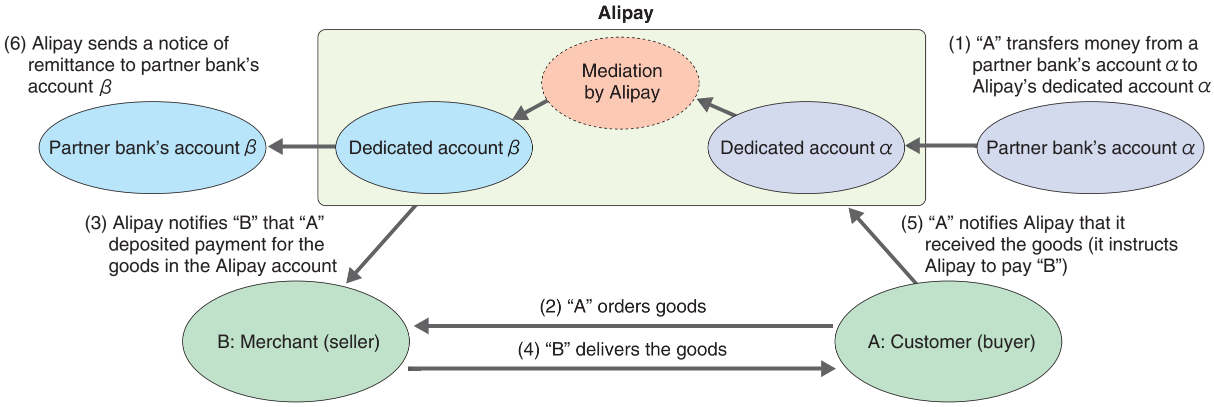
1 Third-party payment platforms provide an effective means of collecting payments

When Japanese companies consider the operation of online sales in China, their first concern may be the "collection of payments." In China, very few people possess credit cards. However, because "third-party payment platforms" such as Alibaba Group's Alipay are very common, it can actually be said that the system for collecting payments from users (consumers) is more advanced than that in Japan.

Figure 1 shows an overview of Alipay service. As this figure shows, a third-party payment platform such as Alipay is positioned between the seller and the buyer (by using electronic money) on the Internet and provides an "escrow" function. For the seller (enterprise or sole proprietor), it is possible to confirm that the buyer (consumer) has the ability to pay before any goods are shipped, whereas the buyer is provided with a means of withholding payment until goods are received and confirmed. In China, where it is difficult for both buyers and sellers to have confidence in each other, such platforms are actually very useful.

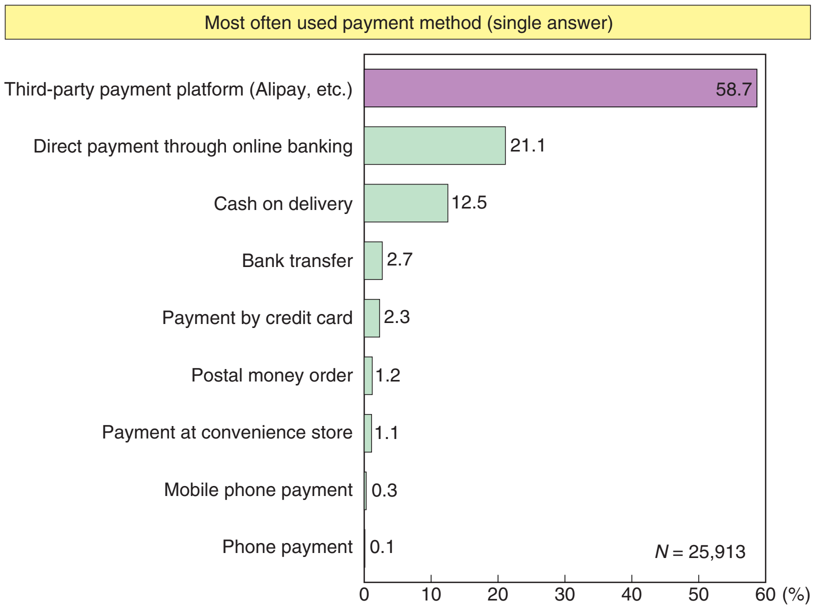
In the case of Alipay service, which is offered for transactions through Taobao, the seller pays a commission equal to 1.5 percent of the selling price, which is much lower than the average 3-percent commission that is charged for cash on delivery. Actually, in 2009, 58.7 percent of online sales users made use of third-party payment platforms (Figure 2), with Alipay enjoying a 50.7-percent share (as of December 2009). As such, for any Japanese company thinking of starting online sales in China, they should look at Alipay as being an essential tool for settling payments.

Figure 1. Overview of Alipay service (third-party payment platform) in China



Note: Payments can be made through online banking, by prepaid cards, at convenience stores or by postal money orders.
Source: Compiled based on material published by Alipay.

Figure 2. Payment methods used for online shopping in China (December 2009)



Source: Compiled based on data published by iResearch.

2 China Post EMS and major private-sector home delivery companies together offer delivery coverage to all of China

The next point of concern to a retailer is delivery to individual homes. Currently, a combination of China Post's services and those of major private-sector home delivery companies can provide delivery coverage to all of China. The history of home delivery services in China dates back to 1980 when China Post, a government-owned enterprise, started EMS (express mail service). Since then, the 1990s saw the entry of private-sector home delivery companies into the market and, in 2005, the market was opened for foreign investment. As such, the market has been growing rapidly. (Some foreign-owned companies such as FedEx (Federal Express) and DHL had entered the market in the mid-1980s when there were no apparent restrictions on foreign investment.)

Currently, there are more than 5,000 private-sector home delivery companies operating in China, leading to fierce competition and prices that largely undercut those of China Post's EMS. For example, as of January 2010, the cost of China Post's EMS to mail a 2-kg package between Shanghai and Beijing was 38 yuan. However, the cost of Yunda, a home delivery company, was 15 yuan for the same weight and distance. Thus, the price difference is more than double. Among major home delivery companies, SF Express and ZJS Express, which adopt the direct operation system, are growing most rapidly followed by STO Express, YTO Express, ZTO Express, HT Express and Yunda, which adopt the franchise system. While some major home delivery companies offer enhanced services such as guaranteeing 24-hour delivery to major cities or providing a tracking function for packages in transit, the focus of the overall industry is still on price competition rather than on service competition. It appears that there are still many complaints among consumers such as delivery delays and goods arriving damaged.

Because of these issues, online retailers such as Amazon.com and 360BUY.com, which are discussed in Volume 1, as well as Redbaby are building their own distribution networks with the aim of differentiating themselves by offering higher levels of customer services. On the other hand, because Taobao Mall, which was introduced in Volume 1, does not offer its own delivery service, any company that sells through this online shopping mall must choose a home delivery company. For a Japanese company that will either open an online store in the Taobao Mall or develop its own website, probably the best delivery option would be to partner with major home delivery companies to cover large cities, and to use China Post's EMS to reach inland cities, even though this approach incurs extra expense.

Regarding the cost of delivery, there are very few sites that directly charge the consumer for this service. For example, on Sony's "Sony Style" shopping site, anything costing 200 yuan or more is delivered at no charge, while goods costing between 100 and 200 yuan are delivered for a flat rate of 20 yuan, and anything costing less than 100 yuan is shipped for a flat rate of 30 yuan. It is worth noting the method of charging a fixed-rate delivery fee for low-priced goods as the Sony Style site does.

3 The use of an outsourcing service covering all business processes merits consideration

Even though external delivery and payment collection services are used, it is still difficult for a Japanese company to single-handedly establish the operation system needed to start online sales. Doing so requires substantial initial investment and takes a considerable amount of time to employ and train personnel needed to operate and manage all business processes such as building and operating a shopping site, receiving orders, handling inquiries by phone and e-mail, conducting inventory management, issuing instructions for shipments and package deliveries and handling complaints and returns. In particular, it is very likely that sales will be very low immediately after an online sales site is launched. Depending on the company, there is a risk of fixed costs increasing.

In response to these issues, China has several companies that offer to undertake all of the operations related to online sales for foreign companies. These companies include Commercial Global and Jumbo, which have both been growing over the last few years. Among these companies, Jumbo undertakes online operations for US and European companies such as Philips (home appliances), Hewlett-Packard (PCs and printers), and Nine West (shoes), as well as for major Chinese home appliance manufacturer, Midea.

Uniqlo also outsources its online operations, which allows it to concentrate on product planning, site planning, sales promotion planning, etc. As a result, there are actually very few personnel on the ground in China, with all the functions related to online sales being shared and managed well by the Tokyo headquarters.

In this way, by consigning all operating processes related to online sales to a Chinese contractor, foreign companies can not only make all their costs essentially variable but also, because the contractor takes the role of an agency, circumvent the regulatory issues mentioned in Chapter I.

Unlike a typical agency agreement, when business processes are outsourced in this way, it is common for the foreign company to remain responsible for management such as site planning and price-setting, as well as for stock levels. In fact, this model is similar to that whereby Japanese department stores sell products on consignment. For Japanese companies, therefore, the presence of these Chinese contractors is very useful because it enables a company to start online sales with only a few personnel stationed in China during the initial period until the scale of online sales expands.

III Promotional Activities Tailored to the Characteristics of Chinese Internet Users

1 Using Chinese Internet communities for improving brand awareness

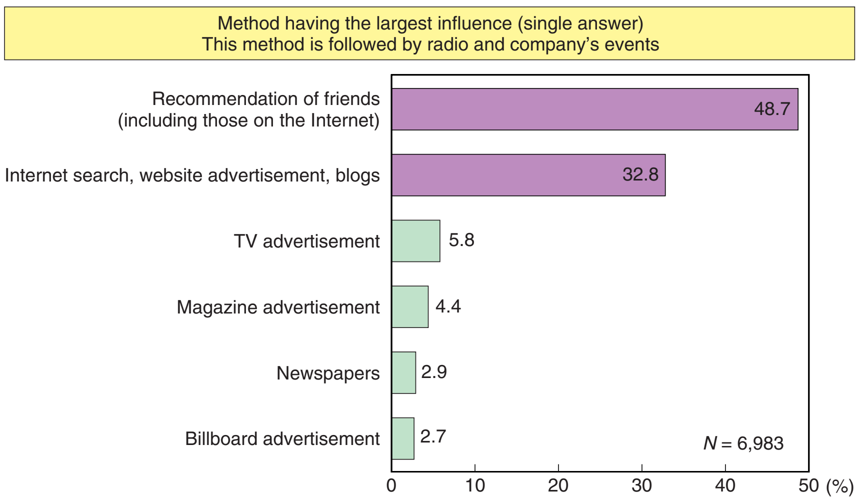
For a company to succeed in online sales in China, it is necessary to raise the level of awareness of its website and its product brands (Figure 3). Of course, by paying for keywords on Baidu, China's largest search engine, consumers will be brought directly to the company's site. However, the cost of doing so is considerable.

Recently, however, Chinese social networking service (SNS) sites, as exemplified by Kaixin, Renren, Tianya Club and QQ zone, have been proving effective in improving a company's brand awareness (Table 2). Among such SNS sites, there are sites that are already among the top ten Chinese Internet sites in terms of the total number of accesses, with users spending large amounts of time staying in the sites. As such, these sites are positively used for brand promotion.

2 Kaixin skillfully uses "product placement" to attract corporate advertising

The technique whereby companies skillfully embed advertisements in SNS sites is called "zhi ru guang gao"

Figure 3. Methods by which Chinese Internet users find online shopping sites (June 2009)



Source: "China Online Shopping Market Survey Report," China Internet Network Information Center (CNNIC), November 2009.

Table 2. Website access ranking in China (top 10 sites and major SNS sites as of November 2010)

Rank	Website name	Website address	Category
1	Baidu	baidu.com	Search engine, music
2	QQ	qq.com	SNS, IM
3	Taobao	taobao.com	Electronic commerce (EC)
4	Sina.com	sina.com.cn	News, blogs
5	Google Hong Kong	google.com.hk	Search engine
6	NetEase	163.com	News, SNS
7	Google USA	google.com	Search engine
8	Sohu	sohu.com	Search engine, SNS
9	Soso	soso.com	Search engine
10	Youku	youku.com	Video viewing site
16	Renren	renren.com	SNS
19	Tianya Club	tianya.cn	SNS
21	Kaixin	kaixin001.com	SNS

Notes: 1) Alexa ranked the sites based on the number of user accesses and the number of page views over the past month. 2) IM = instant message, SNS = social networking service. 3) The shaded sites are SNS sites.
Source: Compiled based on the website of Alexa (alexa.com) (as of November 21, 2010).

(a type of product placement). For example, Kaixin offers its "Mai-fang-zi" game space, where players work part-time to save money, buy a house, furnish its rooms and invite friends into the room to chat within the game. In this game space, company advertisements are incorporated into each scene.

Specifically, when you are choosing a room's interior, it is possible to buy Lenovo-sponsored furnishings very cheaply; however, the floor covering will carry Lenovo's logo. In another example, when choosing a part-time job, many players strive to find a position with Wanglaoji (China's largest soft drinks manufacturer) because the pay is very high. However, the real result, of course, is that Wanglaoji's brand recognition is improved. If you were to select a part-time job selling Sony Ericsson mobile phones, your experience of hearing customers praising the phones within the game such as "the performance of a Sony Ericsson's mobile phone is good" would ultimately result in improving Sony Ericsson's image.

Various similar ideas and devices are incorporated in these types of SNS sites. The experience of users in selecting companies and products is intended to imperceptibly improve users' recognition of companies and product brands and increase their favorable impression.

3 COFCO uses gift campaigns to quickly improve the awareness of its Lohas brand

One feature of Chinese SNS sites is the custom of giving one's online friends a virtual gift. Recently, many companies have been using these virtual gifts as a way of improving awareness of their product brands.

Often quoted as a successful example of this strategy is that of "Lohas" 100-percent fruit juice, which is produced by the major Chinese state-owned food manufacturer, COFCO. Because Lohas was a latecomer in the fruit juice market, which was crowded with Taiwanese and Japanese manufacturers, there was very little brand recognition. Under these circumstances, when introducing Lohas, COFCO launched a two-month virtual gift campaign that successfully and quickly lifted the Lohas brand recognition to 50 percent (which means that half the Chinese population including those in the offline world knows the Lohas brand). This promotion campaign functions as follows. In the game space, "song hua yuan" (farm game), which is offered in Kaixin and corresponds to "FarmVille" in Facebook and "FarmVillage" in Mixi (Japan's largest SNS site), choosing the Lohas-provided background setting causes a flower garden to change into a fruit orchard, where players can obtain seeds for growing the fruit that is used to produce Lohas. After planting the seeds and harvesting the fruit, juice can be made, which is presented to online friends as a virtual gift.

The idea that proved successful in this promotion is that COFCO added a campaign in which actual Lohas juice was presented to the friends of players who were chosen by lottery among those who presented virtual gifts on the SNS site. After the actual product was received, the campaign became a topic of conversation among families and people in the workplace, which served to raise the brand awareness of Lohas in the real world as well. During the two-month period, as many as 22.8 million people participated in the campaign. In addition, the virtual experience of raising fruit from seeds and then producing fruit juice successfully led to a widespread understanding among participants that the product is 100-percent pure juice.

Similar virtual gift-based campaigns are used by other brands such as Mengniu (dairy products), Lipton (beverages) and Oreo (cookies). This type of campaign is being established as one marketing technique that makes use of the Internet by companies in addition to those that sell products through the Internet. To maintain player interest, the game spaces of these SNS sites are constantly being changed. Recently, there have even been spaces where it is possible to virtually marry and bring up a child on the Internet; such sites are said to be very popular. Japanese companies need to recognize the constantly changing characteristics of Internet users in China. They should plan promotion programs by keeping such characteristics in mind.

4 Uniqlo improves its brand image through the use of "viral marketing"

The word-of-mouth spread of information between Internet users is known as "viral marketing" because it spreads in a manner similar to that of a virus. Many companies have already made use of viral marketing techniques with due care not to be perceived as being intrusive.

Uniqlo, for example, made use of a blog site to spread the term "UNIQLOCK" (described below) by word of mouth and succeeded in raising the awareness of the brand on the Internet in a highly cost-effective manner. Specifically, on the blog site of Song Xiao Bo (actor and personality who is very popular with women, and who became famous on the "My Hero" TV program, where viewers use their mobile phones to vote for male models), a promotion for "UT (Uniqlo T-shirts)" was casually developed. Photographs of Song Xiao Bo wearing UT were published, and the T-shirts were introduced as his "favorites."

Even though this promotion alone sufficiently raised the brand awareness of Uniqlo, the company went on to offer a free UNIQLOCK PC screen saver download through the Song Xiao Bo blog site, and this came to be very popular on the Internet through word of mouth. UNIQLOCK is software that displays a clock, with the screen changing every 5 seconds to show a video of a woman dancing in Uniqlo clothes. Because the background scenes and dances are different each time, the person watching tends to be captivated. It is likely that some young people wanting to mimic these dances will watch the UNIQLOCK video over and over. Among young people with relatively straightforward tastes who are targeted by Uniqlo, this campaign was highly successful in fostering a favorable impression of the brand.

After looking into advanced marketing methods such as "product placement," "virtual gift campaigns" and "viral marketing," Japanese companies need to consider how to tailor their promotional campaigns to the characteristics of Internet users in China. In the Chinese market, simply opening a single store in the vast ocean of the Internet and waiting for customers to arrive will have little or no effect on any of the more than 400 million Internet users (see Volume 1), regardless of the superiority of the product. By effectively making use of various community sites in China, companies must achieve highly cost-effective brand promotion.

IV Future Developments in China's Online Sales and Responses of Japanese Companies

In the future, how are online sales in China likely to develop? In concluding this paper, we look at the major trends that are likely to influence these developments as well as the points on which Japanese companies should focus when dealing with these developments.

1 Integration with other media such as mobile phones and TV

In the same way as in Japan, we cannot ignore the role that mobile phones play in online sales in China. According to a survey conducted by the China Internet Network Information Center (CNNIC), the number of mobile phone subscribers in China had reached 805 million as of June 2010, with 276 million of those (34 percent of all subscribers) using their phones to access the Internet. Moreover, the number of Internet users is growing at an annual rate of 78 percent, and continues to outstrip the annual rate of growth in the number of mobile phone subscribers (16.6 percent at the end of 2009).

Currently, mobile phones are used for online sales principally for the purposes of marketing and customer service, such as sending direct mails to members by using short message service (SMS), confirming orders and responding to inquiries. With the spread of smartphones such as 3G mobile phones (25.2 million subscribers as of the end of June 2010) and Apple's iPhone, which offer high-resolution screens and powerful capabilities, online sales through mobile phones will very likely become popular overnight, as has happened in Japan.

We continue to see progress in the integration of TV shopping and online sales. Taobao has established a joint venture with Hunan Television, which is well known for its entertainment programs, and launched its "yue tao yue kaixin" TV program in April 2010. In this program, show business celebrities introduce the apparel and accessories that they are wearing, all of which are available for purchase from Taobao through both the Internet and mobile phones. Future plans include enabling consumers to make purchases by using their TV remote controls.

Japanese companies already have experience in TV shopping programs offered in digital broadcasting and online sales through mobile phones. By making use of such experience gained in Japan, they should be able to differentiate themselves from their competitors in the new marketing activities in China.

2 Adoption of latest US business models such as Groupon

The "Groupon" virtual joint purchasing service was launched in Chicago in November 2008, and quickly spread to China where it is called "Tuangou." Currently, with more than 140 participating companies, this group buying has become a major trend. The business model works in a way that a particular product or service is offered for joint purchase on the Internet at a highly discounted price provided that a prescribed number of people sign up to purchase within a prescribed time. The attraction is not only the available discount but also the sense of excitement that stems from the time pressure and limitation on the number of purchasers. Used primarily by restaurants and beauty salons, it has now become an important means of initially attracting new customers. In China, "Ju an tuangou," "Mituan," "Lashou.com" and "Fan tuangou" are all well known.

It is not only the Groupon model that has been adopted in China. Chinese entrepreneurs in the Internet service industry are always paying close attention to the latest trends in the US. They have been very quick to imitate successful US business models such as You Tube, Twitter and Facebook, modifying them as necessary for the Chinese market.

Japanese companies should also continue to pay close attention to the latest trends in the US such as by establishing a department that is responsible for global online sales in Japan. While forecasting future trends in China, they should work to stay one step ahead of their competitors.

3 Growth of online sales transcends national borders

The tie-ups between Yahoo! Japan and Taobao and between Baidu and Rakuten are examples of Internet transactions transcending the borders of Japan and China. This trend is both expanding and deepening. Although companies currently face the issues of tariffs and international distribution, once these issues are resolved, in the future we will find ourselves in an age where services can be provided to all of Asia, enabling a free flow of products, funds, logistics and information to any Asian country. In the near future, we may well see a situation where online sales are offered in each Asian country by making use of production bases located in each country. Those companies that have not actually made full-scale moves into the Chinese market are placing great expectations on the prospects of online sales that transcend national borders.

The biggest issue facing cross-border online sales is how products and services can be recognized on the Internet. As was described in Chapter III, regardless of whether we look at China or any other country in Asia, each country has its own Internet user characteristics. Therefore, any promotions must be tailored to those users.

Japanese companies should not leave cross-border online sales in the hands of an agency, but should instead accumulate marketing expertise, such as by deploying personnel responsible for marketing planning in China, and should be fully prepared for the next development, which may well be expansion to all of Asia.

In this paper, together with Volume 1, we looked at the expansion of the middle class consumer market from the coastal region inland and the rapid growth of the online shopping market in China. We discussed the strategic use of online sales by Japanese companies in response to these moves.

For foreign companies including Japanese companies, the significance of online sales in China is not just providing a means of increasing sales volumes for goods and services. They also enable forecasting future demand, which can lead to improved accuracy of production plans and reduced distributor inventories. In addition, it is possible to establish brands aimed at young people in online communities. Online sales offer one of the most powerful tools for taking on Chinese competitors, who are superior in terms of sales capabilities and price competitiveness. Since August 2010 when restrictions on foreign investment were eased, online sales constitute an important theme on which foreign companies should concentrate. In particular, for Japanese companies, a positive approach toward online sales is needed because there is a good chance for them to differentiate themselves from competitors in China by making the best use of the experience gained in Japan through marketing and related activities for mobile phones.

Hisao NAKAJIMA is the director and senior consultant of NRI's Business Strategy Consulting Department. His specialties include business strategies in emerging economies (especially China) and business strategies in the infrastructure field.
Tomoyoshi KUZUSHIMA is a consultant of NRI Shanghai Limited. His specialties include business strategies, marketing strategies and support for developing new businesses in China.
Xiaoge Guanis a consultant of NRI Shanghai Limited. Her specialties include business strategies and support for developing new businesses in China.

As a leading think tank and system integrator in Japan, Nomura Research Institute is opening new perspectives for the social paradigm by creating intellectual property for the benefit of all industries. NRI's services cover both public and private sectors around the world through knowledge creation and integration in the three creative spheres: "Research and Consulting," "Knowledge Solutions" and "Systems Solutions."

The world economy is facing thorough structural changes led by the dramatic growth of IT industries and the rapid expansion of worldwide Internet usage—the challenges of which require new concepts and improvement of current systems. NRI devotes all its efforts to equipping its clients with business strategies for success by providing the best in knowledge resources and solutions.

NRI Papers present selected works of NRI's 5,000 professionals through its worldwide research network. The mission of ***NRI Papers*** is to contribute new ideas and insights into business management and future policy planning, which are indispensable for overcoming obstacles to the structural changes in our society.

Inquiries to: Corporate Communications Department
Nomura Research Institute, Ltd.
E-mail: nri-papers@nri.co.jp
FAX: +81-3-6660-8370