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RESEARCH NOTE

Opportunities and Risks for China's E-Commerce Sector

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Executive Summary

New entrants to Chinese e-commerce thrive on different business models, rivaling giants like Alibaba and JD.com. Rising players include Pinduoduo, Meituan and Shein

China has welcomed influencer-led online shopping, with users enjoying live-streamed sales as a form of entertainment

Some 10 percent of Chinese e-commerce revenue comes from international markets, but newer entrants see more than 50 percent of annual growth from overseas. Pinduoduo's mobile shopping platform became the most downloaded North American shopping app within months of launch

Uncertain regulatory environments and China's recently-launched IPO procedures deter companies from being listed at home or abroad

E-commerce is now motivated to expand in alternative markets, including Southeast Asia, the MENA region and South America

Background and Context

China's e-commerce industry is one of the most dynamic and rapidly growing in the world. The sector has been driven by the country's growing economy, rising disposable incomes, the Covid-19 pandemic and widespread adoption of digital technologies. The two players that have traditionally dominated in China are Alibaba and JD.com, with market capitalizations of $590 billion and $140 billion, respectively, as of 2023. Alibaba accounts for 50 percent of the domestic market, and JD.com 16 percent. In recent years, however, new entrants have been swiftly making up ground. Companies like Pinduoduo, Meituan and Shein have thrived using China's integrated mobile apps, with innovative business models bringing huge success.

Pinduoduo, founded in 2015, has flourished by offering discounted products and focusing on lower-tier Chinese cities that the conventional giants have overlooked. Meituan was founded in 2010 with a business model of group-based bulk purchasing, and later expanded into food delivery and other on-demand services. Meituan and Pinduoduo have each reached $140 billion in market capitalization, and are now competing to replace JD.com as the second largest player.

These companies invite users to reimagine retail, but they also face risks in expanding globally as regulations tighten. In 2014, Alibaba became the largest-ever American IPO when it went public on the New York Stock Exchange, raising $25 billion. Alibaba's sister company, Ant Group, was on its way to breaking that record and surpassing the Alibaba IPO in 2020, but the deal was blocked without warning by Chinese President Xi Jinping. In mid-2022, Alibaba itself was added to the U.S. Securities and Exchange Commission's delisting shortlist. These memories linger, and Chinese e-commerce has learned painful lessons from being caught in the geopolitical crossfire.

Key Issues

INNOVATIVE MODELS

Today's Chinese e-commerce firms share a few characteristics: they leverage integrated mobile apps, rely on social media marketing, and take advantage of ubiquitous e-payments and advanced logistical systems. These companies have also revolutionized the shopping experience by turning advertising into entertainment.[1] The new "live commerce" (zhibo) sales channel has created a generation of profit-making internet personalities, similar to social media influencers but with a focus on sales. Austin Li, known as China's "lipstick king," has amassed nearly 50 million followers by making entertaining videos to showcase specialized products. He famously sold 10 billion yuan (over $1.4 billion) worth of beauty products in just 10 hours of China's "Singles' Day" on the Taobao shopping platform, over 10 percent of eBay's annual revenue.[2]

Chinese companies also capitalize on content-generating social media content and algorithms to sharpen customer outreach. TikTok exemplifies the platforms catering to these new marketing demands. It locks onto the younger demographic with a variety of creative ad-placement options, including in-feed ads, branded content and sponsorship videos. The rise of Kuaishou and RED, popular Chinese lifestyle and content-sharing platforms, advanced this trend of "shopping as entertainment." Douyin, the sister company and Chinese version of TikTok, earned some $27 billion in revenue in 2022; Instagram, in comparison, generated roughly $30 billion in global revenue in 2020.

The proliferation of mega apps such as WeChat integrates social networks, e-payments, entertainment and ID verification into the same platform. Whereas a company like Groupon may struggle to persuade users to download its own app, Pinduoduo and Meituan, which offer similar functions, allow new users to easily register through the omnipresent WeChat. These innovations have made the online shopping experience in China more seamless than anywhere else in the world.

GLOBAL EXPANSION

Most Chinese e-commerce companies generate around 10 percent of their total revenue from overseas markets. Alibaba's international retail business brought in over $24 billion in revenue in 2020, according to financial statements, accounting for 12 percent of total revenue. JD.com's 2020 annual report shows 7 percent of net revenue from global markets.

Unlike these traditional firms, newcomers have looked to international horizons for future expansion. Pinduoduo's key international markets are Southeast Asia and South America, especially Indonesia, Vietnam and Brazil. In 2021, revenue from Pinduoduo's international operations was still small compared to domestic revenue, standing at $3.6 billion, or 10 percent of overall revenue. But those volumes have been growing rapidly: in the second quarter of 2021, the company's international revenue grew by 173 percent year-over-year, driven by strong growth in Southeast Asian markets. As of March 2023, Temu, Pinduoduo's mobile platform, is the most downloaded shopping app in the North American iOS market, surpassing Amazon and Walmart.[3]

Shein is a Chinese online fashion retailer with its revenue mostly coming from the international markets. It focuses on fast fashion at low prices, targeting consumers outside the country, and has found great success using search engine optimization and individualized advertising. According to eMarketer, in 2021 Shein's market share was about 1.7 percent in the U.S., 1.5 percent in the United Kingdom, 2.5 percent in Australia, 3.2 percent in France and 2.7 percent in Germany. These are impressive figures, on par with the likes of Zara and Gap. Despite speculation over a potential U.S. IPO, Shein has kept a low profile in an attempt to shield its global business from scrutiny.

Other Chinese e-commerce firms have faced struggles, like Meituan, whose position in the domestic market was badly affected by the pandemic. The plaform does have a presence in Southeast Asia through partnerships with local on-demand service providers, including Grab, Gojek and Shopee, and has also expanded into Europe, where it operates under the brand Wolt. But it remains unclear how Meituan will balance its resources between expanding overseas and recouping domestic losses. Gearbest, a Shenzhen-based e-commerce platform that specializes in consumer electronics and home appliances, had established itself abroad, particularly in Europe and the U.S. However, in 2019 the company filed for bankruptcy in the U.S. due to American tariffs on Chinese imports, one of the many e-commerce firms affected by U.S.-China tensions.

What's next?

With this rapid expansion, Chinese e-commerce and cross-border shopping face several regulatory challenges. These range from logistics and supply chains to retaliation over deteriorating U.S.-China ties. Since Alibaba's American IPO was stymied, the most serious such case so far, Alibaba and other Chinese companies have explored listing their shares on exchanges in Hong Kong and elsewhere. However, the delisting issue remains a source of uncertainty for companies listed in the U.S.

At the same time, Alibaba, Pinduoduo, Meituan and Shein have turned their focus to expanding in Southeast Asia, Latin America, the Middle East and North Africa as alternatives. Although there is no bulletproof formula to mitigate the geopolitical risks, there are measures that e-commerce companies and others in critical sectors can take. In this increasingly harsh regulatory environment, they will be pressed to improve working conditions and reduce human rights violations, adopt higher-standard accounting practices and disclosures to meet U.S. scrutiny, and combat counterfeiting to comply with intellectual property rules.

1 https://www.imd.org/research-knowledge/articles/how-china-revolutionising-e-commerce/
2 https://www.cbndata.com/information/212269
3 http://www.eeo.com.cn/2022/1128/568868.shtml