

An independent research report by Azoya Consulting

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### Mentioned Companies

Little Red Book

Tmall Global

JD Worldwide

Netease Kaola

Inagora

### About Azoya Consulting

Azoya Consulting advises international brands and retailers on entering the China market through cross-border e-commerce. Our services include market research, business planning, and advisory on e-commerce operations, merchandising, marketing, logistics, etc.

### About Azoya

Azoya is a borderless e-commerce group headquartered in Shenzhen, China. We have helped more than 35 international retailers expand to the China market via cross-border e-commerce, and strive to be international retailers & brands' master partner in the China market.



## An Introduction to Offline Cross-border E-commerce

The emergence of cross-border e-commerce has enabled Chinese consumers to purchase foreign products in China with greater ease than ever before – the new import model cuts the red tape and lengthy procedures required for overseas retailers to register a China entity and apply for an import permit, making it easier for them to sell to Chinese consumers directly.

Consumers now have a legitimate avenue to purchase products directly from overseas retailers at an affordable price, whereas in the past many purchased from friends/family based overseas or individual daigou, agents who purchase products overseas on behalf of Chinese consumers and profit off the price difference.

And yet Tmall Global's and Netease Kaola's recent brick-and-mortar store openings in Hangzhou show that branching into offline retail is inevitable for pureplay e-commerce - both retailers and marketplaces alike. The reasons are clear - as e-commerce user growth slows in a maturing market, traffic acquisition and online marketing operations become increasingly expensive. There is only a limited amount of time that internet users spend online in a given day, and retailers have to spend more and more money to get a piece of that time.

International e-commerce players are moving to offline retail in China, in order to reach consumers who have yet to begin purchasing overseas products, or who are looking for more convenience or a way to try out the goods before they buy. In today's competitive market, brands are also looking for a physical space in which they can build a stronger connection with their target customers.

### What's holding back the offline retail expansion of cross-border e-commerce?

The issue with taking cross-border e-commerce offline lies within the very nature of the regulation that dictates how it works – all products imported via cross-border e-commerce are regarded by Chinese customs authorities as personal artifacts, which means that there needs to be an authentic consumer to pay for the products and authenticate the order with their personal ID card, transaction records, logistics information, and payment serial number when the product is imported.

Because of all the paperwork and information needed for an order to go through, it is difficult for retailers to completely fill a brick-and-mortar store with cross-border e-commerce goods that they can sell to consumers in a hassle-free transaction. It is much easier if the products are imported via general trade, as the authorities don't have to worry about illegal transactions going through untaxed and consumers don't have to submit so much information to government authorities.

However, e-commerce companies and retailers alike have been lobbying for offline cross-border e-commerce stores for quite some time, as demand for overseas products has risen considerably and retailers are seeking a way to reach Chinese consumers without having to deal with importers and distributors in the middle.

In the next part of our article, we discuss the evolution of such offline retail stores over the past few years, as well as their pain points and how they

continue to evolve. We also present a few leading examples of how players such as Tmall Global, Netease Kaola, and Little Red Book have set up such stores.

## **The Evolution of Offline Cross-Border E-Commerce**

Above, we gave our readers an introduction to offline cross-border e-commerce and discussed some of the challenges key players face in setting up offline retail stores, particularly with regards to customs clearance issues. Below, we dig deeper and explain how offline CBEC retail stores have evolved over the past few years.

### **Offline CBEC Stores v1.0 – O2O Experience Stores**

The first brick & mortar stores for cross-border e-commerce emerged in 2015 and were known as O2O experience stores - that is, consumers could visit these stores and view and touch the products, but they couldn't buy them on the spot. These early stage CBEC O2O stores didn't have products displayed in a 'bonded' status; the products that were exhibited in-store were either used products, or empty shells/packaging collected from users.

Examples include the MeijoyBest store (Jan 2015) and the Mopark store (Apr 2015) in Guangzhou, U-Pin Shop in Xiamen (Jan 2016), and the Good Import store in Shanghai's free trade zone (Dec 2014). Customers would have to scan a QR code to order the products, which were stored in bonded warehouses. They would then be imported and taxed under general trade regulations, which meant that they weren't really cross-border e-commerce goods. They would then be delivered to customers' home address. The customer experience for these offline retail stores was poor. Seeing and testing products on the shelf that can't be purchased was frustrating for many customers, and the shelves were stocked with packages that were empty. Such stores also suffered from a highly limited selection of products. Lastly, many of these stores were placed far away from the city center in logistics zones, making it inconvenient for many consumers.

### **Offline CBEC Stores v1.5 – “The stores look much better, but you still can't take the products home with you”**

The next version of offline brick & mortar CBEC stores became those in which consumers could view products and goods in person, but would still have to order via online platforms, with the goods shipped to their homes at a later time. This time around, the benefit was that the import duties would be lower because the goods would be taxed as cross-border e-commerce goods instead of general trade goods. However, they still couldn't take them home on the spot. This is because with bonded transactions, consumers must submit the order, payment, and logistics information to China Customs and the China Inspection & Quarantine Bureau; they also have to pay the corresponding import duties as well.

Since there is a fair amount of information that must be submitted for the relevant authorities to approve the transaction, doing everything online makes things easier. The vast majority of CBEC stores employ this method, including Tmall Global and Netease Kaola, which set up stores in downtown Hangzhou in April 2018, each with 1,000 or so SKUs across cosmetics, fashion, maternity & baby, furniture, and food & beverages. They both offer same day delivery, if consumers live within a 5km radius of store locations.

This past May, Zhengzhou's e-commerce zone Zhongdamen also saw two new offline retail stores open up, operated by Little Red Book and Inagora, a cross-border e-commerce company that specializes in importing Japanese goods. However, goods are stocked in Zhengzhou's Henan Bonded Logistics Center nearby, and have to go through a shortened clearance process before consumers can pick them up. Inagora boasts 500 SKUs from leading Japanese brands, and Little Red Book reportedly offers a simplified 3-minute checkout process.



Tmall Global Hangzhou Store  
Credit: Sohu News



Netease Kaola Hangzhou Store  
Credit: Kaola Weibo Page



Inagora Zhengzhou Store, Little Red Book Zhengzhou Store  
Credit: Sina News

While the Zhongdamen trial VFTZ may provide a convenient shopping experience for customers to purchase cross-border, imported products, the mall itself is located in a distant suburb of Zhengzhou, requiring a 1.5 hour drive from the city center. It is also unclear how long it takes for the customers to pick up their goods as well, despite the fact that the bonded logistics center is close by.

**Offline CBEC Stores v2.0 – Cross-border E-commerce + New Retail**

Last but not least, you have the latest version of the offline CBEC store, in which consumers can view, purchase, and take home the latest imported goods. Thus far, Rainbow, a large department store chain, has been the most well-known example, having set up a test store in Shenzhen in March 2017, and later setting up an enormous 3,000 sqm store in July 2017. This store is located next to Shenzhen’s well-known Coastal City shopping complex and carries a whopping 3,000 SKUs. With a special certificate issued from the Shenzhen customs authorities, this store sells goods through three different ways: 1. General trade (import duties have already been paid), 2. General trade + bonded transaction (sell first, customers pay duty after), and 3. Cross-border bonded transactions, in which consumers have to submit the relevant information and cross-border e-commerce duties.

In the first two scenarios, consumers can pay on the spot and take home the imported goods they’ve purchased. The products stocked in the Rainbow store are either bonded products or duty-paid products. In the last scenario, customers still need to wait for parcels to be cleared from the bonded zone warehouses before picking up them up at the store or having them delivered directly to their home address.

Here’s a recap of some of the platforms that have opened up offline retail stores.

CBEC Offline Model	Platforms	City	Open Date	Store Size	# of SKUs	Type of SKUs Sold	Brands Represented	Logistics	Shipping Time
1.0	Good Import	Shanghai	Dec-14	N/A	N/A	N/A	N/A	Bonded warehouse	N/A
	MeijoyBest	Guangzhou	Jan-15	230 sqm	N/A	Maternity & baby, skincare, food	N/A	Bonded warehouse	N/A
	Mopark	Guangzhou	Apr-15	300 sqm	1000	Maternity & baby, health supplements, cosmetics & skincare	N/A	Bonded warehouse	N/A
	U-Pin Shop	Xiamen	Jan-16	400 sqm	N/A	Maternity & baby, cosmetics, general merchandise, health supplements	N/A	Bonded warehouse	N/A
1.5	Tmall Global	Hangzhou	Apr-18	300 sqm	1100	Cosmetics & skincare, maternity & baby, health supplements, fashion retail, furniture, food & beverages	Refa, Chloe, Pinko	Bonded warehouse	5km same day delivery (order before 2pm)
	Netease Kaola	Hangzhou	Apr-18	300 sqm	1000	Cosmetics, skincare, maternity & baby, luxury goods, electronics, athleticwear	Gucci, Miumiu, YSL, Philips	Bonded warehouse	5km same day delivery (order before 8pm)
	Inagora (豌豆公主)	Zhengzhou	May-18	N/A	500	Cosmetics, fashion, furniture, nutritional supplements, food, luggage & bags, maternity & baby goods	Hacci, Simplisse, Lion, Kincho, Ayura, DHC, Loft	Bonded warehouse	Same day pick-up
	Little Red Book	Zhengzhou	May-18	N/A	N/A	N/A	Redwin, Herbacin, Natio	Bonded warehouse	Same day pick-up
2.0	Rainbow	Shenzhen	Mar-17 Jul-17	100-3000 sqm	3000	Cosmetics, fashion, furniture, nutritional supplements, food, luggage & bags, maternity & baby goods	N/A	1. General Trade 2. General Trade + Bonded Transaction 3. Virtual Bonded Zone	Same day pick-up



### Why International Retailers Should Care

- There is always demand from consumers who predominately shop offline. For retailers that want to expand offline, the cross-border e-commerce model-powered VFTZ could be a potential route to sell offline.
- However, since the VFTZ model is still in testing phases, there are not many cross-border retail stores in major commercial areas to satisfy consumer demands for more convenient access. In the near future, brick-and-mortar practices will focus more on improving logistics and O2O services for Chinese haitao shoppers – which would allow people to order goods online and pick them up offline.
- The majority of products that can be accepted in the customs-regulated VFTZ still require a commercial license and registration certificate from the CFDA, which presents a barrier for international brands and retailers.
- For retailers and brands, the VFTZ's core function is to provide a physical space to showcase their products and provide an offline experience for customers. While the v2.0 VFTZ model is still far from perfect, it may still be a viable option for brands that are foraying into offline retail.