The Competitive Landscape for E-Commerce in China

Jeff Towson - Peking University

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Alibaba paved the way for the e-commerce revolution that has taken China by storm. Today, China is the largest e-commerce market in the world. Roughly 50% of global online transactions occur within China. To truly understand the Chinese competitive e-commerce landscape, we need to look into the consumer trends, the characteristics of the Chinese consumer, the Chinese marketplace, and the growth of internet users and fintech. Joining us for a discussion on the Chinese E-commerce competitive landscape

Jeff Towson— Keynote Speaker on Digital China and Asia, Head of Research at Asia Tech Strategy

US-China Series has been blessed to have leading authorities on many segments of the Chinese economy, but I struggle to find another with Jeff's knowledge of e-commerce and the digital landscape. His understanding of companies such as JD, Alibaba, and Pinduodou was exceptional, and our deep dive into these companies and their ecosystem provided insights into not only the prevailing competitive landscape but where the industry is likely headed in the years to come.

Chinese e-commerce has merged content, commerce, and social media into one platform. Traditional retailers like Walmart pitch themselves as places where one would buy what they need with extensive selections to choose from, and many e-commerce retailers have followed this model. In contrast, the shopping mall represents a different retail experience: one may go there for fun with friends and experience different things. China's e-commerce platforms follow this path, where Alibaba, JD, and Pinduoduo emphasize the experience as a big part of the equation. This includes content, live-streamers, videos, and offerings that merge with shopping.

We discuss the misnomer that is the idea of "Super Apps" as WeChat was an anomaly for China. Consumers will continue to use multiple apps. Choice and competition will ensure this. Local factors remain vitally important despite the size and scale of JD and Alibaba's logistics infrastructure. We look at the opportunities and challenges for Pinduoduo, Didi, and more broadly Grab as well as whether Baidu can turn around its low growth image and where it should be in this conversation.

No discussion is complete without addressing the elephant in the room that is regulation. A global push is underway to regulate mega-cap technology companies. In China's case, financial services have come under regulation, one particular example being Ant Group. How regulation impacts both fintech and e-commerce will be a key valuation driver in the quarters to come.

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E-Commerce: Background

Jeff Towson: Chinese e-commerce has merged content, commerce, and social media into one platform. Traditional retailers like Walmart pitch themselves as places where one would buy what they need with extensive selections to choose from, and many e-commerce retailers have followed this model. In contrast, the shopping mall represents a different retail experience: one may go there for fun with friends and experience different things. China's e-commerce platforms follow this path, where Alibaba, JD, and Pinduoduo emphasize the experience as a big part of the equation. This includes content, live-streamers, videos, and offerings that merge with shopping.

Pinduoduo, for instance, is experience first, where activity and engagement are primary metrics, followed by gross merchandising volume (GMV) and sales. And American platforms are trying to create a hybrid model that combines retail with experience as well. Facebook has moved into e-commerce, while Walmart tried to bid on TikTok to add content to their retail operations. So, while the US is somewhat on this path, China is quite advanced in capitalizing on the shopping model.

My work focuses on researching and analyzing tech strategy in Asia, and my angle is that strategy meets technology. While I may not follow Alibaba too closely on a quarter-by-quarter basis, I map out its business model and try to examine its future down the road. I look at questions of strategy and business models in several years.

Strategy coupled with technology involves many new things that become complicated, and Asia/China tends to be more dynamic in these domains. With high turnover in companies in Asia, one gets a very good sense of the competitive dynamics in technology.

Structural Advantages

Does the concept of the moat exist with Chinese companies?

Jeff Towson: Decades ago, strategists would have been talking about moats in the sense of stable business models. Strategy would be a question of scale and position: getting big and occupying a profitable position within an industry with structural advantages serves as a moat. That is what companies such as Coca-Cola did: becoming the best at selling soda.

In more dynamic industries where change happens quickly, structural advantages have replaced traditional moats. Netflix, American Express, and Alibaba all have new structural advantages that are quite powerful. Many old structural advantages are becoming obsolete: daily newspapers like the New York Times, which once had powerful business models, now suffer in the digital age.

There are two observable trends: firstly, the structural advantage is becoming more dynamic, and it must be constantly maintained. Advantages no longer last for decades, and they have to

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be built continuously. Secondly, there is an idea of operating speed, which some argue is the new scale. Fast innovation is a crucial component at this level.

The structural advantage is akin to the top of a pyramid, while operating speed forms the bottom half. Companies are trying to excel at both levels, building the best advantages while operating as fast as they can. Some companies, like Alibaba, are good at both: it has powerful structural advantages, and it is incredibly fast at the operational level. Tesla may be another example.

In short, this is a digital competition pyramid consisting of two levels: the top half is a structural advantage that gives strength and defensibility, while the bottom half is reliant on speed, coming up with new innovations all the time.

Operating Speeds

Do fast operating speeds — such as getting things to market —essentially come down to having the best people and attracting the best talent?

Jeff Towson: It is a combination of factors. At the top of the pyramid, operating activities and business models seldom go through quick changes. Within operating speed, companies choose a dimension to focus on, which may be innovation, adaptation, or rate of learning.

In some businesses, this involves people. Creative industries such as fashion and entertainment will involve human talent working at a fast, data-driven pace. Some companies may unveil new fashion once every six months, while Zara does so every six weeks. Other businesses do not rely on people and instead, use AI. Ant Group's financial services are one great example, while YouTube is similar in its content offerings. In these two cases, companies operate at a scale and speed that humans could never do. Companies need to understand who they are and what type of race they are running: they cannot be fast at everything.

Scale and the Super App

Discuss the notion of the Super App

Jeff Towson: The notion of a super app is misleading and does not exist. Some key points:

- WeChat was one example of a super app, but it was an anomaly related to China. There has not been another super app since, and in reality, most people will use many apps for different things.
- However, platforms do evolve in complexity. As businesses add more products to their offering, services expand similarly.
- For example, Alibaba has Taobao as a marketplace for merchants and buyers, Tudou for video streaming, and Alipay for payments. This is what is usually referred to as a digital giant, but calling it the "Alibaba ecosystem," "Alibaba economy," or "Alibaba super app" does not accurately describe something much more complicated.

- In the past, businesses run by people had a limit to their offerings. Companies could do not offer tens of thousands of different products, and businesses are defined by what they offer: shoes, soda, real estate, etc.
- Software-based business finds no limit with complexity: YouTube can offer billions of videos while Ant Financial can easily offer thousands of different banking products.
- Two product companies like Snickers and Mars that compete are akin to checkers; platforms like Lazada versus Shopify would compete as in a chess match; while ecosystems in competition are similar to 3D chess. In the last category, it is difficult to figure out all the dimensions and who will win.

In short, size and complexity are not problems for software, and we may see the emergence of these complicated businesses because there is the ability to scale up.

The Power of Logistics: JD

Is JD the true ecosystem because it has such a tremendous logistics network, and is Alibaba an ecosystem despite not having the same logistics network?

Jeff Towson: Alibaba and JD have different types of ecosystems. JD is asset-heavy, and it employs hundreds of thousands of employees and owns hundreds of warehouses. It is much more operationally intensive than Alibaba, which works through partnerships by building platforms and providing connectivity.

Both are doing logistics at a massive scale, guaranteeing next-day delivery across thousands of small cities in China. Both infrastructures took years to build and cost worth billions of dollars, and they are both competitive fortresses that few other companies can replicate.

Both companies benefit from Asia's population density, making logistics much more manageable and is helped along by low-cost labor. In contrast, the diffused nature of US suburbs and high labor costs are impediments to the logistics business, although Amazon has built a similar logistics business to JD.

Logistics is a powerful asset, and JD owns an infrastructure that allows outsiders to come in and leverage off this ecosystem. Should we think of logistics as another, separate platform?

Jeff Towson: There are several aspects to JD's logistics operation. Some key points:

- It is key for a company to have a system that is difficult to replicate. Companies like to be digital because their economics can be scaled at no cost; the danger is that it is easy for these systems to be replicated.
- Businesses that mix the digital and physical worlds are ideal. In JD's case, a marketplace platform software is accompanied by hundreds of warehouses, which can then be sold as a service to everyone in the form of JD Logistics, a B2B operation. While the economics is not as attractive, it is a model that cannot be easily reproduced.

- Amazon has a similar model, wherein the process of building servers to support its business, the company has managed to run that infrastructure as a separate business. That is how Amazon Web Services became a separate division and a powerful business in its own right.
- JD is advancing this logistics platform by standardizing the digital connections and infrastructure. Just as interstate railroads, if standardized, create a lot more economic value, JD is standardizing all the digital connections, robots, GPSs, and components to connect the whole system.

JD's potential is in a future where they will use this operating system for everyone who can run on this digitized logistics network.

If Alibaba does not have this logistics network in place, it will always run on a different system compared to JD?

Jeff Towson: JD and Alibaba run differently. Like Apple, JD pursues an integrated, controlled model where everything is built in-house. The benefit is greater control over quality at the cost of speed since everything has to be done by itself. Alibaba is approaching logistics in a modular way, just like Android, where anyone can write something for it. The experience on Android is not as good, but it grows much faster.

In summary, JD does everything in-house and creates an end-to-end experience, while Alibaba builds technical architecture, digital and data technologies, and works with many delivery companies and warehouses. Both companies will work fine as two national logistics smart networks in China. Both aim to go global, extending their supply chains to Europe and Asia.

There may be one or two other competitors to JD and Alibaba, but not more than a few. It is uncertain whether JD's and Alibaba's platforms can be classified as ecosystems or operating systems. It is too early to tell, as we have to wait and see what smart, digitized IoT meets AI logistics will look like.

Where does the dominance of two logistics networks like JD and Alibaba leave an upstart like Pinduoduo?

Jeff Towson: Retail is not a winner-takes-all space. Shopping malls, for instance, contain a range of stores, and there are dimensions in which retail brands differentiate themselves. The same could be said of e-commerce companies. Services that offer utility usually end up in a winner-takes-all situation, such as messaging apps in WhatsApp and WeChat or Zoom. In most parts of the world, express delivery is also dominated by several names like FedEx or DHL.

Some utility-service companies such as DiDi are trying to transform themselves into other areas beyond its original, single operation as a ride-hailing service. However, a company such as DiDi remains a utility service that works at the local level instead of an entire logistics network. Indeed, there are overlaps, and delivery could be considered a type of logistics. But a single-service company would find it difficult to compete with Alibaba, which merges offerings such as

products, services, and digital content altogether. Alibaba sees itself as the ultimate B2C marketplace.

Alibaba's Growth

Given that Alibaba is focused on both the consumers' and merchants' sides, including increasing their share in the consumer market while increasing the expenditure from merchants, which side will become more prominent in the next five years?

Jeff Towson: Alibaba's primary purpose is to help merchants and customers interact with each other, enabling transactions that otherwise would not be possible. The company must create value for both sides: for customers, it's their consumption, while merchants see benefits in logistics, payment, and marketing services.

Yet Alibaba's revenue comes mainly from the merchant side, and it generally earns little from consumers. This represents a larger fact of the digital world. Whereas traditional business dealt with transactions, the digital business creates values for the consumer in the form of services, media, and community. Nike sells shoes and builds a community of runners, and within this experience for consumers, it monetizes along the way the sales of shoes.

Companies are creating tremendous value for both customers and merchants, but mainly monetizing from the latter — such as in Alibaba's case — by offering the merchant services in exchange for a percentage fee.

Will cloud services be dominated by Alibaba, or will competitors such as JD inevitably compete?

Cloud services have a massive structural advantage in the form of scale. It is an innovation platform that others will build tools on, the same way that everyone built software that ran on Windows.

Currently, it seems that a few giants will dominate that cloud services: the US has Microsoft, Google, and Amazon, while China has Tencent and Alibaba, and finally, either Huawei or Baidu, both of which could be major players. This is where China and the US each have their three domestic champions, and both sides could compete for market share in regions such as Southeast Asia.

These companies recognize the importance of the cloud to them. For instance, in the case of Alibaba, Ali Cloud is one of its most important businesses in terms of future growth and Cainiao Logistics. And cloud services have gone beyond storage to including innovations in AI and prediction, all of which will be key to the digital infrastructure of the future.

Baidu's Potential

Should Baidu be on a list of the 20 most transformative companies in China?

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Jeff Towson: Despite its critics, Baidu's core business in search is immensely profitable. Some key points:

- Dominant search engines worldwide, including Google and regional companies such as Naver and Yandex, are all great businesses.
- As a business model, the monetization of pay-for-performance clicks is profitable but limited to its expansion, and Baidu is experiencing this slump. The revenue line will be flat despite the profitability.
- As a response, Baidu has made forays into video-streaming service iQIYI, which has not been profitable; food-delivery; and now self-driving cars, which may not be commercialized in the near future.
- The company can develop web services as a growth engine by leveraging its AI experience in search engines.
- But it seems that management has not been fast in innovating; it may be that there is less urgency to run fast given that their core business is so profitable. Facebook has experienced a similar problem where it has not created an innovative service in a decade.
- In contrast, the creators of ByteDance built dozens of apps, resulting in TikTok. Tencent has built its structural advantage by creating multiple platforms such as gaming, QQ, coins, messenger, WeChat, and video, among others.

Another sector that has undergone a similar divergence — where immensely profitable businesses hardly innovate — is travel. Airbnb has done little to innovate for almost a decade, while Ctrip innovates with content and live streaming.

Global Tech Regulation

A global push is underway to regulate mega-cap technology companies. In China's case, financial services have come under regulation, one particular example being Ant Group. How will regulation impact both fintech and e-commerce?

Jeff Towson: Instead of a standard narrative of governments versus big tech, it is better to look at this issue on a sector-by-sector basis.

Traditionally, e-commerce has not caught the attention of governments, although, in China's case, regulation has become restrictive from an antitrust perspective. There is the fear that platforms like Taobao have too much power over merchants, especially small ones. Any rule changes at the hands of these platforms leave vendors with little choice but to continue working with them. In these circumstances, the regulations so far have been relatively prudent and thoughtful.

Yet fintech and financial services are areas where the US, EU, India, and China have all been very active. China has been preoccupied with credit for some time: in 2010, shadow banking was a

significant risk to the entire country, where half of all loans were being given by unregulated private companies. In 2015, private lending created problems that the government then spent years trying to curb. Unsurprisingly, authorities intervened in Ant Group's IPO, which would have gone through while billions of loans were outstanding. The government's insistence that 30 percent of the loan value had to be held was a prudent stance, forbidding Alipay to leave off loans as mortgage securitization.

One type of regulation particularly unique to China is the control of media and information. China is unique in its strict control over Western platforms such as YouTube and Facebook, dominating an information ecosystem vastly different from the US or Europe. These restrictive measures are in line with what China has been doing: in 2015, the government stopped all-new gaming licenses because they were afraid of the content. So far, the regulation of media is a uniquely China story, and given its track record, it is nothing new.

And from a public market valuation standpoint, will regulatory action bring down multiples?

Jeff Towson: Yes, and perhaps it is not a bad outcome, as I am wary when tech companies expand into areas such as financial services and healthcare. From a social standpoint, it could be argued that there is little benefit in making it easier and faster to borrow. These considerations do not necessarily apply to e-commerce, where retail choices seldom touch upon societal issues.

Recent regulatory measures from other governments have come across as less sensible compared to China's actions. California's law that regulates the gig economy, for instance, toes the line of union policies; Australia forcing Facebook to pay newspaper publishers who are private; GDPR, which has done little but to prompt cookie acceptances on every page: these all make little sense and may have little impact on their respective markets.

Countries could opt to build their own technology and social media infrastructure, like India, where it has unlimited capital and intellectual capacity in the form of its diaspora.

Jeff Towson: Rather than techno-nationalism — since technology in its global form is beneficial — I would call it a form of info-nationalism. Consider that the vast majority of information on smartphones is not chosen by the individual but rather curated on social media platforms. That curation and control are currently dominated by a cartel of several companies in Silicon Valley.

Instead of algorithms created by these tech companies, better results may come from national authorities — an individual or company —that curate content. Google and Facebook, for instance, should enlist local partners who may decide what type of content is allowed in India. India may be at the forefront of this movement, where it has banned companies and apps that impact its information flow in a major aspect. All in all, it comes down to decisions that elevate certain information and not others, resulting from curation, which requires cultural decisions.

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