Pity the parcel people

Online sales are booming in China. But where are the profits?

It is “one of the few bright spots in the Chinese economy,” says Zeng Ming. He is talking about e-commerce. Mr Zeng, the chief strategy officer for Alibaba, a giant Chinese internet firm, predicts that digital transactions on his firm’s platforms will top 1 trillion yuan ($159 billion) this year—more than Amazon’s and eBay’s combined. That is a bold claim; but consider what happened on Singles Sunday.

Invented a few years ago by students and seized upon by digital marketers, this festival for lonely hearts falls annually on the 11th day of the 11th month (since 1 is the loneliest number). It is like St Valentine’s Day, only worse. Singletons shower each other with tender gifts: a barrage of pearls; a storm of sweets.

This November 11th they spent a staggering 19 billion yuan on Alibaba’s online platforms—a fourfold increase on a year ago, and more than double what Americans spent online last Cyber Monday (the Monday after Thanksgiving, when retailers urge Americans to shop online). More than 100m purchases were logged, accounting for 80% of the packages shipped that day. Couriers were buried in parcels.

So life is good for China’s etailers, then? Not exactly. The number of digital marketers is increasing and online sales are booming (see chart). Consumers are enjoying lower prices, better service and more variety. The problem? The pressure on margins in Chinese e-commerce is worse than in America, reckons Elinor Leung of CLSA, a broker. “Almost no one makes money,” she says.

The fiercest battles are being fought between online retailers and their bricks-and-mortar rivals. Dangdang, a firm that resembles Amazon, and 360buy, another online retailer, have cut prices ferociously. Tencent, a cash-rich online giant known for its instant-messaging software, is splashing out to win market share. 360buy has also just raised $400m from investors to do the same. But it is unclear how much longer such firms can burn through capital.

That is especially so since physical retailers are fighting back. Walmart has increased its stake in Yihaodian, a local e-commerce firm. Jeff Walters of BCG, a consultancy, argues that in a good year a retailer like Walmart could open 40-50 physical stores, just a sliver of the Chinese market, “which is why e-commerce is so important for them here”. Many Western rivals have

flopped in China with the big-box strategy; including, most recently, Best Buy (an electronics chain) and Home Depot (a do-it-yourself shop).

Suning and Gome, big Chinese high-street electronics stores, are putting an expanded range of products on their websites. Alan Lau of McKinsey & Co, a consultancy, says they are also pushing manufacturers to stop offering etailers such big discounts. He estimates that in 2011 computers and handsets sold online were 12% cheaper than in stores; this year they are only 7% cheaper. As the gap gets smaller, so do nearly everyone's margins.

The great exception is Alibaba, which handles nearly three-quarters of China's e-commerce. Because its Taobao (consumer-to-consumer) and Tmall (business-to-consumer) platforms connect buyers and sellers, the firm does not carry the cost of logistics or inventory. It makes none of the products it sells. (American officials have branded it a "notorious" counterfeit market, a charge Alibaba deems unfair.) It makes money chiefly through advertisements, not user fees, a model that works thanks to its dominant position.

Privately held Alibaba does not discuss its finances, but Yahoo! owns a stake (which it is winding down). The American internet firm's disclosures this month reveal that Alibaba's revenues nearly doubled year-on-year, to $2.9 billion for the three quarters ending in June. Its profits tripled to $730m over that period.

Alibaba is bullish. In China e-commerce already accounts for nearly 5% of total retail sales, roughly the same as in America. But its potential is greater, argues the firm. In America, physical retailers are already efficient and everywhere. In China, they are highly fragmented, inefficient and barely visible outside big cities. So etailers could leapfrog them.

Mr Zeng notes that legions of Chinese have yet to go online. As they do so, Alibaba will be watching, recording and analysing their shopping habits. The firm is devising a "big data" strategy. It hopes to help vendors harness customer information quickly and share insights among themselves. This could allow them to accelerate product-design cycles.

The firm's lofty ambition is to help China move towards "mass customisation" and "user-generated innovation"—turning trendy jargon into reality. "The entire supply chain will sit on e-commerce," insists Mr Zeng. "It will be not just a tool, but the heart of the entire economy."

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