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# Boao Review

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## The Growing Importance of E-Commerce in China

### The legal framework and accessibility to the Internet



**Authors:** Cristiano Rizzi and E.E. Lehman

**Overview:** E-commerce represents a huge business opportunity in China, due to the large percentage of internet users in the population, their consumption patterns, improved internet and Wi-Fi accessibility, and most importantly, the favorable legislation environment.

**Rating:** ★★★★★

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The "booming" of e-commerce in China contributes to internal consumptions, helping to sustain the economy. Broadly, e-commerce means doing business over the Internet, selling goods and services delivered off-line as well as products which can be 'digitized' and delivered on-line. This form of commerce experienced a rapid growth in the last two years and it is expected to expand further in future.

The growing importance of e-commerce and the spreading of the Internet have pushed legislators, both national and international, to adopt new legal instruments to accommodate it and to foster its development. No single government or nation can completely regulate electronic commerce. Co-operation amongst States is necessary in order to harmonize the existing rules and to give that certainty and predictability that business activity needs when taking place over the "Net". Today the Internet, and in particular e-commerce, is the foundation for all business practices. It allows companies to establish a global presence, which is of paramount importance for relatively small and newly established entities who want to engage in cross-border trade. This electronic medium offers many possibilities: (i) reducing operational cost; (ii) increasing efficiency due to increased precision and speed; (iii) expanding access to local, national or international markets; (iv) allowing personalized products and services to be offered; (v) allowing specialized marketing due to the many databases available. Forward-thinking companies have opened their own websites to increase and enhance their business and efficiency.

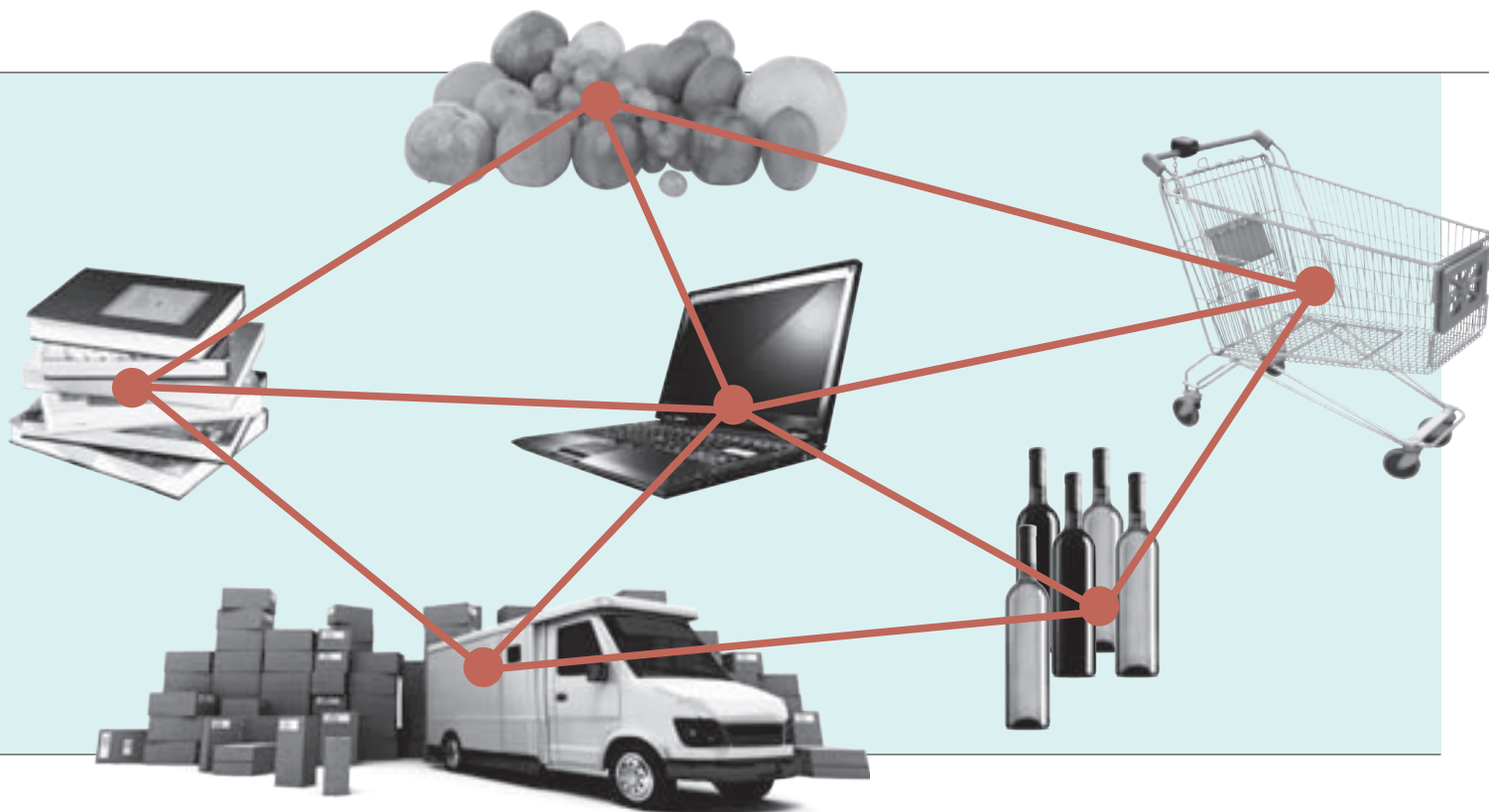
This new way to conduct business is literally changing the material marketplace in China (and be-

yond). The legal environment in which e-commerce is developing, and the instruments adopted in order to regulate it, have an important role to play in realizing its full potential.

#### General panorama of e-commerce regulations in China

The current legal system for on-line transactions is governed mainly by the SAIC's "Interim Measures for the Administration of On-line Commodity Trading and Relevant Services Activities" (hereafter the "Measures" ), which took effect on 1 July 2010. The scope of the Measures is to regulate behavior in on-line commodity trading, to safeguard market order in on-line commodity trading, and to guarantee the legitimate rights and interest of both the consumers and the business operators in on-line trading. A more comprehensive legal framework a 12-article National People's Congress Standing Committee Decision concerning Strengthening Network Information Protection, passed on 28 December 2012, having the same legal effect as a law. The aim of these rules is to enhance the protection of personal information online and safeguard public interests, requiring Internet users to use real names to identify themselves to service providers when signing web access agreements. The decision includes an identity management policy requiring Internet users to use their real names to identify themselves to service providers, including Internet or telecommunications operators. Other pieces of legislation related to e-commerce and data protection in China are:

(i) *The Several Provisions on Regulating Market Orders*



of *Internet Information Services*, issued by the Ministry of Industry and Information Technology of the PRC (MIIT Provisions), which took effect on March 15, 2012;

(ii) *Information Security Technology – Guide of Personal Information Protection*, issued jointly by the General Administration of Quality Supervision Inspection and Quarantine and the Standardization Administration of the PRC on 30 January 2011;

(iii) "Circular on the Regulation of Sales Promotion of Online Purchases" issued January 2011, and "Guiding Opinion on the Development of Electronic Commerce in the 12th Five year Plan Period" by the Ministry of Commerce (October 2011).

Then we have also to consider:

(i) *Law on the Protection of the Rights and Interests of Consumers* (i.e. *Consumer Code*) adopted by the State Council in 1993; there also exists a political decision, namely

(ii) *the Decision on Safeguarding Internet Security* (adopted at the 19th Session of the Standing Committee, December 28, 2000), which clearly lays down the prohibition to sell fakes or poor quality products, or to promote products and services in a misleading way.

Further consumer protection rights are provided by *Product Quality Law* (revised in 2000); *Standardization Law of the People's Republic of China*; *the Price Law of the People's Republic of China*; *the Anti-Unfair Competition Law*; *the Advertising Law*, and *the Trademark Law*. The majority of these acts apply to on-line transactions. Therefore, it must be noted that the laws and regulations regulating physical transactions still serve as the legal basis for on-line transactions.

### Understanding Chinese online consumers and their behavior

Selling here in China can be a difficult task, requiring patience (more than in other countries), resources and commitment. Businesses willing to expand their presence in China through on-line sales should understand the preferences of the locals and consequently adapt their products and offers.

It is also important to note that most Chinese consumers are highly sensitive to price. In a society where social status is an investment, some buyers are willing to pay a premium for items that will be seen by others such as clothes, mobile phones or cars, as the display of a personal success. Unlike their counterparts in the West, Chinese customers on average are looking for inexpensive products that are of good quality materials; and they look for companies that offer post sales support and/or a guarantee. Indeed, a physical presence in China instills more confidence among potential customers who can establish a direct contact with their favorite brand.

However, as Chinese population varies greatly in taste, income and purchasing behavior, before deciding what to sell, foreign companies should define their targets or segment of potential consumers. Currently, China's growing middle class, making up 25% of the entire population, having an income between \$7,250 and \$62,500 a year and holding post secondary degrees (National Bureau of Statistics), are looking for value at a bargain price except when it comes to their children's education and health. After recent health risk scandals related to toys produced in China, parents have become highly concerned about product >>



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safety and are willing to spend 20% more on products they feel are safer for their children. In any case, this new wealthy class offers vast opportunities for luxury brands looking to sell or expand their presence in China.

The wealthy singles, on the other hand, spend much of their discretionary income on products that will help them raise their position or *status* in society. China is already the second largest consumer of luxury goods, with an untapped demand for high end cars, real estate and designer clothes and other expensive products. As new spending habits are formed, foreign luxury brands such as Louis Vuitton, Rolex and Giorgio Armani are taking notice and high end luxury brand stores are already doing well in Beijing, Shanghai and Guangzhou.

### **The Internet's impact on Chinese life and the future of e-commerce legislation**

The impressive increase in the rate of Internet users in China is the result of China's on-line communication infrastructure improvements as well as a general increase in computer skill. According to China Internet Network Information Center, there are more than half a billion Internet users in China, about half younger than 25 years old, many linking to the 'Net' through wireless device, including tablet PCs and in particular smart phones. According to the research company IHS iSuppli, the number of smart phones shipments within China in 2012 was estimated to be 164 million. In Beijing, according to the Beijing Economic and Information Technology Committee, the whole city will be covered with free high speed Internet access in about three years and Beijing will build more than 200,000 wireless access points.

In 2012, in Shanghai, China Telecom and the coffee chain Starbucks jointly put out free Wi-Fi hotspots across the city at more than 200 Starbucks shops. Moreover, Shanghai as part of the i-Shanghai project, it is expected to become a fully operational wireless city by 2015 (in line with the directives of the new five years plan). In an effort to reach the majority of the citizens, the Shanghai municipal government has been reported to be working on installing wireless access point at bus stops and soon on buses. In other parts of China, wireless and transportation has become a hot topic, for example Beijing, Hong Kong and Guangzhou authorities also have added wireless devices to bus stops so people not only can check the status of their bus, but passengers are also able to connect to the Internet with their devices.

The Internet is highly important for economic growth and it represents a unique market place in terms of market penetration. Furthermore, it reduces the economic barriers to entry into commerce. Any computer, anywhere in the world, connected to the "Net" can access a web site and may conclude an electronic transaction. An

electronic transaction has to be respected and valued in the same manner as a written or oral contract. This is why it is necessary to establish a predictable and precise legal system governing electronic transactions. This new way of doing business, which represents, in a sense, a new channel of distribution, has to be fully exploited by firms willing to expand not only their presence in China, but also to boost their sales here.

China has put at the core of its new five years plan, in order to sustain its economy, "consumption", which can be achieved if more attention is given to e-commerce. In fact, it seems the Chinese legislator, in order to grasp the full potential offered by e-commerce, is rationalizing the framework regulating e-commerce.

There is no doubt that e-commerce represents one of the key strategies to expand or to accelerate sales in China. Indeed, a report by Forrester Research Inc. stresses that China is Asia's top market for electronic retail, where e-commerce is expected to generate more than \$170 billion in 2013 and e-commerce sales are set to grow 20% annually to reach \$356 billion by 2016. However, approximately 40% only of on-line Chinese consumers shop through the Internet today. This represents an enormous opportunity: e-commerce in China has the potential to surpass that of any other market in less than four years, especially if we consider that when the U.S. on-line retail market was roughly the same size as China is today, it was growing at a fraction of the pace of the Chinese on-line market.

As e-commerce grows in importance and due to the fact that in a few years time a substantial percentage of both commercial (B2B transactions) and consumer contracts (B2C transactions) will be concluded through the Internet, the legal framework governing both the Internet and e-commerce is of particular importance. The legal instruments regulating the "Net", and in particular e-commerce should, in fact, create a climate able to foster the growth of the latter rather than impede its development.

Although the current legal framework governing e-commerce in China is effective and it seems to respond well to the necessities of business activity it still needs to be refined and rationalized. This is why new initiatives have been put in motion. It seems there is the necessity to create a new set of rules for a more secure legal environment, which is of basic importance for instilling confidence among consumers, and providing the predictability needed by business activities carried out through the Internet. ■