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## Book

# China : structural reform in the retail services sector

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*Reference:* (2017). China : structural reform in the retail services sector. Singapore : Asia-Pacific Economic Cooperation Policy Support Unit.

This Version is available at:

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**Asia-Pacific  
Economic Cooperation**

**Advancing** Free Trade  
for Asia-Pacific **Prosperity**

# China: Structural Reform in the Retail Services Sector

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**APEC Policy Support Unit**  
**May 2017**

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Produced for:  
Economic Committee  
Asia-Pacific Economic Cooperation

APEC#217-SE-01.7



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This paper was first published in the APEC Economic Policy Report 2016, under publication number APEC#216-EC-01.1.

The views expressed in this paper are those of the authors and do not necessarily represent those of the APEC Member Economies.

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# 1. INTRODUCTION

The study documents and assesses the process and impact of structural reform in the retail services sector in China and the flow on effects into other goods and services sectors and across the entire economy. The structural reforms involved were initially policy-driven as a result of market-opening commitments on China's accession to the WTO. Commencing in an experimental manner in 1992 and phased in fully after WTO accession in 2001, these reforms centred on opening up to commercial presence of foreign retailers.

The reforms had far reaching impacts of various kinds not only on local small and medium-sized retailers (SMEs) but also on growth and employment across the retail sector more generally. Major effects were experienced by SME goods suppliers accessing the new and increasingly efficient domestic business-to-business (B2B) supply chains for produce of all kinds into the retail sector. Chinese consumers also benefitted by way of greater choice of consumer goods at lower prices, in wider geographic regions, with more attractive embedded services and higher product quality.

The story does not end there. Ongoing radical structural reform in the retail sector is underway everywhere in the world as consumers increasingly shift from "bricks and mortar" towards online electronic retail (e-tail) platforms. While e-tail has a higher penetration rate in some other APEC members, the sheer number and rapid increase of Chinese consumers gives special significance to this transition to electronic commerce (e-commerce) in China, Chinese online services providers such as Alibaba are rapidly proving highly competitive not only in China but in the global markets. In this very dynamic traditionally business-to-consumer (B2C) sector, other disruptive technologies such as the sharing economy, consumer-to-consumer (C2C) transactions and 3D printing (3DP) are already presenting additional challenges impacting on the retail value chain, generating both threats and new opportunities for services providers. This ongoing technology-driven structural change presents new regulatory challenges of its own, and is driving major new flow-on effects in other sectors such as financial services (especially electronic and mobile payments systems) and transportation. Unlike traditional retail, which is focused on goods transactions, e-tail involves transactions in both goods and services - and a wider variety of potential regulatory rethink.

The study points to some successful strategies in sequencing and managing policy and regulatory reform in the retail sector over a period which has seen China both open up to the rest of the world, reconsider its regulatory approach in the face of technological transformation, and respond in new ways to take advantage of emerging domestic and global market opportunities. Consideration is given to potential next steps in the reform process against the background of intensifying technological change and its evolving impact on business models in the distribution services sector.

Methodological elements include value chain mapping as a means to help identify the backward and forward flow of regulatory reform impacts across many sectors of the economy. Quantitative analysis is based on sectoral and firm level data from China's national accounts, OECD/WTO Trade in Value-Added (TiVA) data, and the OECD and World Bank Services Trade Restrictiveness Indices (STRI).

## 2. GLOBAL TRENDS IN RETAILING

### 2.1 TRADITIONAL ROLE OF RETAIL

Distribution services are a dynamic high value-added downstream activity, occupying - in value chain terms - a strategic position along the pathway to market, connecting goods and services to final consumers. In what has traditionally been a B2C market, virtually every good makes its way through distributors; wholesalers, retailers, commissioned agents and franchisers who provide the domestic infrastructure for reaching final consumers.

**Figure 2.1.1: Traditional Retail Value Chain**



The value added in the distribution stages can greatly exceed the value added in production; the value created in distribution accounts for example for 70 percent of the total value for textiles and over 75 percent for food products, according to UNCTAD<sup>1</sup>. A well-developed efficient retailing system supports the welfare of all economies through, inter alia lower consumer prices and greater choice and availability of products.

In some economies, including a number of developing economies in the APEC region, retail is the largest industry in terms of both share of output and employment. Even for OECD economies, studies in the 1990s suggest the sector accounts typically for around 13-17 percent of employment, 25-30 percent of business activity and 8-17 percent of GDP. Within distribution, the bulk of these contributions come from retail rather than wholesale.<sup>2</sup>

Once a sector comprised typically only of SMEs, dependent on their suppliers, the retailing sector has seen, since the 1990s, a rapid process of market concentration, as well as vertical integration of wholesale and retail, resulting in retailers now figuring among the largest national firms (Walmart, Carrefour, Tesco, Aldi etc.). Even though the role of modern retail increases as economies develop, SMEs retain nevertheless an important role.

The recent concentration experienced in the sector globally, plus a progressive expansion of retailers' own-label products, has significantly shifted the balance of power in consumer goods distribution from the supplier to the retail chain. Add to this the innovation associated with IT-enabled retail systems, and retailers have emerged as the lead firms in increasingly "buyer-driven" supply chains. Integrated logistics and supply chain management methods have also enabled the adoption of "just-in-time" demand-pull supply systems - systems which have linked reordering with real-time purchases. This has enabled the adoption of "lean retailing" practices, allowing big reductions in inventory holdings and in the capital tied up in those holdings.

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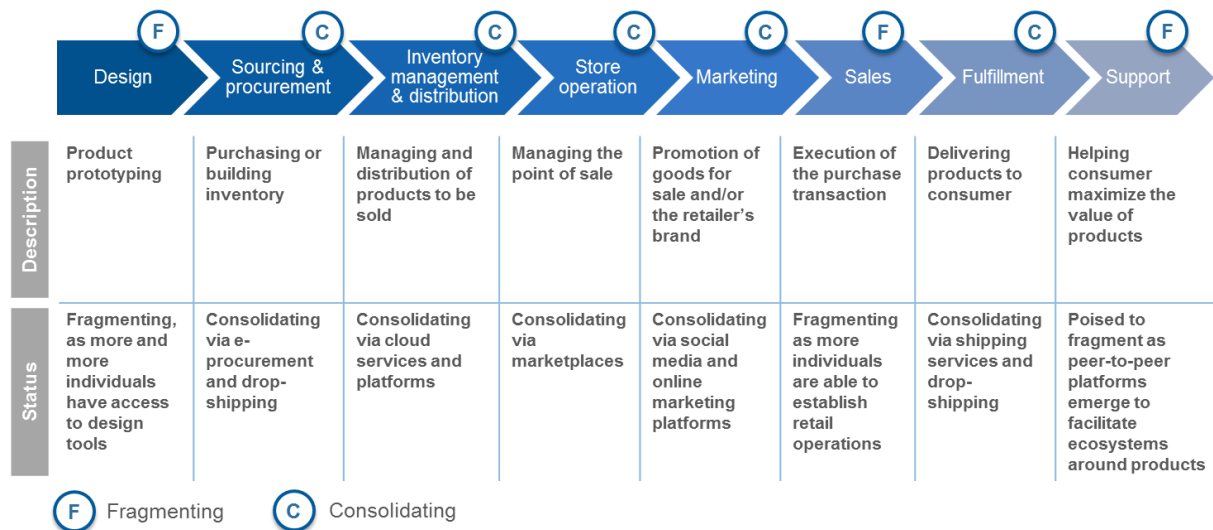
<sup>1</sup> UNCTAD, 2013, Global Value Chains and Development; Investment and Value-added Trade in the Global Economy, Geneva

<sup>2</sup> See for example OECD, 2000 Employment Outlook, Paris

These various developments have led to what is generally called Modern Retailing or Organised Retailing, in which order acquisition, order execution, promotions and launches, transport and payment processes are all done very differently from the way they are handled by the traditional “mom and pop” stores. Figure 2.1.2 highlights the growing importance in many stages of the transforming retail value chain of telecommunications and ICT services.

**Figure 2.1.2: Evolution of the Modern Retail Value Chain**

### The traditional retail value chain – consolidation and fragmentation



## 2.2 INTERNATIONALIZATION OF RETAIL

From the mid-1990s, the transformed modern retail firms of a small number of OECD economies began a period of sustained international activity – as exporters of retail expertise, chiefly via mode 3 (commercial presence) but also via mode 1, in particular franchising.<sup>3</sup> The late 1990s saw a rapid increase in retail FDI, largely by European and US retailers and primarily into East Asia, Latin America and Central and Eastern Europe.

By the late 2000s, multinational retailing had become substantial; 8 of the world's top 15 retailers derived over 50 percent of their sales outside their home economy and on average they traded in 18 different host markets, with several leading firms operating in as many as 30.

Within retail, it is food and fast moving consumer goods that account for the biggest sales. And it is the retailers of these items, loosely described as “grocery” that are also leading the globalisation push. If leading global retailers are ranked on the basis of their annual international sales (rather than on total annual sales), then by 2008, all but one of the top 10 largest retailers were “grocery” retailers – the exception being Ikea. After the “grocers” come the specialty “hardline and leisure” retailers (1/3 of the top 20) and then the home improvement, office, toys and electronics retailers (56 of the top 250 retailers). Next come the “fashion goods” retailers; despite being the group with the highest percentage earnings from global activity,

<sup>3</sup> Franchising is generally considered as Mode 1 (cross-border) supply of services rather than Mode 3 (commercial presence) because it involves no investment of capital by the foreign franchisor but rather a cross-border (electronic) provision of brand and associated business model and technology.

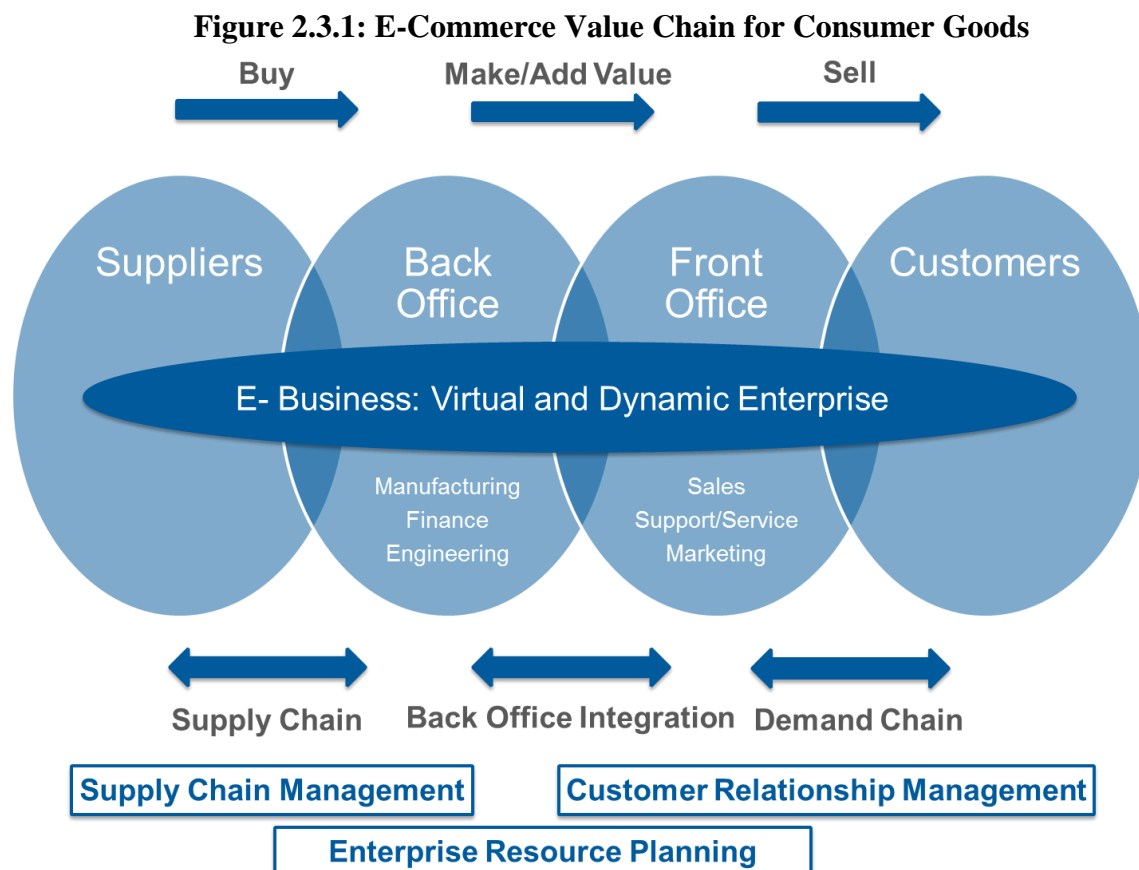


none of these, not even LVMH, H&M etc., have sufficiently large international sales to put them in the top 20 group.

One study (Dawson 2007) which looked at the top global 100 retailers, showed the average number of economies in which they operate has increased from 2.8 in 1986 to 5.5 in 1996 and 10 in 2004. A study of Deloitte's largest 250 retailers, showed that in 2005, international sales accounted for less than 15 percent of total sales; by 2008 this had increased to 23 percent. The globalisation process has also seen the emergence of some large transnationals which in addition to expanding their network of stores in emerging markets, have also put into place extensive networks of regional and global sourcing.

## 2.3 FROM RETAIL TO E-TAIL

Ongoing radical structural reform in the retail sector is underway in all parts of the world as consumers increasingly shift from "bricks and mortar" towards online "e-tail" platforms and "omni-channel" retail. Market research firm eMarketer projects e-commerce sales to exceed USD3.5 trillion within the next five years. The web accounted for more than 7 percent of global retail sales in 2015 and is expected to grow beyond 12 percent by 2019. According to eMarketer, the fast-growing Asia-Pacific market fueled a 25 percent year-over-year increase in global e-commerce in 2015. Much of that growth is sourced from consumers in rural areas making online purchases from mobile phones. This is discussed in detail in the next section. The essential point to note here is the associated dramatic shift in the nature of and extent of new players in the e-tail value chain.



## 2.4 POTENTIAL DISRUPTION FROM 3D PRINTING

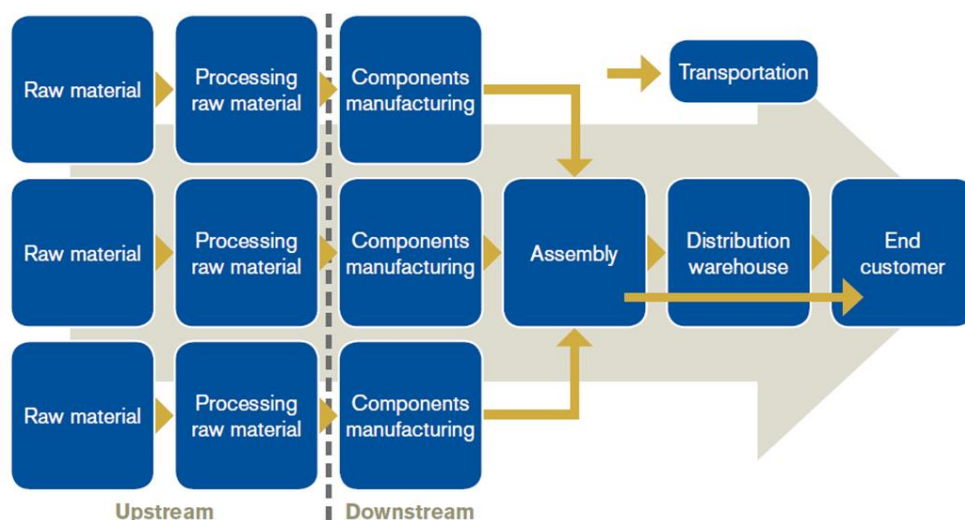
3D printing (3DP) is potentially highly disruptive of both traditional retail as well as e-tail of consumer goods. 3DP is a technology that builds physical objects directly from 3D computer-aided design (CAD) data and adds different materials, layer-by-layer, with the help of a 3D printer. With 3DP certain stages of manufacturing are bundled into one and certain transportation of goods is replaced by transmission of data.

In 3DP, the creation and transfer of the CAD-file is the essential component and the main difference between 3DP and traditional manufacturing. There are almost no economies of scale so complexity is almost cost-free. The cost-advantage of manufacturing large quantities is removed and allows for profitable printing of smaller numbers. Additionally, the cost-disadvantage of making complex goods is reduced as 3DP makes it almost as easy to design complex items as it is simple ones. These features allow for moving manufacturing (printing) closer to the consumer (near-shoring) and for more adaption to the individual's needs.

3DP changes the production process by removing the need for intermediate goods beyond the “ink” and by allowing manufacturing to move closer to consumers. Intermediate goods are replaced by CAD-files, hereby adding a central digital input (a service) to the process. The goods components of consumer goods value chains are likely to be made shorter; the services components however might become much longer? Business interviews conducted with Li and Fung Ltd in Hong Kong, China suggest that one consequence is that the large scale retailers will outsource the design stage rather than the making or manufacturing stage in the procurement of merchandise.

3DP will therefore allow for new companies, to enter the value chain. This includes SME designers of CAD-files and companies running platforms where these files are created and traded and new producers (that start producing goods on a small scale for niche markets). Different types of firms are already emerging, such as print shops and “FabLabs”, where customers can have items developed and printed. On the input side, new “ink” producers are also emerging. Figures 2.4.1 to 2.4.3 illustrate the likely evolution of the value chain.

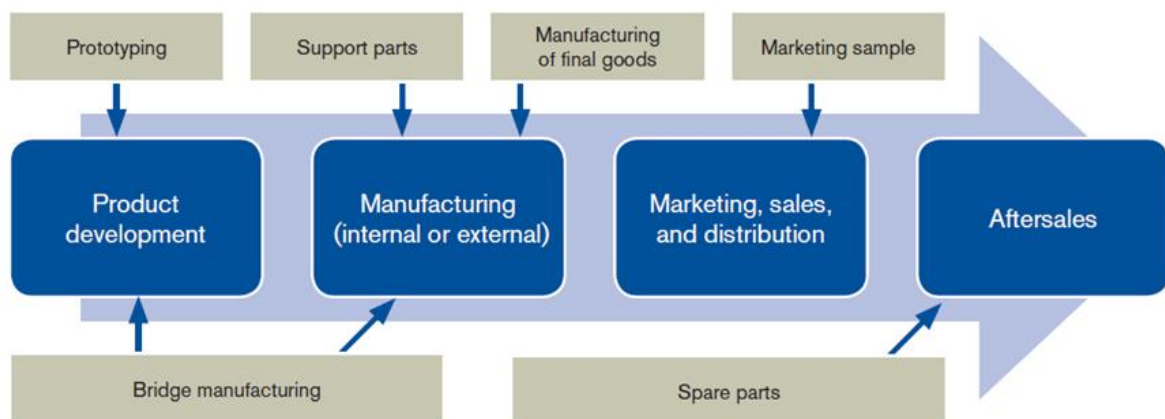
**Figure 2.4.1: Traditional simplified manufacturing value chain, pre 3DP**



Note: From assembly the product can be distributed directly to end customer or more commonly to the customer via distribution centres.  
Source and Graphics: National Board of Trade Sweden

Source: Swedish National Board of Trade “Trade Regulations in a 3D printed World”

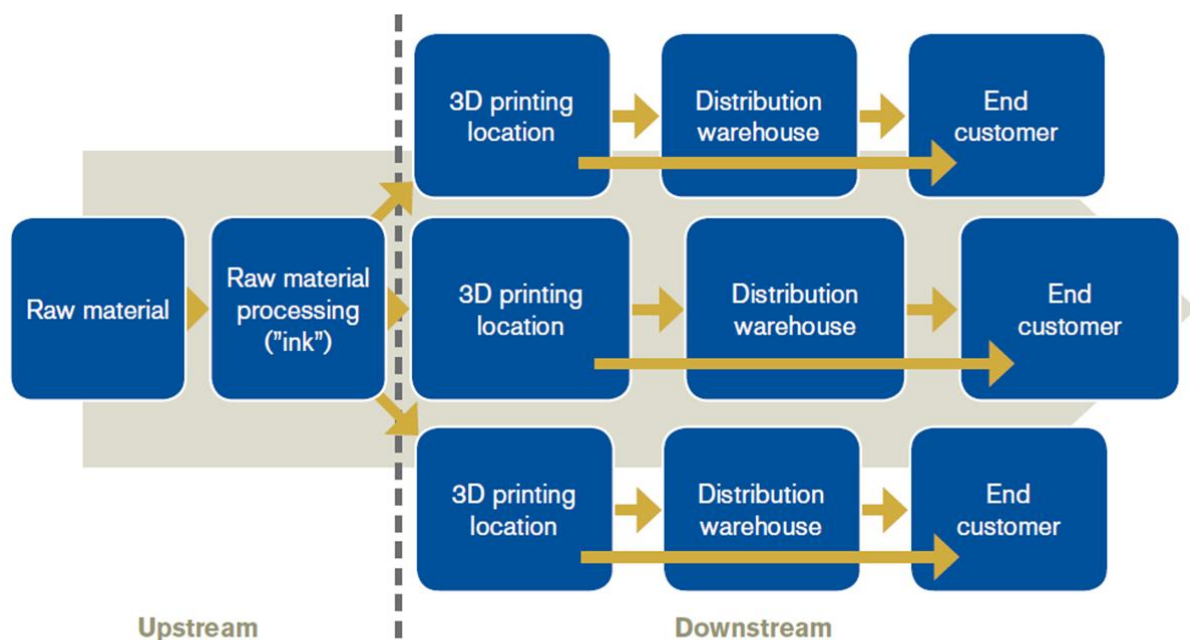
**Figure 2.4.2: Insertion of 3DP into the goods production chain**



Source: Additively.com Graphics: National Board of Trade Sweden

Source: Swedish National Board of Trade “Trade Regulations in a 3D printed World”

**Figure 2.4.3: Mapping the new 3D printed goods value chains**



Note: From 3D printing location, the printed good can be shipped directly to end customer or via distribution centre.

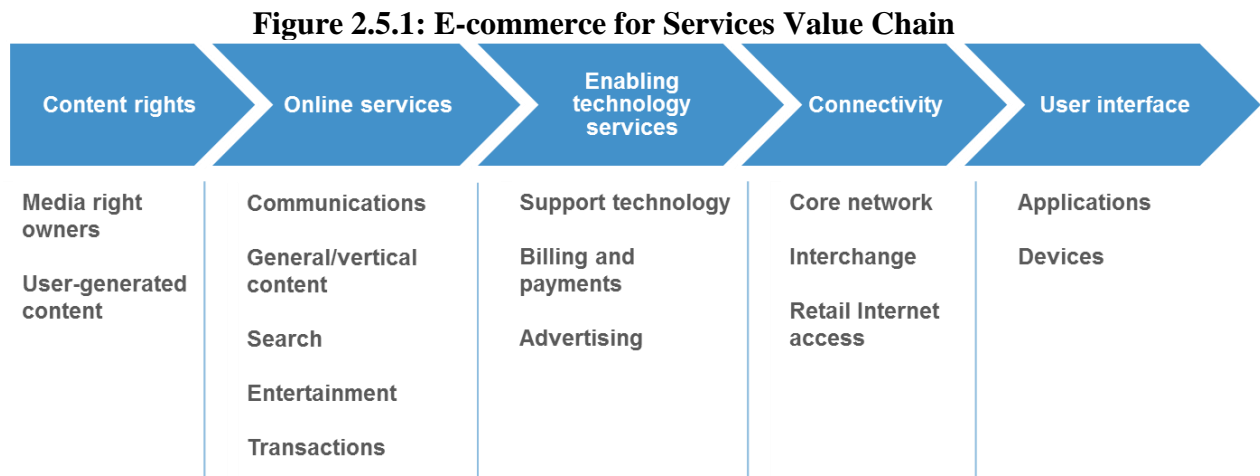
Source and Graphics: National Board of Trade Sweden

Source: Swedish National Board of Trade “Trade Regulations in a 3D printed World”

Another anticipated consequence is that by 2025 there will be much reduced cross-border trade in goods. This means a significant alteration in the cross-border components of the retail value chain is likely to take place. Numerous domestic regulatory challenges are likely to arise, including with respect to the interpretation of the borderline between what is a good and a service under the WTO.

## 2.5 E-COMMERCE, INCLUDING CROSS-BORDER, FOR SERVICES

As is the case for all trade in services, measurement of cross-border e-commerce in services is problematic. And the need or not for regulation is another hot topic. The point to note here is simply that the value chain again is morphing, and new corporate players are participating. Figure 2.5.1 illustrates the nature of the evolving value chain.



## 2.6 BARRIERS TO TRADE IN RETAIL

Globalisation has not been without its challenges. Trade barriers exist in the retail and other distribution sector and these have been prevalent in all parts of the world: typical barriers are listed in Box 1. In some cases, local industry and consumer stakeholders have lobbied governments to retain these barriers chiefly due to concerns about increased imports of goods from foreign suppliers into the local retail supply chains.

### Box 1: Typical barriers to trade in retail and other distribution services

- restrictions on investment in certain sectors or with respect to certain goods or services;
- foreign ownership caps;
- limitations on ownership, location, and store size;
- limitations related to special sales, prices, and operating hours;
- burdensome authorization/licensing procedures, discriminatory inspections;
- lack of transparency with regard to rule of law; and economic needs tests.

In general, global experience is that despite the penetration from global retailers, including their success in progressing from urban niches of predominantly relatively wealthy consumers to smaller cities and rural towns and to serving the relatively poorer consumer, and despite their success in adapting and broadening their product range even into fresh food, the reality is that while the traditional/informal sector has been squeezed, the process of opening up to modernisation of the sector has not meant loss of all national retailers.

On the contrary, global firms rarely dominate the local market in any of the emerging markets. This is only partly the result of regulatory intervention. Indigenous retailers have been successful in emulating imported innovations and best practices and strong resistance has been

shown by the informal retail channels which retain their popularity, including wet markets and street markets.

The global giants are also under pressure from the next tier of globalised retailers which perhaps have greater cultural “embeddedness” and institutional familiarity or deeper experience with local real estate and land-use zoning practices, enabling them to expand their regional footprint; for example firms like Shoprite or DairyFarm.

The huge recent growth of cross-border e-commerce platforms has further radically altered the nature of trade in retail services.

On-line web-based retail and payments platforms such as eBay and PayPal have opened up major new export opportunities for SME retailers, who benefit from the removal of the “middleman”. Of the firms doing business on eBay – many with fewer than 5 employees – 97 percent of those with more than USD10,000 in annual sales sell their goods internationally. Ebay estimates that if the logistics costs associated with order fulfilment were reduced, SMEs could experience a 60-80 percent increase in cross-border e-commerce sales, equivalent to a USD4.8 to US6.4 billion in trade.<sup>4</sup>

Larger retailers have their own websites, but also use platforms such as eBay. Multi-channel retailing (“bricks and clicks”) seems to be the route that even the largest global retailers now prefer to take. This makes sense, as consumers clearly prefer choice. Some business stakeholders also claim however that multi-channel retailing is partly a business response to barriers to trade imposed on retailers, a way of hedging against different forms of protection.

Indeed the list of trade barriers to e-tail differs significantly from that set out in Box 1 with respect to retail. In essence this is due to the evolution described above in the retail value chain and the need to take new components of the value chain into account. Naturally the list of barriers needs to include a variety of additional elements in relation to the functioning and regulation of the local internet economy which impact on the manner in which foreign retailers can enter and participate in the various aspects of the e-tail market. This includes all kinds of restrictions affecting both retailer and consumer access to search engines, to e-commerce platforms, to e-payment and m-payment systems as well as restrictions affecting digital content and freedom of data flows. The list also needs to be expanded to restrictions impacting on transport and logistics which similarly can have the effect of limiting foreign access to the e-tail market.

One thing that is quite clear is that online platforms for international e-commerce are now here to stay. And Asia has become a market leader. In the global market, Alibaba for example is now larger than both Amazon and eBay combined. New opportunities for SMEs are arising, as consumer uptake of e-commerce continues to disrupt traditional retail. Business pressure for further market opening is therefore strong.

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<sup>4</sup> World Economic Forum (in collaboration with Bain & Company and the World Bank). 2013. *Enabling Trade: Valuing Growth Opportunities*, Geneva. Chapter 33.

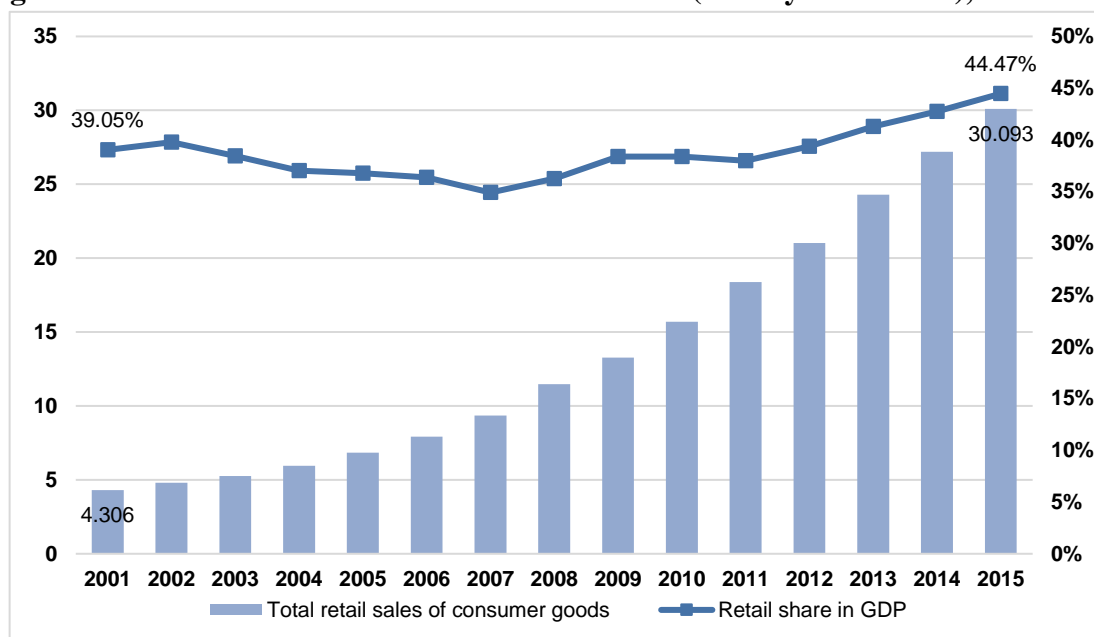
### 3. DYNAMICS IN THE RETAIL SERVICES SECTOR IN CHINA

#### 3.1 GROWTH AND TRANSFORMATION

Over the period 2001-15, China's total retail sales of consumer goods has increased nearly seven fold. Growth has been slowing from the very rapid nominal rates experienced in the middle of this period, which peaked at 23 percent per annum in 2008 (Figure 3.1.1). For 2015, total retail sales (including restaurants and catering) grew in real terms by 10.6 percent to reach 30.1 RMB yuan trillion (USD4.6 billion).

To put this in perspective, total retail sales now amount to nearly half (45 percent) of China's GDP. Urban areas account for 86 percent of sales (25.9 RMB yuan trillion), up by 10.5 percent; rural areas account for 4.2 RMB yuan trillion, growing at 11.8 percent.<sup>5</sup> Subtracting out restaurants and catering (3.2 RMB yuan trillion or USD491 billion and up 11.7 percent), retail sales of consumer goods were 26.9 RMB yuan trillion (rising at 10.6 percent in nominal terms).

**Figure 3.1.1: Total Retail Sales of Consumer Goods (RMB yuan trillion), 2001-2015**



Source: National Bureau of Statistics of China using real rather than nominal GDP

<sup>5</sup> **Total Retail Sales of Consumer Goods** includes: (1) commodities sold to residents for daily use and building materials for construction/repair of houses; (2) office appliances and supplies sold to institutions; (3) food and fuels sold to canteens (4) grain and non-staple food, clothing, daily articles and fuels sold to military personnel; (5) **consumer goods sold to foreigners, overseas Chinese, and Chinese compatriots during their stay in China PRC**; (6) Chinese and western medicines, herbs and medical facilities purchased by residents; (7) newspapers, books and magazines directly sold to residents and social groups, new and old commemorative stamps, special stamps, first-day covers, stamp albums; (8) consumer goods purchased and sold by second-hand shops; (9) stoves and heating facilities and liquefied gas sold by gas companies to households and institutions (10) commodities sold by farmers to non-agricultural residents and social groups. Excluded are: raw materials, fuels, equipment, tools sold to enterprises, institutions and state farms for production purposes; commodities sold to trade establishments for re-selling; commissioned sales at second hand shops; operational income of urban public utilities; stamps sold at post offices; income of water, power, gas production and supply companies from supply of their products; and sales of commodities among farmers.

It is worth noting the persistently marked geographical concentration of retail sales in the eastern and coastal provinces. In 2001, the eastern and coastal region provinces accounted for nearly 60 percent of total retail sales of consumer goods. By 2013 this had dropped 8 percentage points with the difference made up by growth of 5 percentage points in the central region and 3 percentage points in the western region. In 2013, the top four provincial retail sales were all still in the eastern region however, namely Guangdong, Shandong, Jiangsu and Zhejiang, with the shares growing for both Shandong and Jiangsu. Household incomes are generally lower in the central and western regions and the development of large retail chain operators has lagged considerably behind.

Most domestic retailers remain region-focused in China. Apart from a couple of home electronics players such as Suning and Gome, very few of the Top 100s domestic retailers achieve national footprints in China. Most domestic retailers, such as the Dalian Dashang Group Co. Ltd in Liaoning Province and Anhui Huishang Group Co. Ltd in Anhui Province, focus on their respective regional markets, partly because of big regional differences in consumer tastes but also because of ongoing supply chain inefficiencies and reliance on local government support.

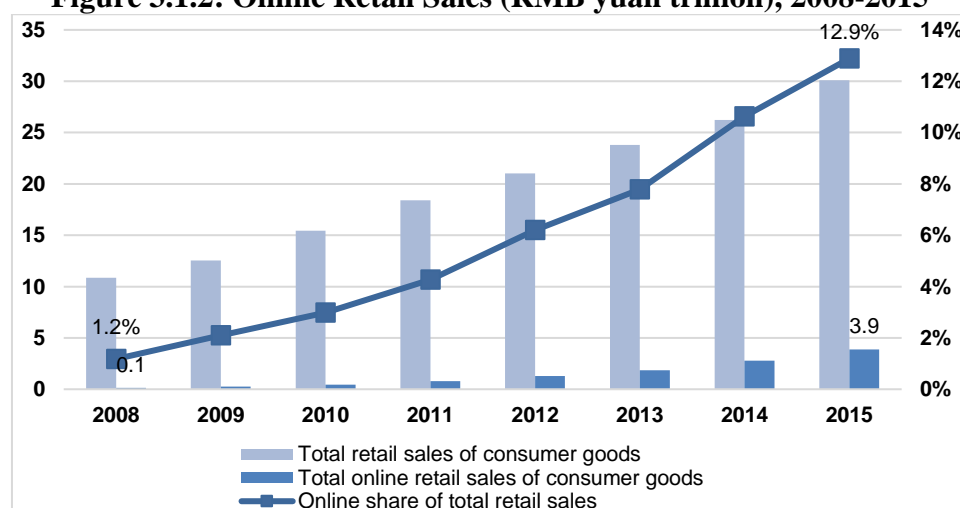
**Table 1: Regional and Provincial Share of Consumer Retail Sales (%), 2001-13**

Region	2001	2013	Region	2001	2013	Region	2001	2013
<b>Eastern region</b>	<b>59.8</b>	<b>59.0</b>	<b>Western region</b>	<b>13.0</b>	<b>13.5</b>	<b>Central region</b>	<b>27.2</b>	<b>27.5</b>
Guangdong	11.5	10.7	Sichuan	4.3	4.4	Henan	5.0	5.2
Shandong	7.2	9.4	Shaanxi	1.7	2.1	Hubei	5.0	4.6
Jiangsu	7.3	8.8	Chongqing	1.8	1.9	Hunan	3.8	3.8
Zhejiang	6.5	6.4	Yunnan	1.7	1.7	Anhui	2.9	2.8
Liaoning	5.2	4.5	Guizhou	1.0	1.0	Heilongjiang	3.1	2.6
Hebei	4.5	4.4	Gansu	1.0	0.9	Jilin	2.3	2.3
Beijing	4.1	3.5	Xinjiang	1.0	0.9	Shanxi	1.7	2.2
Fujian	3.8	3.5	Ningxia	0.3	0.3	Inr Mongolia	1.4	2.2
Shanghai	4.7	3.4	Qinghai	0.2	0.2	Jiangxi	1.9	1.9
Guangxi	2.4	2.2	Tibet	0.1	0.1			
Tianjin	2.1	1.9						
Hainan	0.5	0.4						

Source: National Bureau of Statistics, China

Meanwhile as shown in Figure 3.1.2, China's online retail sales, now the world's largest e-commerce market in volume terms, increased more than 30 fold over 2008-15, to reach 3.9 RMB yuan trillion (USD589.6 billion), nearly 13 percent of total retail sales of goods.

**Figure 3.1.2: Online Retail Sales (RMB yuan trillion), 2008-2015**



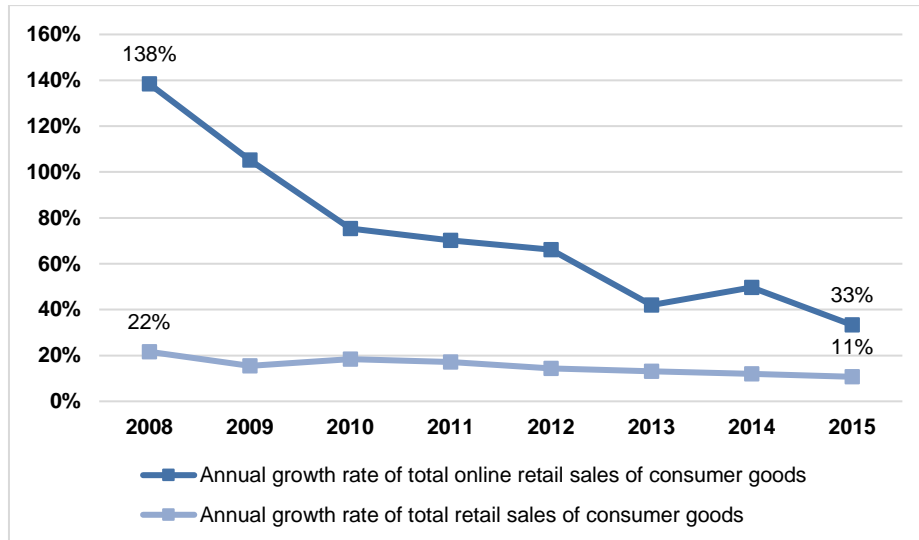
Source: National Bureau of Statistics of China



Figure 3.1.3 tracks the rate of growth in total and online retail sales since 2008. In 2008 and 2009, online retail sales more than doubled, starting from a small base with growth declining to 33 percent in 2015, still nearly three times faster than total retail sales growth in 2015.

Online retail sales of physical goods, which account for the bulk of these sales (3.2 RMB yuan trillion or USD493 billion) experienced an annual increase of 32 percent and now exceed 10 percent of total retail sales of consumer goods, compared with just over 1 percent in 2008. In 2015, online retail sales of virtual products and services were approaching 20 percent of total online sales at 634.9 RMB yuan billion (USD96.5 billion), growing at 42.4 percent per annum.

**Figure 3.1.3: Annual Growth Rate of Total Online Retail Sales of Consumer Goods (%)**



Source: National Bureau of Statistics of China

Facing the challenge of an increasing switch in consumer preferences and mounting competition from internet retailing, store-based retailers suffered in 2015, and a number of stores have closed across various distribution channels, ranging from hypermarkets and apparel and footwear specialist retailers to department stores. Earlier over-expansion, which intensified homogenization rather than differentiation, together with rising operational costs associated with rental and labour, also played a role in store closures.

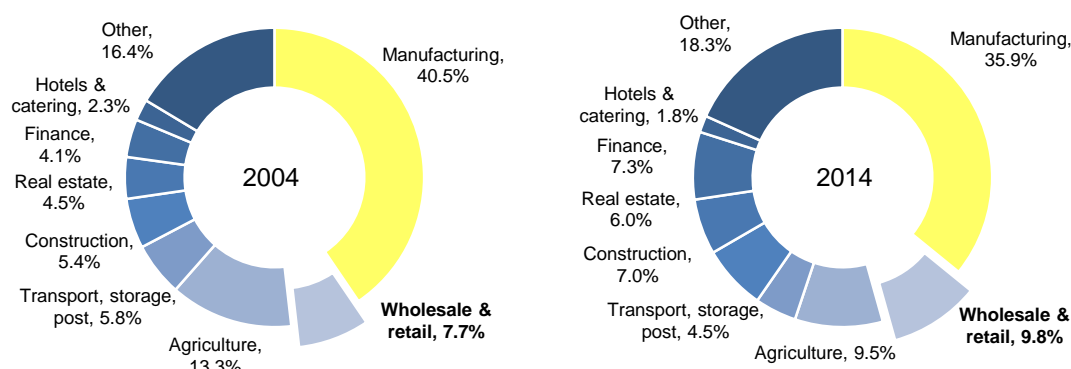
Traditional grocery retailers are particularly hit, with the availability of groceries having spread to a wide variety of distribution channels, especially internet retailing. Compared with grocery retailers, non-grocery retailers performed relatively better in 2015, thanks to continuous outlet expansion and penetration into lower-tier cities with huge potential demand. Many brands preferred to open stand-alone stores in order to promote the shopping experience, with wider ranges of products and more professional services.

The market is clearly changing very fast. Competition has intensified as consumers' shopping habits, and particularly their behaviour in terms of the purchasing and payment decision, has similarly rapidly evolved. Consumers are looking for enhanced convenience, security and quality, as well as innovative products and services. Internet retailing and mobile m-commerce are playing an increasingly important role, not only for non-store based retailers, but also for traditional store-based retailers in China. Online-to-offline (O2O) practices and even omni-channel retailing is now widespread.



Meanwhile the sector continues to grow. In terms of industry value-added share to GDP, the wholesale and retail services sector combined contributed a share of 9.5 percent in 2014, up from 7.7 percent in 2004 (Figures 3.1.4 and 3.1.5).

**Figures 3.1.4 and 3.1.5: Share of Wholesale and Retail in GDP (%), 2004-2014**



Source: National Bureau of Statistics of China

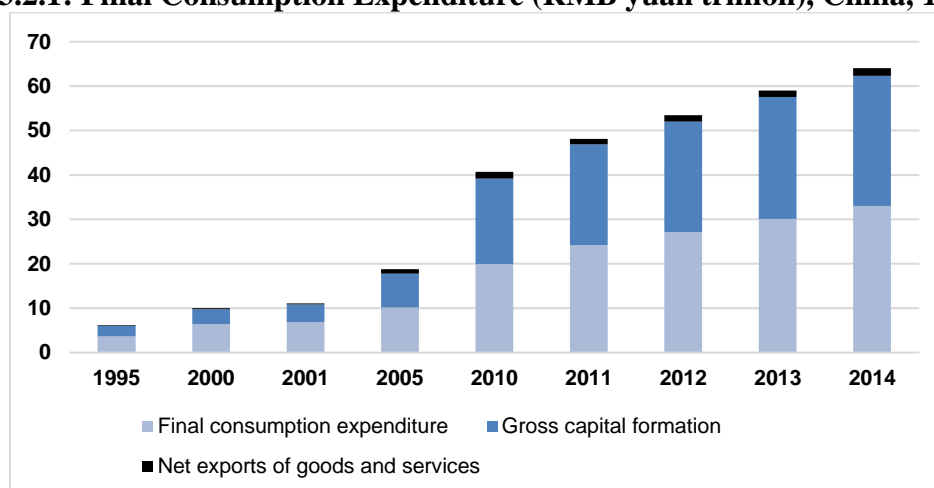
## 3.2 DRIVING FORCES

China's retail sales of consumer goods have grown at an impressive rate over recent decades, driven by robust economic development, changes in household consumption structures associated with income growth and urbanization and rapid technological changes in the sector. Policy reform and liberalization of the sector has also played a vital role; the policy aspects are discussed in the next section while the focus here is on the key factors of income and consumption growth, urbanization, internet and the age of digitization.

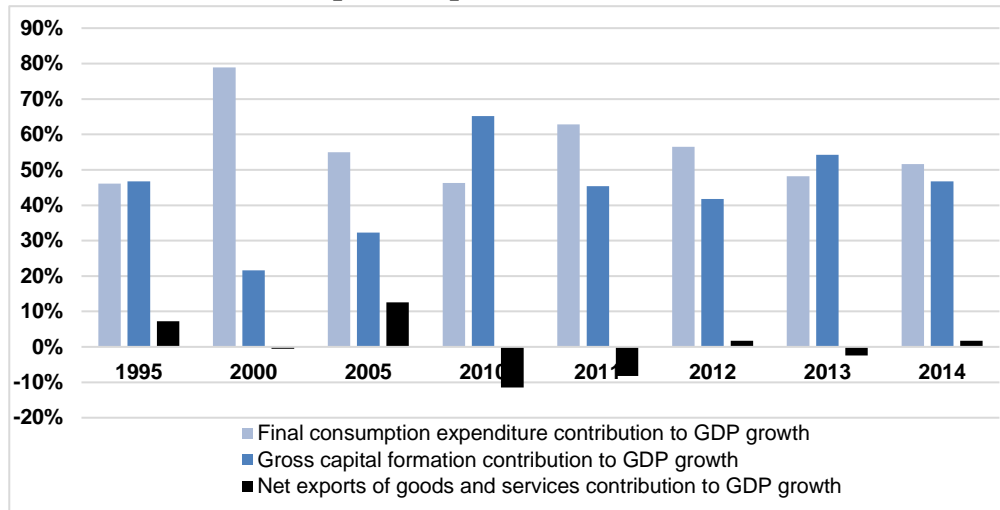
### 3.2.1 Consumption

As highlighted in Figures 3.2.1 and 3.2.2, in 2014, consumer spending was the dominant driver of the Chinese economic growth, with the contribution of consumption to GDP exceeding the combined contribution of investment and net exports. In 1995, the contribution from final consumption expenditure to the growth of GDP was 46.1 percent; in 2014, final consumption expenditure contributed 51.6 percent of the growth in GDP.

**Figure 3.2.1: Final Consumption Expenditure (RMB yuan trillion), China, 1995-2014**



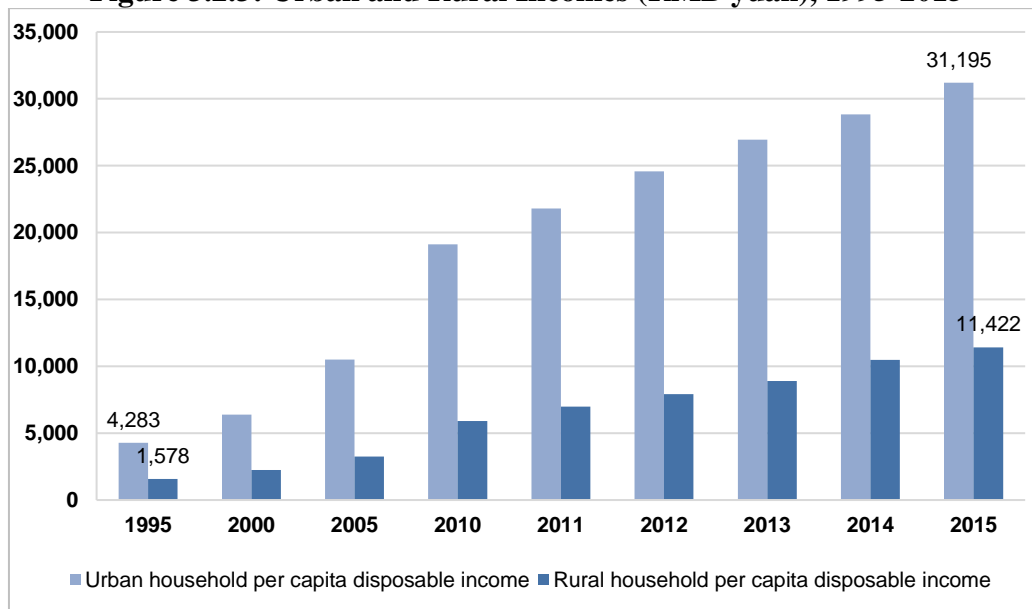
Source: National Bureau of Statistics of China

**Figure 3.2.2: Final Consumption Expenditure Contribution to GDP Growth (%)**

Source: National Bureau of Statistics of China

### 3.2.2 Household income

The Chinese consumer market is in the midst of a transformation that offers tremendous new opportunities. The rise of upper-middle-class and affluent households act as the drivers of consumption growth and household disposable income is on the rise. As Chinese consumers become more affluent, consumer spending is expected to increase further.

**Figure 3.2.3: Urban and Rural Incomes (RMB yuan), 1995-2015**

Source: National Bureau of Statistics of China

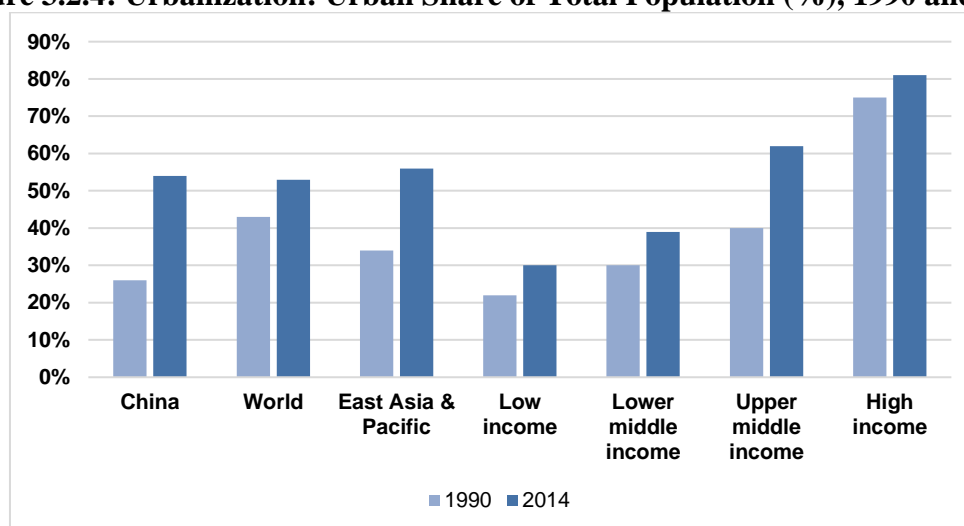
Annual per capita disposable income of urban households in China increased nearly 8 fold from 4,283 RMB yuan in 1995 to 31,195 RMB yuan in 2015. Annual per capita disposable income of rural households in China increased somewhat more rapidly over the same period from 1,577.7 RMB yuan in 1995 to 11,422 RMB yuan in 2015. Per capita disposable income for urban households remains around 3 times more than rural households.

The rising middle class' increased disposable income, and altering lifestyles are driving retail demand. China's consumer economy has been powered by the ascent of hundreds of millions of people from poverty to an emerging-middle class, which includes households with annual disposable income of USD10,001-16,000, and to the middle class, with incomes of USD16,001-24,000. Consumption growth will be driven by the dramatic rise of upper-middle-class households (USD24,001-46,000) and affluent households (over USD46,000).

### 3.2.3 Urbanization

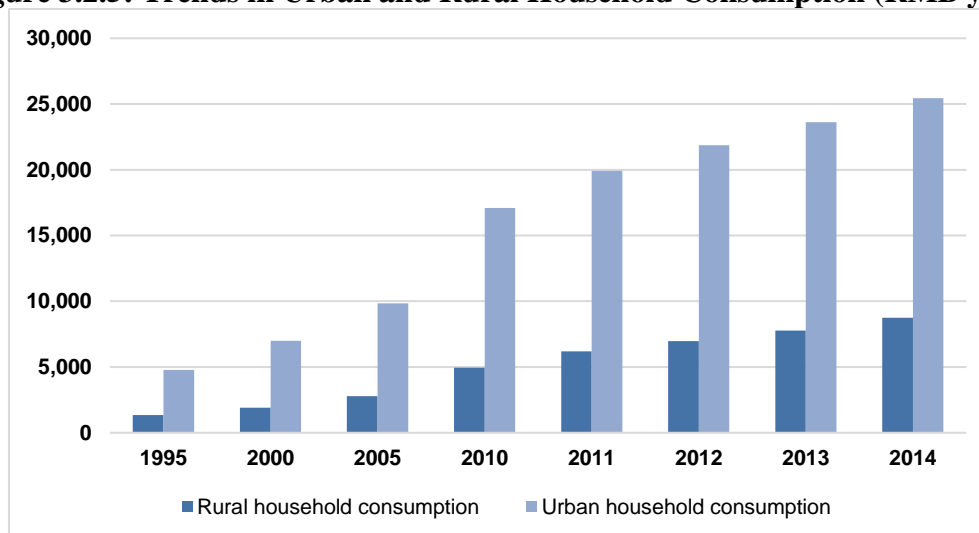
Urbanization is bringing big new opportunities to the retail industry due to significant changes in the consumption capability and structure of urban populations, especially in the third and fourth-tier cities. In 1990, the urban share of China's population was 26 percent, well below not only the world average of 43 percent, but also the East Asian average of 34 percent (Figure 3.2.4). In 2014, the urban share of China's population amounted to 54 percent, slightly higher than the world average of 53 percent and approaching the East Asian average of 56 percent.

**Figure 3.2.4: Urbanization: Urban Share of Total Population (%), 1990 and 2014**



Source: World Bank World Development Indicators

**Figure 3.2.5: Trends in Urban and Rural Household Consumption (RMB yuan)**



Source: National Bureau of Statistics of China

In 1995, average annual rural household consumption expenditure was 1,344 RMB yuan while urban household consumption was 3.5 times larger at 4,769 RMB yuan. By 2014, rural household consumption had reached 8,744 RMB yuan with average urban household expenditure just under 3 times more at 25,499 RMB yuan. The consumption expenditure differential is decreasing, but slowly (Figure 3.2.5).

### 3.2.4 Internet and the age of digitization

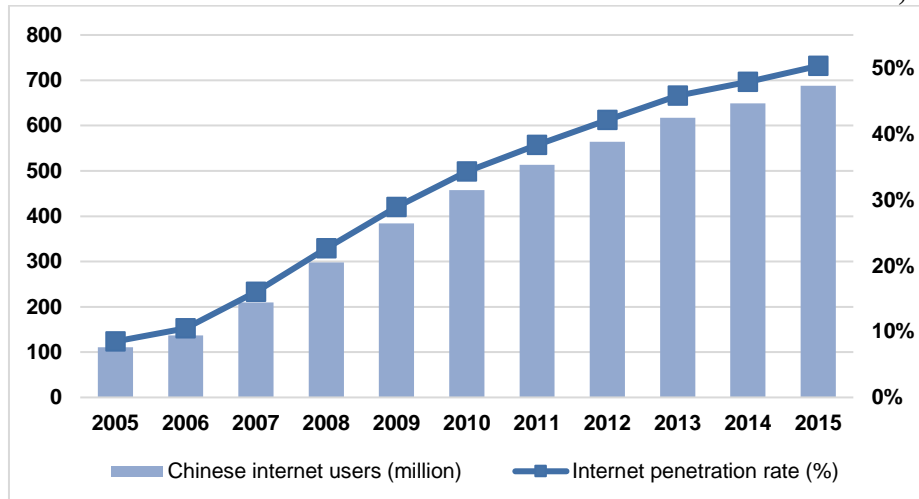
Radical shifts in the business uptake of new information and communications technologies, especially mobile internet-based applications and strides forward in internet penetration means online retail has become the engine of China's retail services sector. This is also the case in much of the rest of the world. An added factor perhaps in China was the fact that modern retail was a relative latecomer to China and expansion beyond the eastern part of the economy was incomplete, even while new technologies were altering consumer options. As was shown in Figure 3.1.2, B2C e-commerce sales grew over 20 percent in 2012 to reach beyond USD1 trillion for the first time.

None of this would be possible of course without related technological change in financial services, both e-banking and mobile payments processes. Nor would it be possible without radical shifts in consumer goods logistics and delivery systems. Financial services and logistics are not the only sectors impacted by the trend to e-tail. Nor is the internet the only disruptive technology in play as already discussed above.

The internet has delivered extraordinary economy-wide productivity gains and enabled many different markets to function more efficiently. Extending internet access increases market efficiency by reducing barriers to entry, reducing transaction costs, and increasing transparency. SMEs are able to reach a broader market if they take advantage of these benefits. There is abundant evidence for this in the retail sector in China with major increases in internet usage by both consumers and suppliers.

According to a survey by the China Internet Network Information Center (CNNIC), at end 2015, internet users in China numbered 688.3m, up 39.5m over the year. At 195m, rural netizens accounted for 28.4 percent of the national total, up by 17m from end 2014. The overall internet penetration rate rose to 50.3 percent, up 2.4 percentage points from end 2014.

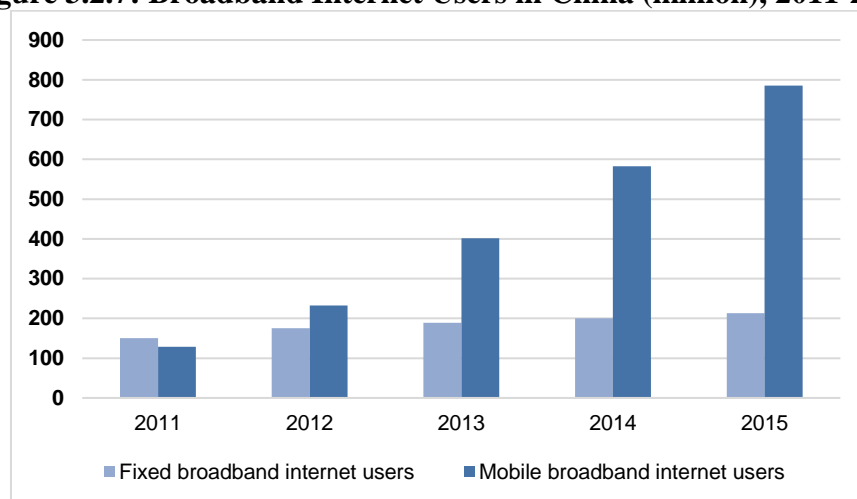
**Figure 3.2.6: Number of Internet Users and Internet Penetration Rate, China**



Source: China Internet Network Information Center (CNNIC)

As of December 2015, the number of mobile internet users in China reached 620m, an increase of 63m from end 2014. Mobile netizens accounted for 90 percent of the total netizen population, up from 85.8 percent in 2014 (Figure 3.2.7). The mobile phone has become the standard device for internet access by new internet users (71.5 percent, up more than 7 percentage points from end 2014). Of new internet users in 2015, 46 percent were under the age of 19 and 46.4 percent were students.

**Figure 3.2.7: Broadband Internet Users in China (million), 2011-2015**



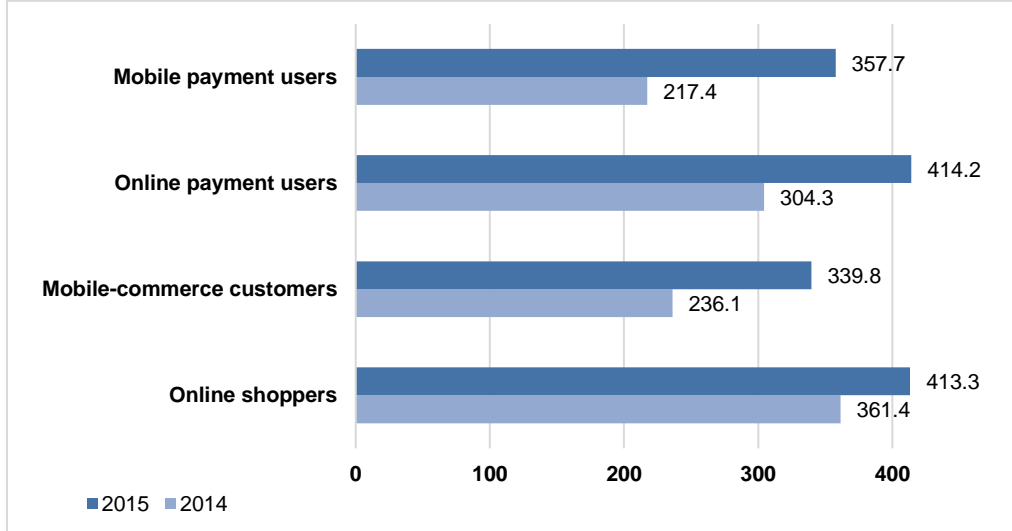
Source: National Bureau of Statistics of China

Chinese companies are similarly widely employing internet-based tools for communications, information acquisition and release, internal management systems and the provision of commercial services. A growing number of them have applied systematic, integrated internet tools to the entire business process, from R&D, purchase and sales, financial management, customer relations to human resources management, turning use of the internet from a single supportive instrument to an integrated platform right across the management and transformation of the company's supply chain.

According to CCNIC, as of December 2015, 95 percent of Chinese companies used computers for their office work and 89 percent were internet users; 86 percent accessed internet via fixed broadband and 24 percent via mobile broadband; 32.6 percent were engaged in online sales, 31.5 percent in online purchase and 33.8 percent launched online marketing and promotional activities.

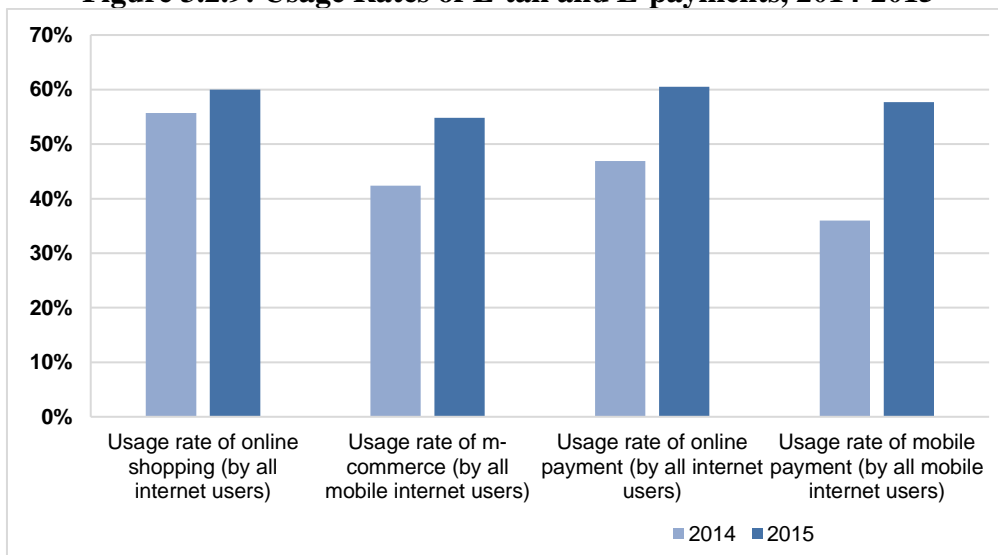
In 2011, there were 150m fixed broadband internet users and 128m mobile broadband internet users in China. There has since been a marked shift to mobile internet. In 2015, there were 213m fixed broadband users, 1.4 times more than in 2011 and 785m mobile broadband users, over 6 times more than in 2011.

Online platforms are now key retail services channels in China. By December 2015, China had 413m online shoppers, a yearly increase of 51.8m or more than 14 percent. Meanwhile, the number of mobile online commerce (m-commerce) customers grew by 44 percent over the year to 340m; and usage of m-commerce increased from 42 to 55 percent.

**Figure 3.2.8: Online Shoppers and E-payment Customers (million), 2014-2015**

Source: CNNIC

To pursue the trend to large-scale deployment of e-business services, all economies need the support of innovative electronic payment and shipping solutions to leverage a higher volume of on-line transactions. 2015 saw rapid development and accelerating popularization of e-payment processes. By December 2015 China had 416 million e-payment users, an annual increment of 112 million or 37 percent. The utilization ratio of online payments increased from 47 percent to over 60 percent over the year to December 2015. Mobile payments saw dramatic growth of 64.5 percent in 2015, covering 358m users; the usage rate of mobile payment increased from 36 to 58 percent (Figure 3.2.9).

**Figure 3.2.9: Usage Rates of E-tail and E-payments, 2014-2015**

Source: CNNIC

In recent years, e-payment companies have vigorously expanded internet and mobile internet channels, making initial opening offers of transactions free of intermediation fees, to both businesses and consumers in an effort to encourage use of mobile payment services and diversify mobile payment scenarios. On one hand, e-payment companies have “subsidized” both businesses and consumers to encourage more physical businesses to launch a mobile

payments service. On the other, e-payment companies have supported and enabled foreign currency payments to expand their reach into overseas payments markets.

The growth of e-payment channels has also introduced new prudential risks as third-party payment tools tend to be exploited for cash-out. With e-payment systems, consumers or businesses can make payments via WeChat or Alipay or a credit card online without the need of a Point-of-Sale device, making payments easier and potentially less transparent. As online business forms diversify, it is becoming increasingly difficult to oversee the cash-out of credit cards online. Know-Your-Customer information has become critically important.

In early 2015, eight credit companies including Zhima Credit, Tencent Credit and Lakala Credit obtained consumer credit business licenses from the central bank. Under the consumer credit regulatory system that is under construction in China, bad credit behaviour will be recorded and the consumption of the person in question will be restricted via e payment, forcing consumers to maintain good personal credit reputations and improving the e payment environment for online credit consumption.

Traditional bricks-and-mortar retailers are meanwhile themselves necessarily adjusting to customers increasing preferences for online and mobile shopping and paying. Following the emergence of omni-channel shopping experiences, traditional and internet-based retail channels have started to integrate, offering more seamless shopping experience to consumers. The capital markets continue to show active interest in the retail sector, both online and traditional. As modern retail emerges in China, an integrated approach seems most likely. While investment in online retail start-ups has seen strong venture capital and private equity interest, the number of acquisitions in traditional retail has also been growing.

## **4. STRUCTURAL POLICY REFORM IN CHINA'S RETAIL SECTOR**

China's distribution system has been evolving from a rigid, centrally controlled allocation system to a more flexible one driven by market demand since the implementation of the "open-door" policy. The new market-driven system has allowed both more local entrepreneurs and more foreign enterprises to enter into China's distribution business.

China opened its distribution sector on a trial basis in July 1992. Entry into the WTO brought gradual liberalization of wholesale and retail services and associated gradual transformation from a semi-open market to a fully open market to the world. Way ahead of reforms in other services sectors, China's WTO commitments (set out in Appendix 1) called for phased removal of almost all trade barriers in distribution services by the end of 2004.

Regulatory reforms included deployment of chain franchise systems, easing of commercial trade (exports and imports of goods), removal of limitations on foreign capital investment, abolition of quantitative restrictions on numbers and size of companies, numbers of store outlets and sales volumes.

On entry to the WTO, China made significant commitments, on a 5 year transition basis, on distribution services - providing market access and national treatment advances in all four modes, including commissioned agents, wholesaling, retailing and franchising. China also agreed to phase out restrictions on foreign firms' establishment of joint ventures (JVs).

The transition period expired in 2005, and in that single year, according to MOC data, a total of 1,027 foreign firms were granted approval, three times the total number approved during the 12 previous years. The contracts, worth USD1.82 billion, involved the opening of 1,660 shops covering 4.7m square meters. Most of these firms were in wholesale; only 187 were in the retail sector, including Walmart, Staples, B&Q, Carrefour, Auchan, Metro and OBI.

### **4.1 EVOLUTION OF THE REGULATORY FRAMEWORK – PRE-WTO**

The process began in 1992. Prior to that date, foreign investors were prohibited from setting up either joint ventures or wholly foreign-owned enterprises to conduct retail or wholesale business in China. Foreign-invested manufacturers however were allowed to sell certain percentages of the products they produced in China on the Chinese market.

**In July 1992**, the State Council formulated Provisions on Foreign Investment in Retailing, permitting Beijing, Shanghai, Tianjin, Guangzhou, Dalian and Qingdao, as well as the five Special Economic Zones of Hainan, Shenzhen, Zhuhai, Shantou and Xiamen, to allow foreign investment in retailing on a trial basis. Wholly foreign-owned enterprises were prohibited but JVs were allowed. All retail projects were required to be submitted by local governments to the central government for examination and approval, and the qualifications of both the Chinese and foreign parties required examination by the State Administration of Internal Trade. The scope of the business license was limited to retailing general domestic and imported merchandise with a prohibition on acting as import and export agencies. Agreements could not exceed 30 years and imported merchandise could not exceed 30 percent of the JV's total retail sales for any year. Foreign equity was limited to 49 percent.



**In June 1995**, another major step forward took place. For the first time, retail and wholesale sectors were listed by the State Council on the Directory for Foreign Investment, though under the "restricted" category. By the end of 1995, 14 retail JVs had been approved; 5 from Hong Kong, China; 4 from Japan; 3 from Thailand; and 1 each from Singapore and Malaysia.

**By the end of 1997**, there were 20 approved joint ventures in retail. But local provincial and municipal authorities were reported as having approved close to 300, competing with one another for foreign investment. Given the disorderliness, **in mid-1998**, the central government issued an *"Urgent Circular on Prohibiting Local Governments from Approving Foreign Invested Retail Companies"*. The nearly 300 retail operations were required either to restructure to conform to the 1992 Provisions, or face closure at the end of that year. Tax authorities and Industry and Commerce Administration bureaus were instructed to examine the approval procedures and structure of all retail joint ventures. To stay in business, these companies were required to meet the following criteria:

- Promised foreign investment had materialized and the firms were under sound management.
- No wholesale business was being undertaken.
- Chinese partners held over 51 percent of equity share. In chain store or warehousing businesses, the Chinese partner had to hold majority control.
- Partnership agreements did not exceed 30 years in coastal regions or 40 years in inland and western parts of the economy.

**In June 1999**, the State Council issued *Provisional Rules on Foreign Investment in Retailing & Wholesaling*, providing a somewhat more open regulatory environment, essentially designed to help accelerate introduction of modern management expertise in China's retail industry. The Provisional Rules stipulated, for the first time, the conditions under which foreign investors could form joint ventures, cooperatives or wholesale companies in China's 4 cities directly-administered under the central government, 5 Special Economic Zones (SEZs) and all the capital cities of provinces and autonomous regions.

## 4.2 EVOLUTION OF THE POLICY FRAMEWORK - WTO ACCESSION

Prior to 2003, the regulatory agency which had oversight responsibility for distribution services was the State Economic and Trade Commission (SETC) a department of the State Council in charge of domestic trade. In 2003, the former Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and SETC were combined into one ministry – Ministry of Commerce (MOC), consolidating responsibility for domestic and foreign trade in one body which also had responsibilities with respect to implementation of WTO commitments, competition policy including anti-counterfeit, attraction of foreign investment etc.

MOC became the supervisory body for all distribution services in China; while provincial, municipal, autonomous region, and city-level government departments administering commercial affairs continued to monitor distribution services within their jurisdictions.

The previous approval procedures initially remained in place; all applications had to be approved by the central government but these procedures were quickly seen to be ineffective. Many foreign retailers had initially entered the Chinese market by gaining preferential treatment from local governments, and bypassing the central government. Before China's WTO accession in 2001, as many as 300 foreign retailers had opened stores in China but only

56 of them had received official approvals from the central government. Many local governments had been eager to make deals with the foreign retail giants for they welcomed the prestige, tax revenue, buying power and employment the foreign companies would bring to the localities. The extent of such circumvention of regulatory requirements was such that the central government had difficulty monitoring local government activities in the sector.

After China's accession to WTO, the central government effectively delegated full authority to provincial-level governments and the new measures simplified and sped up the approval process. If the following conditions were fulfilled, the MOC could authorise the respective provincial-level governments to carry out the examination and approval procedure:

- The distribution channels do not involve television, telephone, mail, internet and vending machine;
- If the size per store was below 3,000m<sup>2</sup>: the number of such stores operated by the foreign investor did not exceed 3 in the province and 30 in the whole Chinese Mainland;
- If the size per store was below 300m<sup>2</sup>: the number of such stores operated by the foreign investor did not exceed 30 in the province and 300 in the whole Chinese Mainland;
- The commodities distributed by the foreign investor did not include books, newspapers, periodicals, pharmaceuticals, automobiles, salts, tobaccos, pesticides, mulching films, processed oils, grains, vegetable oils, sugar and cotton.

The MOC committed to a timetable for the approval process. Upon receiving all the required documents, the provincial-level governments had to examine the documents and pass them to the MOC within one month. The MOC was required to make decisions within 3 months and give explanations in case of disapproval.

By delegating part of the authority to the local government and simplifying the approval procedures, the central government aimed to end the above circumvention activities, and enable the distribution sector to develop in a more orderly fashion.

Since restriction by direct administrative measures and procedures is contrary to the spirit of the WTO, the government also enacted laws and regulations to guide a more balanced development of distribution services, and these laws had to be applied to both local enterprises and foreign enterprises. Table 2 sets out the key regulatory steps impacting on non-resident activities in China's distribution sector.

**Table 2: Regulations Governing Non-Resident Activities in China's Distribution Sector**

Effective date	Rules and Regulations	Highlights
July 1992	Trial Procedures Relating to Foreign Invested Commercial Enterprises (FIEs)	Allowing foreign investors to enter China's retail sector by means of joint ventures (JV); 6 cities plus 5 Special Economic Zones (SEZ) were opened for establishment of 1 or 2 JVs.
September 1996	Trial Procedures on the Establishment of Pilot Sino-foreign Trade Equity Joint Ventures	Allowing JVs to engage in import and export in Shanghai & Shenzhen as well as wholesale distribution of imports, but not allowed to engage in domestic trade. Majority Chinese shareholding required and minimum capital requirement of the JV of RMB 100m.
1999	Measures Concerning Pilot Projects for FIEs ("The Pilot Projects")	Expanding the pilot areas to all provincial & autonomous regional capitals, municipalities and independent planning cities. Terminating the restrictions on wholesale operations.
1 June 2004	Administrative Measures on Foreign Investment in Commercial Areas	Ending the practice of "The Pilot Projects" in the commercial sector. Lifting restrictions on geographical location, ownership structure and number of stores.
15 October 2006	Administrative Measures on Retailers' Promotion Activities	Regulating retailers' promotional activities in areas such as pricing, advertising content, return or exchange of goods, after-sales services and safety issues, etc.
15 November 2006	Management Rules on Fair Transaction between Retailers and Suppliers A key step towards healthier relationships between retailers and suppliers; enhancing supply chain efficiency in the long run.	Applying to retailers with annual sales over RMB 10 m and their respective suppliers. Preventing retailers charging suppliers additional fees unless agreed by the parties concerned and specified in the contracts. Requiring retailers to pay for all ordered items, even if not sold; with payment made no later than 60 days upon receipt of goods. Also protecting retailers' interests; eg by prohibiting suppliers from practicing tie-in selling.
1 May 2007	Commercial Franchise Management Regulation	Stipulating the rights & responsibilities of both franchisors & franchisees, establishing a comprehensive legal framework for franchise contract. Reinforcing information disclosure requirements for franchisors; regulating marketing & advertising during franchisee recruitment.
1 May 2007	Administrative Measures on Information Disclosure for Franchise Business	Elaborating in detail the information disclosure requirements stipulated in the regulation.
1 May 2007	Administrative Measures on Filing Franchise Business	Spelling out clearly the filing requirements & procedures for franchise business.
1 May 2007	Administrative Measures on Food Safety	Clarifying food wholesalers and retailers' responsibilities in safeguarding food safety.
1 January 2008	NPC promulgated the Corporate Income Tax Law	Levelling the playing field for FIEs and domestic enterprises by standardizing the tax rate at 25% for both; unifying preferential treatments and deductions
1 August 2008	Anti-Monopoly Law	Forbidding monopolistic market conduct and curbing administrative monopolies.
2009	Legislation for City Commercial Development Plan	Addressing market irregularities and fostering a more orderly business environment.

Table 3 summarizes the requirements for foreign investors pre- and post-WTO.

**Table 3: Requirements for Foreign Entry into China's Distribution Sector**

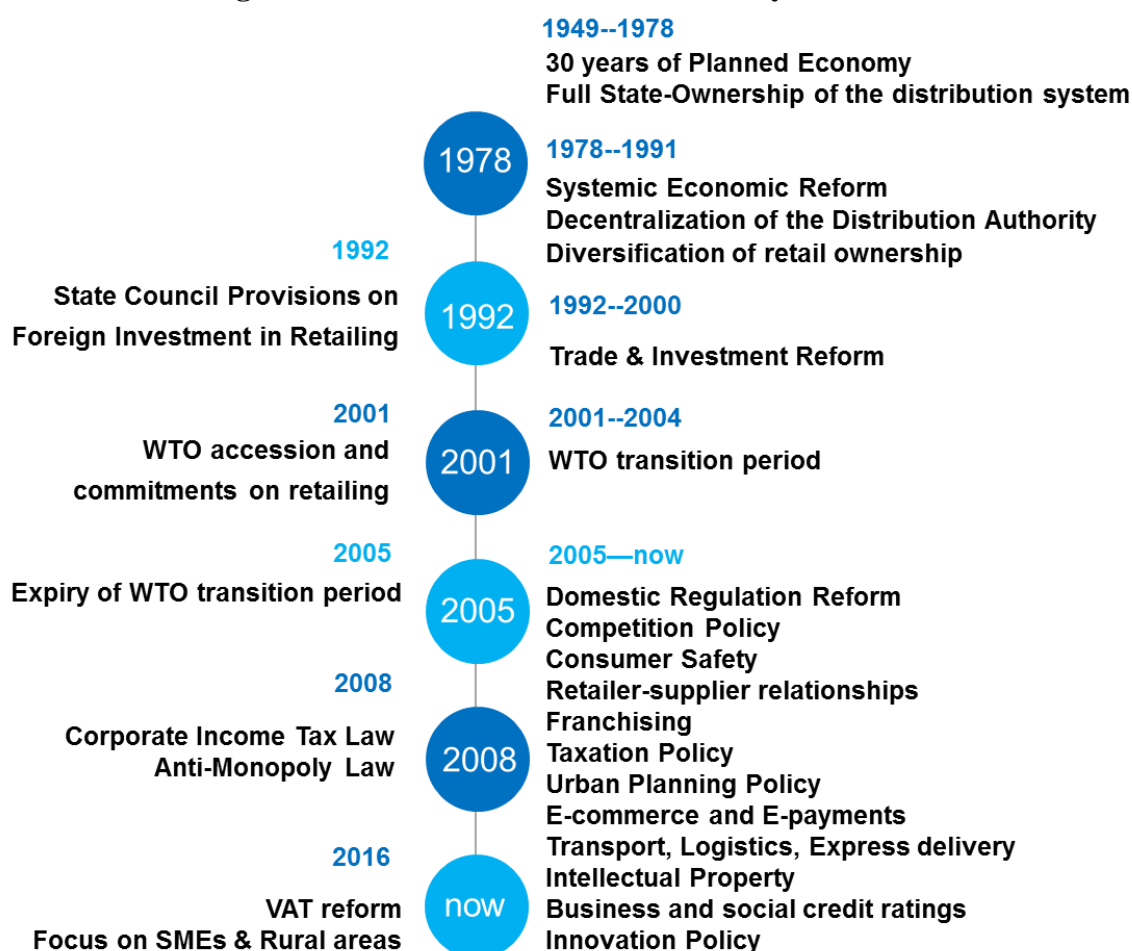
Requirements	Pre-WTO accession		Post-WTO accession	
	Wholesale	Retail	Wholesale	Retail
Average annual revenue of previous 3 years	USD2.5b	USD2b	No limit	No limit
Total assets of foreign investor	USD300m	USD200m	No limit	No limit
Registered capital of JV	RMB 80m	RMB 50m	RMB 0.5m	RMB 0.8m
Foreign shareholding	49%	49% to 65% (Note 1)	100%	100%
Trading rights and scope of business	Only products produced in China;	Except for JV trading companies in Shanghai Pudong & Shenzhen & JV retail companies in certain pilot cities, foreign companies were not allowed to distribute products produced overseas.	Wholesale distribution allowed (excluding salt and tobacco)	All domestic and imported products by 2007
Import value	30% of sales of JV	30% of sales of JV	No limit	No limit
Geographical restriction--Pilot cities	4 Municipalities	4 Municipalities	No limit	No limit
Geographical restriction--Provincial capitals	5 SEZs	Capital cities of all provinces & autonomous regions, independent planning cities	No limit	No limit
Approval Authority	Central Government	Central Government	Provincial	Provincial

Source: WTO documents GATS/SC/135, 14 February 2002, GATS/SC/135/Corr.1, 20 February 2003, and GATS/SC/135/Corr.2, 30 November 2004.

Significant subsequent regulatory changes have taken place including in response to the rise of e-commerce with all the associated implications for infrastructural needs both physical and digital including the regulatory framework for e-payment systems, e-banking, and government support for e-business. These are considered in a later section.

### 4.3 POLICY REFORM TIMELINE

**Figure 4.3.1: Structural Reform Summary Timeline**



**Table 4: Structural Reform Timeline**

Year	Policy area	Types of structural reform	Impact
1949-1978	30 years of Planned Economy	Full State-Ownership of the distribution system. Retailers were all SOEs.	No competition. No private domestic or foreign retailers present.
1978-1991	Systemic Economic Reform Shift from planned economy to market-based economy; introduction of competition	Decentralization of the Distribution Authority Diversification of retail ownership: Government gradually withdrew from direct involvement in the retail sector, gave up its monopoly in procurement of commodities, and relaxed price controls.	State-ownership declined and domestic private enterprise increased. No foreign retailer presence, either as sole owner or joint venture.
1992-1994	Investment Policy Reform in SEZs First, limited, move to open the retail market	July 1992: State Council Provisions on Foreign Investment in Retailing permitted foreign retailers to engage in majority Chinese-owned JVs but limited to establishment of stores in 5 SEZs and experimental cities like Beijing and Shanghai. Approval authority was	15 foreign retailers entered Chinese market in 1992.

Year	Policy area	Types of structural reform	Impact
	to entry of foreign retailers and associated foreign products (trade policy)	decentralized to provincial governments. Each city could have 1-2 foreign retailers (Shanghai had 4). Other cities were forbidden to accept foreign retail investment. Chinese partners had to have at least 51% ownership and could not be wholesalers. No more than 30% of imported products.	
1995-1998	Investment Policy Reform Second move to open up	1995: State Council listed retail and wholesale sectors on the Directory for Foreign Investment in the "restricted" category. JV and 51% Chinese equity restrictions were retained. But foreign retailers could now operate chain stores in Beijing and could partially enter the wholesale sector. Licenses were limited to 30 years.	Increased number and scope of business of foreign retailers operating in China.
1999-2000	Trade & Investment Policy Reform: Foreign retailer entry conditionally allowed beyond the SEZs. Third move to open up	1999: State Council issued Provisional Rules on Foreign Investment in Retailing & Wholesaling; Foreign retailers' allowed in all provincial capitals, municipalities and autonomous regions; JVs only but majority foreign equity allowed. Foreign ownership allowed in both wholesaling and retailing. Franchising prohibited and import of goods by retailers was limited to 30% of annual sales in China.	Increased number and scope of foreign retailers operating in China.
2001-2004	Trade liberalization: WTO commitments on market entry & national treatment in distribution services including wholesaling & retailing	WTO commitments on retailing under all 4 modes of supply: Quantitative, geographical, equity and incorporation restrictions on the establishment of JVs by foreign companies to be phased out. China agrees to gradually liberalize retailing of all but a few commodities within 5 years of accession.	By the early 2000s, distribution was 1 of China's most open sectors to foreign competition with an influx of foreign companies investing in hypermarkets, convenience stores & specialty stores.
2005	Trade liberalization: expiry of WTO transition period	Under China's WTO commitments, starting from 11 Dec 2005, quantity and percentage share restrictions applying to commercial presence in retailing in the regions, quantity were removed.	By end 2005, over 300 foreign retailers had entered the market
2006-2013	Reform of Domestic Regulations in the Retail Sector (some delivering a more level playing field for foreign services providers)	<b>Competition Policy</b> <b>2006:</b> MOC issued regulations on Foreign Mergers and Acquisition of Enterprises in China. Not specific to retailing but applying equally to retailing – foreign M&A required approval from MOC & National Bureau of Industry and Commerce Administration <b>2008:</b> NPC passed the first Anti-Monopoly Law on 30 Aug 2007 which came into effect in 2008. The Law is now being revised and	Walmart's acquisition of Chinese e-commerce platform was approved subject to competition policy restrictions

Year	Policy area	Types of structural reform	Impact
	(More recent domestic regulatory reforms 2014-2016, including in specific industry sectors related to the retail value chain, are covered in Section 5 but not listed in this indicative time-line table)	updated including to take account of internet-based industries.	
		<b>Consumer Safety</b> <b>May 2007:</b> Administrative Measures on Food Safety introduced by MOC to clarify food wholesalers' and retailers' responsibilities in safeguarding food safety. The measures call on food wholesalers and retailers to establish 5 management systems to monitor product safety along the supply chain. <b>Feb 2009:</b> Food Safety Law approved by NPC effective June 2009, to strengthen food safety monitoring and supervision from farm to table includes tougher safety standards and improvement in substandard product recall.	Enforcement of safety regulations has benefitted consumers; as enforcement becomes more stringent, retailers can expect higher compliance costs which might impact on prices
		<b>Retailer-supplier relationships</b> 2006: Administrative Measures on Retailers' Promotion Activities, Management Rules on Fair Transaction between Retailers and Suppliers	Interests of consumers & different market players are better protected but still huge room for improvement
		<b>Franchising</b> 2006: State Council Commercial Franchise Management Regulation, coming into effect in May 2007, establishing a comprehensive legal framework for franchise contract, stipulating rights & responsibilities of franchisors & franchisees, reinforcing information disclosure requirements for franchisors and regulating marketing/advertising activities during franchisee recruitment. MOC is the supervisory body; provincial, municipal, autonomous region, and city-level government departments administering commercial affairs monitor franchise activities within their jurisdictions.	
		<b>Taxation Policy</b> March 2007: PNC Corporate Income Tax Law, coming into effect in Jan 2008, standardized the tax rate at 25% and harmonized the preferential tax treatments, tax deductions and tax holidays applying for foreign and domestic enterprises.	A level playing field now exists with foreign firms no longer enjoying more favourable tax treatment

Year	Policy area	Types of structural reform	Impact
		<b>Urban Planning Policy</b> MOC introduced a system of nationwide City Commercial Development Plans, to bring commercial development of cities in line with overall urban planning and reduce duplicative investment. All major cities are required to design a Commercial Development Plan, taking into account overall development, population distribution, consumption demand trends, transportation systems and environmental requirements. All new retail store openings should comply with the Plan.	The plan has important implications for rationalization of China's retail sector. Almost all cities have compiled City Commercial Development Plans; approved plans can be found on the MOC website.
		<b>E-Commerce</b> 2010: MOC Circular on Issues Concerning Examination and Approval of Foreign-Invested Projects Selling Goods via the Internet allows approved/registered foreign-invested manufacturing & trading enterprises to conduct direct sales via their own Internet platform without additional registration/approval.	A level playing field (national treatment) now exists for foreign-owned companies to make direct sales via e-commerce
		<b>Modernization of Transport and Logistics</b> Aug 2012: State Council Opinions on Further Reformation of Distribution Sector and Acceleration of Development of the Distribution Sector, to facilitate modernization and digitization of the distribution system, improve supply chain efficiency, reduce the ratio of total logistics cost to GDP, and enhance the competence of large-scale distribution enterprises.	Strengthened urban-rural transportation networks, improved in-town delivery, improved logistics facilities and higher degree of digitization in the distribution sector.
		Aug 2013: State Council Opinions on Accelerating Development of the Distribution Sector aim to strengthen enforcement of market supervision and create a sound market environment for distribution	Improved business environment with reduced business costs and stronger IP protection.



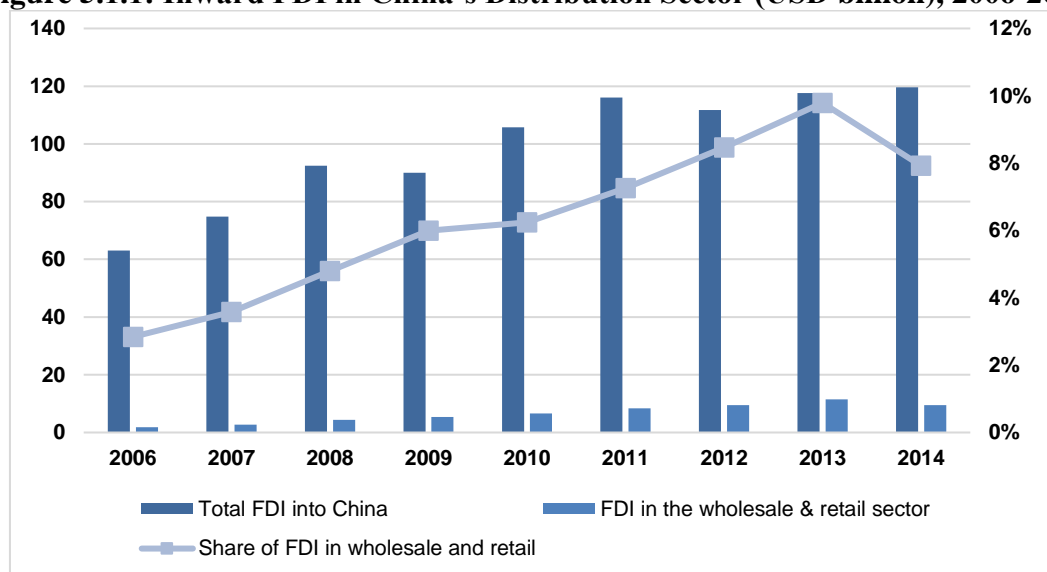
## 5. STRUCTURAL IMPACT OF POLICY REFORMS

### 5.1 MARKET ACCESS IMPACT

By the early 2000s, the distribution services sector had become one of China's most open sectors to foreign competition with an influx of foreign companies investing in hypermarkets, convenience stores and specialty stores. There were 6,338 new foreign retail and wholesale enterprises in 2007, an increase of 36 percent per annum.

In 2007, FDI into the sector reached USD2.7 billion, up by nearly 50 percent per annum. By 2008, China's wholesale and retail services absorbed USD4.4 billion, ranking 4th highest among the services sectors with more than 40 of the world's top 50 multinational retail giants entering the Chinese market. By 2013, this had more than doubled to USD11.5 billion, accounting for 9.8 percent of total FDI inflows into China, before dropping to 7.9 percent in 2014.

**Figure 5.1.1: Inward FDI in China's Distribution Sector (USD billion), 2006-2014**



Source: National Bureau of Statistics of China

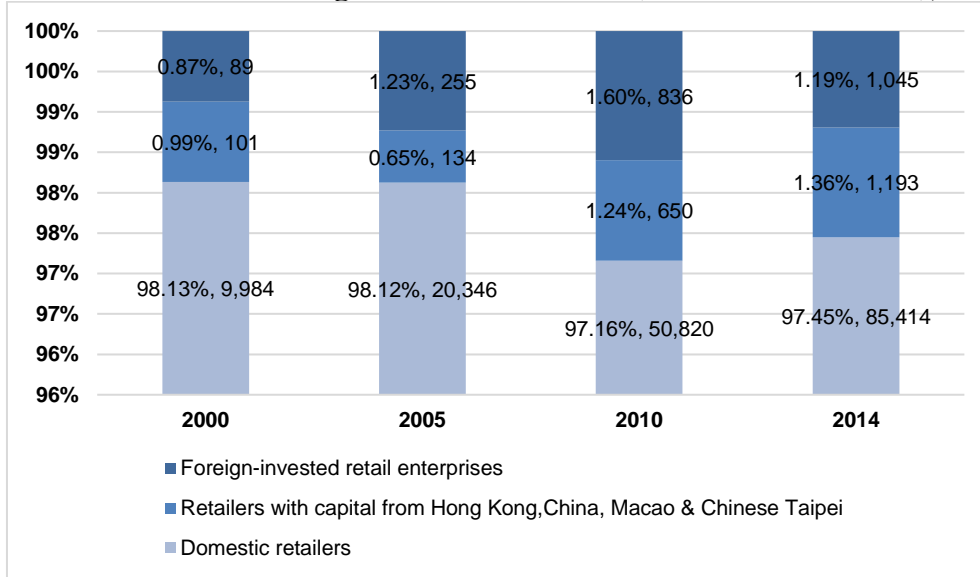
According to data from CB Richard Ellis, in 2007 90 percent of the Top 250 global retailers had a presence outside their economy of origin, and by 2007, 40 percent of them (excluding local Chinese players) had set foot in China. One year later in 2008, 93 percent of the Top 250 global retailers had a presence outside their economy of origin and 42 percent of them had set foot in China. By 2008 China had become the 6th most internationalized retail market, up 3 places from the 9th in 2007.

Every year the China Chain Store and Franchise Association (CCFA) releases its own ranking of “the top 100 retail chain operators” in China (the Top 100s). There were 15 foreign retailers among the top 100s in 2007, accounting for 18 percent of the total sales of the top 100s. Their sales were up by 28 percent per annum, outperforming their rivals on the list which enjoyed average sales growth of 21 percent in 2007.

By 2008, there were 19 foreign retailers with 4,613 stores, up by 13 percent per annum, and growing more rapidly than the total store numbers for the Top 100s (11 percent). This represented 6 percent of the total number of stores and these stores achieved 20 percent of the Top 100s total retail sales. Ranked 6th in 2008, Carrefour was the leading foreign retailer.

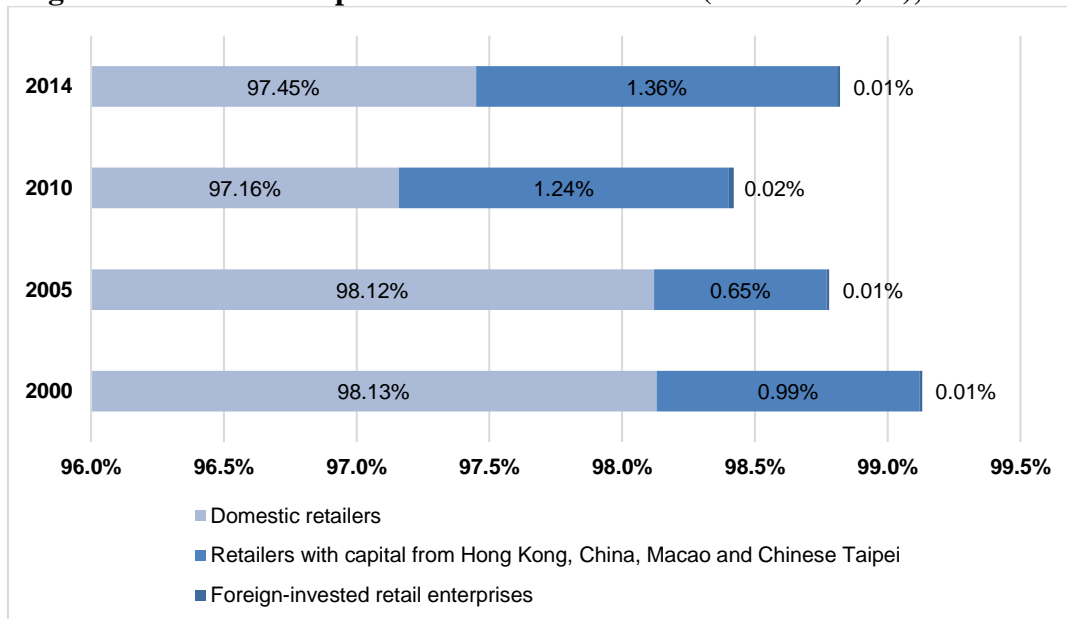
Over the whole period from 2000 to 2014, the total number of foreign retailers increased from 89 to 1,045. Interestingly this growth in numbers was commensurate with the increase in numbers of domestic retailers (Figure 5.1.2). However the number of retailers from Hong Kong, China; Macao; and Chinese Taipei increased much more dramatically, from 101 in 2000 to 1,193 in 2014, registering a relative increase in the number of such firms from just under 1 percent of firms in 2000 to 1.4 percent in 2014.

**Figure 5.1.2: Presence of Foreign Retailers in China (firm number and %), 2000-2014**

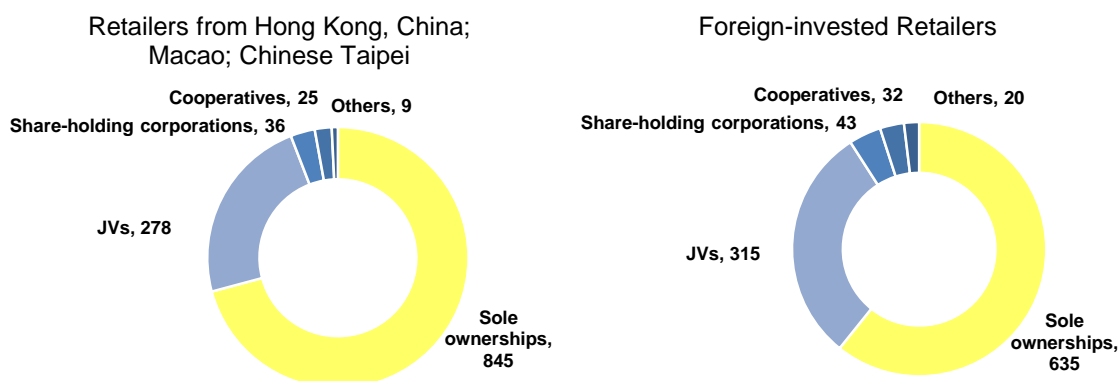


Source: National Bureau of Statistics of China

**Figure 5.1.3: Ownership of Retail Firms in China (firm share, %), 2000-2014**



Source: National Bureau of Statistics of China

**Figure 5.1.4: Retailers from Hong Kong, China; Macao; Chinese Taipei and Foreign-invested Retailers (firm number), 2014**

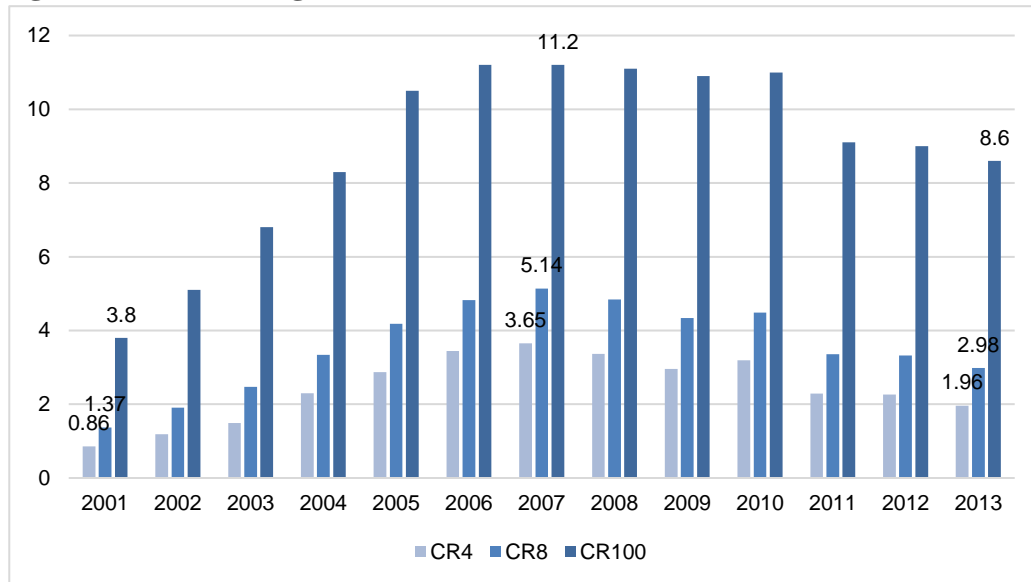
Source: National Bureau of Statistics of China

Since 2006, domestic retailers have effectively held onto their share of both total sales and total purchases by retail firms. In 2006, domestic retailers accounted for 89 percent of both total sales and purchases by retail firms, with sales and purchases by firms owned by Hong Kong, China; Macao; and Chinese Taipei accounting in both cases for another 3 percent and foreign retailers for 8 percent. By 2014, domestic retailers share of sales were steady at 89 percent. Firms owned by Hong Kong, China; Macao; and Chinese Taipei accounted for an increased share of 5 percent at the expense of foreign retailers accounting for 6 percent.

An impact study by the CCFA, covering 27 cities, confirms that foreign firms accounted for 23 percent of stores in big shopping outlets, but still only for a mere 6 percent of the total number of firms and 6 percent of total retail sales. The reality is that foreign retailers have not gained a dominant market share, though they have performed particularly well in the hypermarket format; prominent players include Carrefour, Walmart, RT-Mart and Tesco.

It is worth considering the changes during this period in China's retail market structure and concentration. The standard tools for measuring market concentration include concentration ratios (CR), which measure of the total output produced in an industry by a given number of firms in the industry and hence illustrate the degree of market control. The most common concentration ratios are the CR<sub>4</sub> and the CR<sub>8</sub>, i.e., the market share of the 4 and the 8 largest firms; ratios range upwards from perfect competition at 0 percent.

Based on annual rankings released by CCFA, Figure 4.1.5 shows total sales of the Top 100s accounted for 3.8 percent of total retail sales of consumer goods in 2001, CR<sub>8</sub> took a share of 1.8 percent and CR<sub>4</sub> accounted for just under 1 percent. Market concentration intensified dramatically in the first half of the decade but still remained very "low" at a peak in 2007. After the global financial crisis, concentration ratios have dropped back again and in 2013, the CR<sub>100</sub> was 8.6 percent, dropping further to 6.9 percent in 2015. This evidence suggests that retail remains highly fragmented and the concentration of the retail market remains low.

**Figure 5.1.5: Retailing Market Concentration Ratio in China (%), 2001-2013**

Source: CCFA, National Bureau of Statistics, China

## 5.2 OTHER POSITIVE IMPACTS

The adoption by foreign firms of multiple retail formats (hypermarkets, supermarkets and discount stores) has meant **greater opportunities for a wider number of market segments, including lower income groups.**

While investment was largely been focussed on the wealthier, more highly urbanized eastern and coastal regions, there has also been large-scale foreign retail investment into the poorer central and western regions of China, promoting **local growth in under-developed areas.** The entry of foreign firms had, moreover, a “huge catfish effect” with heightened competition in the retail market generating perceived improvements in the **general level of quality** of local Chinese retail enterprises.

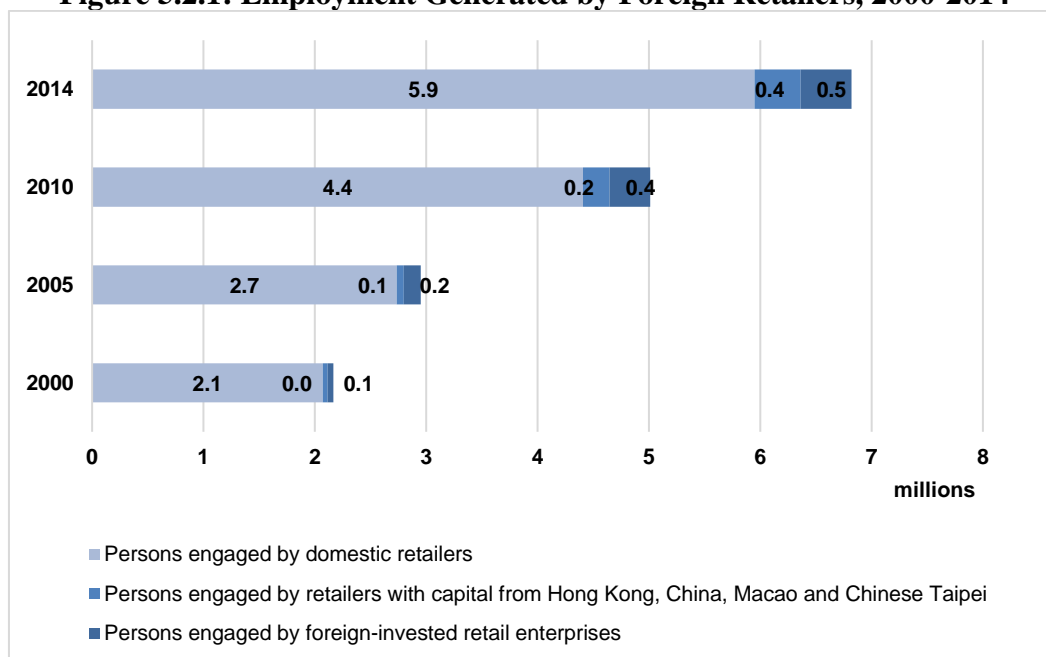
Foreign retailers also proved to be critical role models in demonstrating the improvements in overall **business efficiency offered through innovation.** Most local Chinese enterprises have now followed suit by setting up more efficient modern satellite systems and commercial networks, adopting Bar Code technology and implementing widespread Point-of-Sale Management, Electronic Data Interchange, Management Information and Global Positioning Systems. Application of IT and e-commerce and other improvements in business and marketing management has helped local firms make up their “late-comer disadvantage” more quickly than would otherwise have been possible.

In addition to this beneficial transfer of technology, the experience of watching the process of inward foreign investment through cross border mergers and acquisitions has been an important **source of reference** for domestic Chinese retail businesses as they implemented a “going out” strategy of their own.

**Liberalisation of distribution services has also created jobs.** Retail draws employees primarily from the lower economic strata and provides training, job security, good wages and often the first opportunity for management experience.

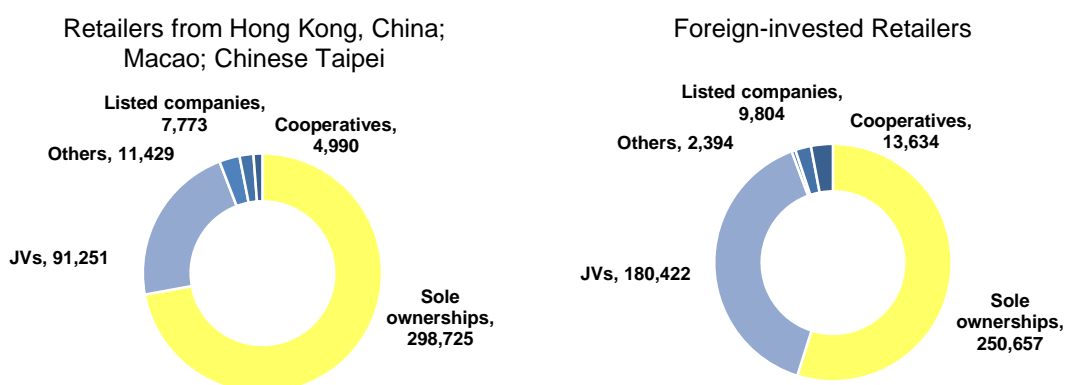
As many as 2.5m people were engaged by retail firms in China in 2000 (Figure 5.2.1). But by 2014, the number had grown to 6.8m, including a relatively high number of management personnel. 87 percent were employed by domestic retail firms. Another 6 percent were employed by firms from Hong Kong, China; Macao; and Chinese Taipei (414,168 jobs). Foreign retailers employed another 7 percent (456,911 jobs).

**Figure 5.2.1: Employment Generated by Foreign Retailers, 2000-2014**



Source: National Bureau of Statistics of China

**Figure 5.2.2: Persons Employed by Retailers from Hong Kong, China; Macao; Chinese Taipei and Foreign Retailers, 2014**



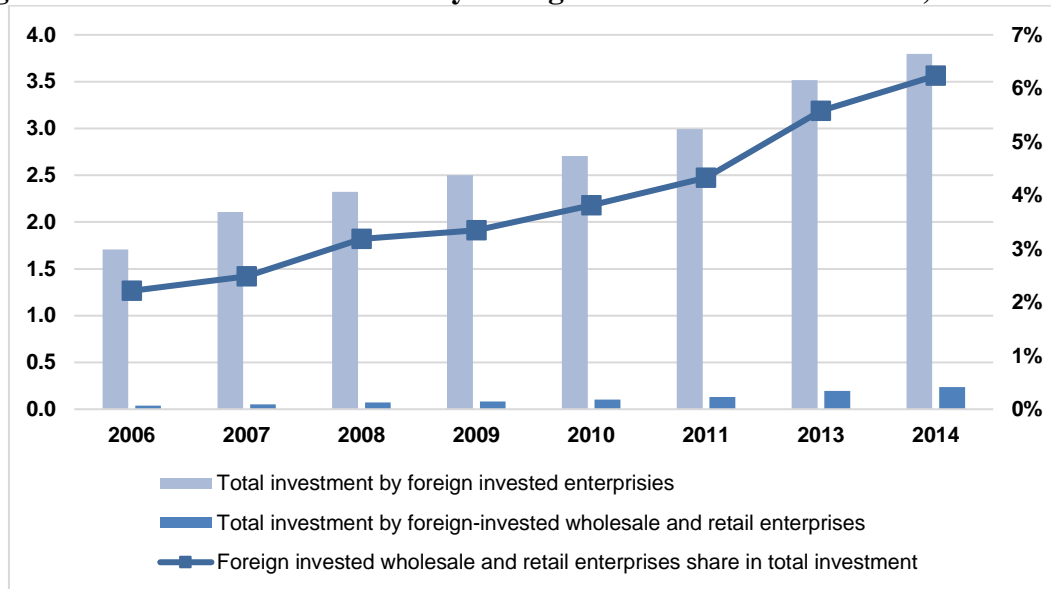
Source: National Bureau of Statistics of China

Figure 5.2.2 shows the detailed breakdown of employment by corporate type of foreign retail firm. In 2014, among the 1045 foreign retailers in China, there were 635 solely owned firms, 315 joint ventures, 43 share-holding corporations, 32 cooperatives and 20 others (Figure 5.1.1). Of the 456,911 employees of foreign retailers, well over half were employed by solely-owned firms, with joint ventures being the second highest employer. Of the 414,168 employees in retail firms owned by Hong Kong, China; Macao; and Chinese Taipei, nearly two-thirds are employed by solely-owned firms.

Very importantly the opening up of the distribution sector has also impacted positively upstream on **local merchandise producers** who have benefitted from a wide variety of opportunities including foreign retail firms' linkages to offshore markets. The opening up to foreign retailers had the effect of attracting major new procurement opportunities for Chinese producers. More than 40 of the world's top 50 retail groups now purchase over USD1.5 trillion in China, through procurement centres which account for 60 percent of total procurement in Asia.

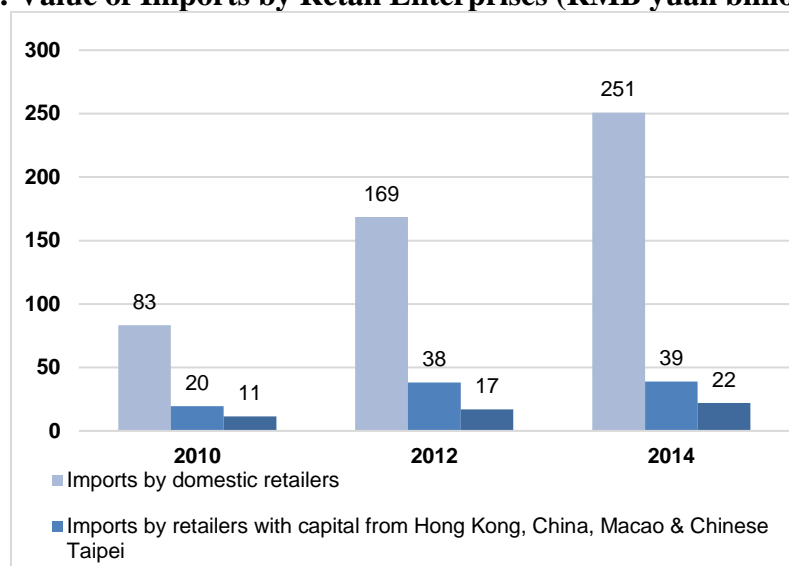
Foreign retailers have also **increased domestic investment** in China. As shown in Figure 5.2.3, the total stock of investment by foreign wholesalers and retailers increased from USD37.8 billion to USD236.8 billion by 2014. The share of wholesale and retail services in total investment by foreign firms increased from 2.2 percent in 2006 to 6.2 percent in 2014.

**Figure 5.2.3: Investment in China by Foreign Wholesalers & Retailers, USD trillion**



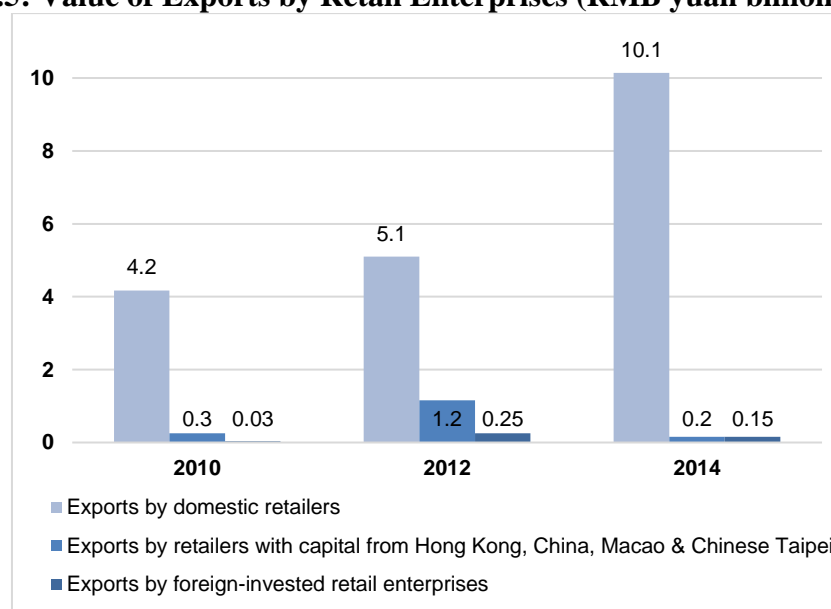
Source: National Bureau of Statistics of China

It is worth noting also the impact on **trade flows**. China's retail firms are growing net importers, with the deficit increasing from 109.7 RMB yuan billion in 2010 to 301 RMB yuan billion by 2014 (Figures 4.2.4 and 4.2.5). Total imports by retailers stood at 114.2 RMB yuan billion in 2010, with domestic retailers accounting for 73 percent, firms from Hong Kong, China; Macao; and Chinese Taipei for 17 percent and foreign retailers for 10 percent. By 2014, total imports by retailers reached 311.6 RMB yuan billion, with domestic retailers importing a larger share just over 80 percent, firms from Hong Kong, China; Macao; and Chinese Taipei and foreign retailers each importing around 10 percent of the total.

**Figure 5.2.4: Value of Imports by Retail Enterprises (RMB yuan billion), 2010-2014**

Source: National Bureau of Statistics of China

Foreign retailers are insignificant players in China's export business. In 2010, total exports of retail firms in China stood at 4.5 RMB yuan billion. Firms owned by Hong Kong, China; Macao; and Chinese Taipei participated in the export business, accounting for a 6 percent share – foreign retailers accounted however for less than 1 percent of exports. By 2014, exports had skyrocketed to 10.4 RMB yuan billion. Firms owned by Hong Kong, China; Macao; and Chinese Taipei retailers accounted for a reduced 1.5 percent and foreign retailers for a small increased share at 1.5 percent.

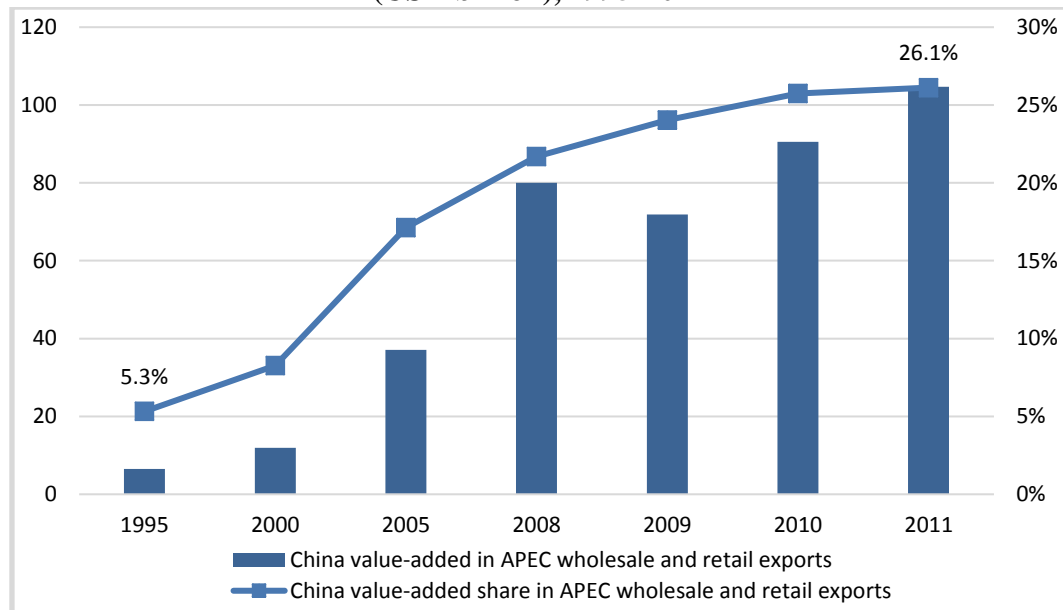
**Figure 5.2.5: Value of Exports by Retail Enterprises (RMB yuan billion), 2010-2014**

Source: National Bureau of Statistics of China

On the other hand, international retailers have evidently acted as very important “export gateways” for local Chinese MSE suppliers; in 2014, Walmart for example sourced US\$18b worth of Chinese goods for sale in the United States market alone. It is also worth observing the strong growth in China's value-added share of exports of retail (and wholesale) services from the APEC region, from 5 percent in 1995 to 17 percent by 2005 and 26 percent in 2011,

confirming that opening up via WTO commitments has helped grow the distribution sectors' overall export performance.

**Figure 5.2.6: China's Share in APEC Region Gross Retail and Wholesale Exports (USD billion), 1995-2011**



Source: OECD-WTO TiVA database 2015

### 5.3 INSIGHTS FROM TRENDS IN TRADE IN VALUE-ADDED

The new OECD/WTO Trade in Value Added (TiVA) data goes beyond the traditional balance of payments data to show the trends of value added content embodied in traded goods and services. It breaks down and measures the domestic and international components of an industry value chain, showing how industries interact along the chain to produce the final traded good or service.

The TiVA data covers retail only in an aggregated industry group where it is combined with wholesale and hotels. This limits the applicability to the retail sector of the policy conclusions which might follow from analysis of this data. Appendix 3 nevertheless provides a detailed analysis of the trends in value added in the aggregated industry grouping wholesale, retail and hotels. Based on 2011 data, what stands out of particular interest is summarised below:

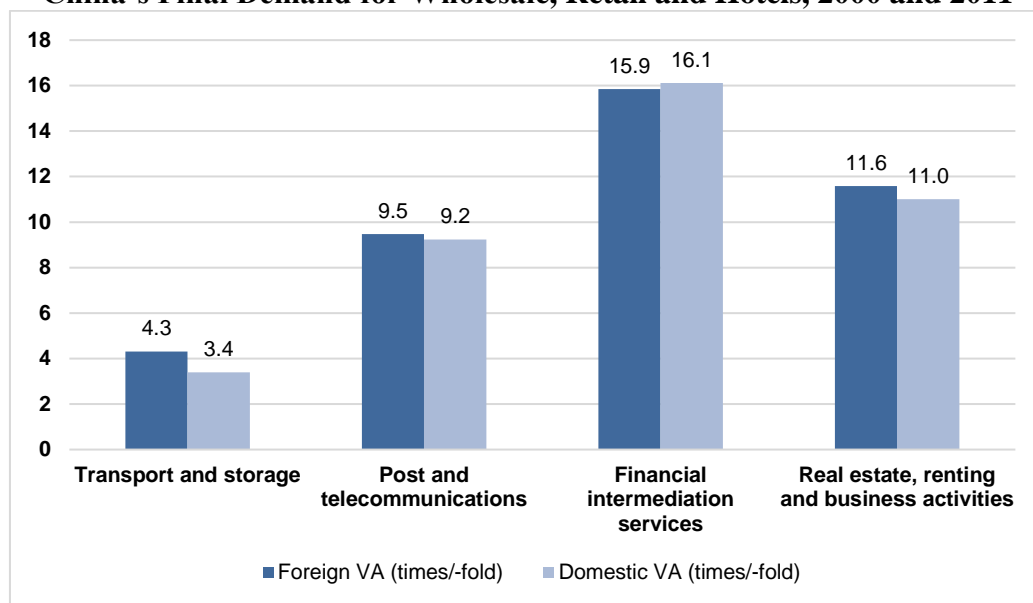
- The wholesale, retail and hotels sector is the largest services sector contributor to the total value-added of China's exports of manufactured goods (12.2 percent, followed Business services 6.6 percent and Transport & Telecommunications 5.6 percent).
- Although the retail, wholesale and hotel sector also ranks number 1 in terms of contribution of China's domestic value-added to gross exports (contributing around 13.5 percent, followed by ICT and electronics (11 percent) and textiles (7.5 percent), it is not particularly export-driven. Foreign final demand accounts for 30 percent of total domestic value added in this sector and this has dropped 5 percentage points since 2008
- The foreign value added share of gross exports of this sector is very small and has seen no significant increase since WTO accession.
- Some local services upgrading has taken place within this sector, with other domestic services intermediates contributing more to exports. There has also been a small but steady



decline over 2008-2011 of imported inputs going into exports of wholesale, retail and hotels.

- Taken together, these findings provides important signals that China is moving upward in the value-chain as domestic services providers integrate upstream.
- Financial intermediation stands out as one services sector where growing local value added participation in the wholesale, retail and hotel sector is apparent.
- Foreign value added is growing slightly in some other services inputs into the sector such as Post and telecommunications, Real estate, renting and other business activities and Transport and Storage.

**Figure 5.3.1: Increase in Key Services Sector Domestic and Foreign Value-Added in China's Final Demand for Wholesale, Retail and Hotels, 2000 and 2011**



Source: OECD-WTO TiVA database 2015

It is also relevant to the discussion of reform in the retail sector, and recent developments in e-commerce, to note that in 2011, only 10.5 percent of China's total final domestic consumption reflects foreign content with as little as 2.1 percent from Europe, 1.4 percent from NAFTA, 3.4 percent from East and Southeast Asia, 0.7 percent from South and Central America and 3 percent from other regions.

#### 5.4 MEASURES OF SERVICES TRADE RESTRICTIVENESS

The OECD Services Trade Restrictiveness Index (STRI) provides policy makers and regulators with a means of measuring progress in structural reform in services and of benchmarking against best practice. The OECD STRI is calculated on the basis of a regulatory database that contains comparable, standardised information on trade and investment relevant policies in force. STRI indices take values between zero and one, one being the most restrictive.

Retail ranks consistently amongst the most open services sectors in all regions of the world, with the overall level of restrictiveness ranging from 0.02 to 0.4. The sample average is 0.13. The APEC region average is 0.17. Typical contributors to the global restrictiveness results are set out in Box 2.

According to the OECD STRI, and illustrated in Figure 5.4.1, China still has a relatively high degree of restrictiveness among APEC members, with a score of 0.311. Detailed STRI indices for China are provided in the Appendix.

### **Box 2: Services Trade Restrictiveness Index for Distribution Services**

**Restrictions on foreign entry significantly** contribute to the restrictiveness results for almost half of the economies covered by the STRI (60 out of the 103 economies covered).

Although most economies allow close to 100 percent foreign ownership for greenfield investments as well as acquisitions, a high level of restriction is attributed to impediments such as screening of investments, limitations on board members and managers, economic needs test for licensing, and restrictions on acquisition of land.

Restrictions also exist on form of entry, ownership, regulatory and sector specific operational limits such as limitations on multi-brand stores, the number of outlets, locations of the store, and the type of products sold. Foreign equity restrictions are found in 2 economies in the OECD sample set.

Some economies require that the distribution of certain products, such as alcohol beverages at the retail level and wholesale level, is reserved for statutory monopolies. In 1 economy foreign invested retailers and wholesalers are not allowed to sell tobacco. 5 economies have no restrictions on foreign entry.

A range of idiosyncratic **domestic regulations** also occasionally impede market entry.

Many developing economies do not have formal regulations for retail activities. The STRI database shows that in 23 percent of economies covered, a license is not required, and 30 percent of economies indicate there is no regulatory authority for retail. It is not clear how far this lack of formal regulation translates into openness. Openness can be deceptive when complicated multi-layered licensing processes and other behind-the-border restrictions are in place.

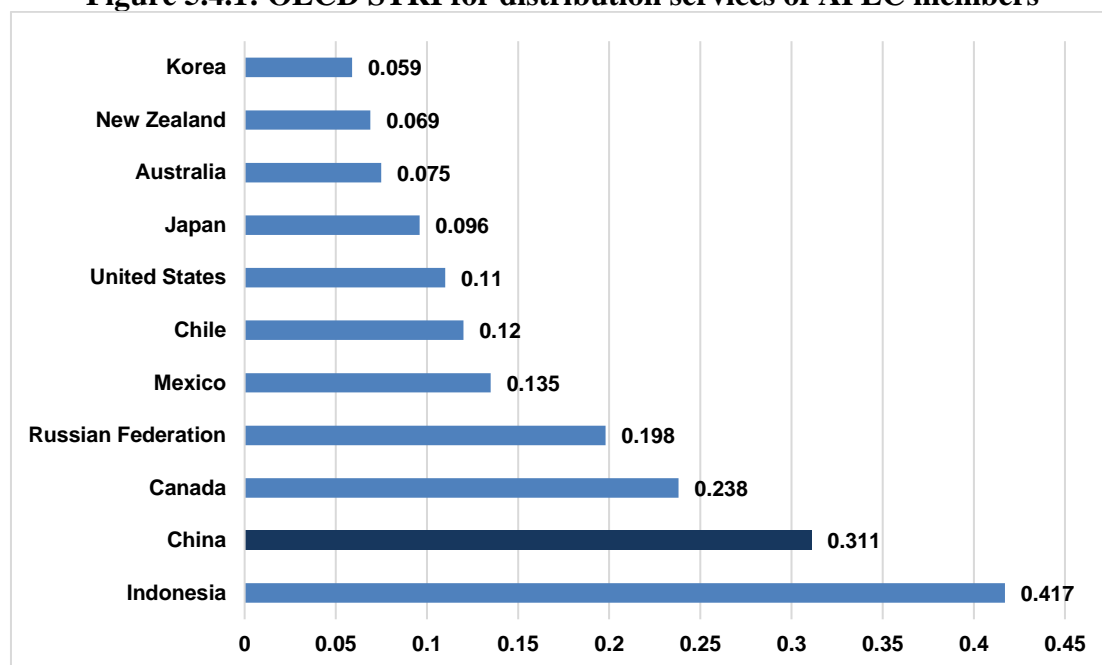
Several economies have discriminatory measures in relation to consumer credit and public procurement. Regulations on pack sizes of pre-packages and labelling provisions beyond information requirements are also observed in a few economies, although almost half of the economies included in the STRI database do not have any restriction in this policy area. Other discriminatory measures include local sourcing requirements for multi brand retail trading which are found in 1 economy.

Restrictions on the **movement of people** have the biggest contribution to the indices in 8 economies in the data set.

**Barriers to competition** also have a substantive impact on many economies and are the most significant restrictions in 9 economies. Restrictions on business practices, such as shop opening hours, seasonal sales periods and price regulations, are prevalent. In addition, two-thirds of economies have minimum capital requirements.

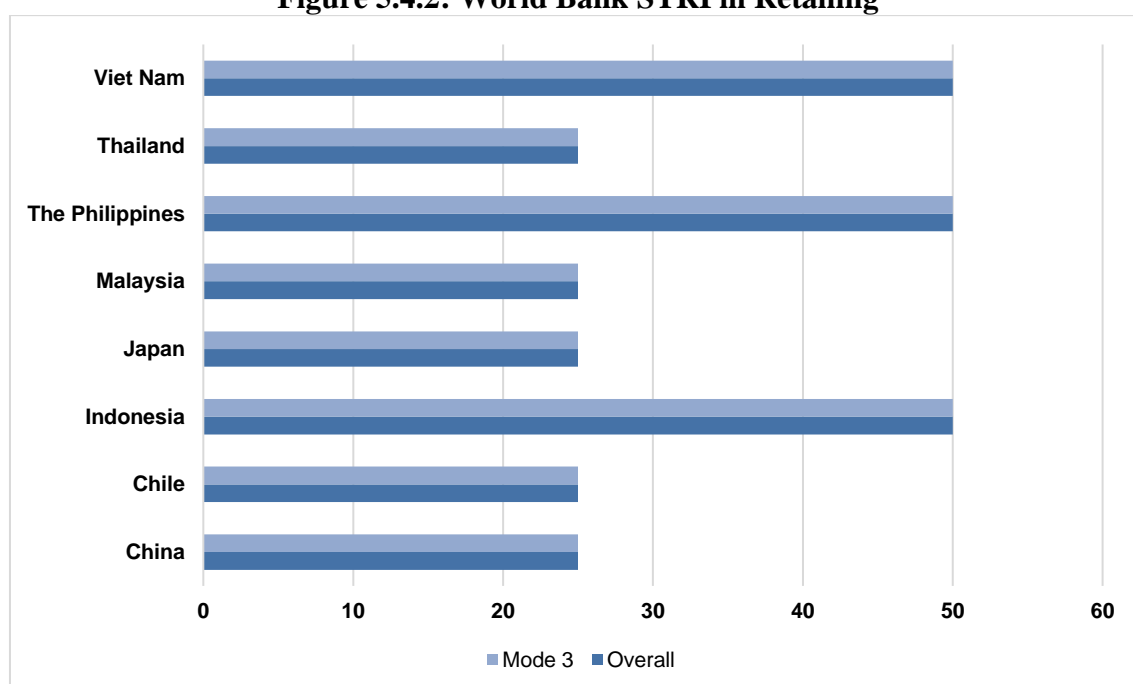
The market structure of distribution services is changing rapidly with the emergence of e-commerce and multi-channel retailers. The STRI covers only some of the issues with respect to these new types of services providers. Restrictions that impede e-commerce and multi-channel retailers warrant closer attention as developments in this area continue to advance.

Source: OECD

**Figure 5.4.1: OECD STRI for distribution services of APEC members**

Source: OECD Trade Policy Papers No. 173

While China's policy and regulatory regimes affecting the distribution sector cannot yet therefore be described as regional best practice, the market opening experiences of China, and the many positive impacts along the value chain, hold important lessons for other APEC economies with even higher STRI in the distribution sector. According to the World Bank measure (Figure 5.4.2), China has the same score of 25 for both overall retailing and for mode 3 (commercial presence). This is on a par with Thailand, Malaysia, Japan and Chile, lower than Viet Nam, The Philippines and Indonesia.

**Figure 5.4.2: World Bank STRI in Retailing**

Source: World Bank STRI database

Moving beyond traditional retail to measuring restrictions specifically in e-tail, would require of course an additional examination of regulatory barriers affecting the evolving value-chain. As discussed earlier, a full study would need to take into account restrictiveness also with respect to telecommunications services, ICT services, financial services, transport, logistics and express delivery services.

## **5.5 OTHER QUALITATIVE FACTORS TO CONSIDER**

In addition to reform of many of the regulatory impediments picked up in the STRI, the Chinese government has taken a number of other steps to promote transformation of the retail sector, to facilitate innovation, to remove domestic chokepoints along the value chain and to expand consumer choice. Not all of these pro-competitive policy stances are necessarily picked up in the legislative and regulatory data-base compiled by the OECD.

For example, the government has traditionally encouraged retail enterprises to expand their scale through acquisitions and mergers, contracting and equity investments in order to achieve greater competitiveness. Central government policy has also guided small and medium retail enterprises to modernize, in particular to actively apply modern distribution technology, as well as marketing and management techniques.

Implementation of State Council policies on “promoting the development of distribution” and “invigorating distribution and expanding consumption options” has helped ease chokepoints in domestic and international retail supply chains and diminish domestic market fragmentation.

Both the 12th and 13<sup>th</sup> Five-Year plans introduced by the MOC have included promotion of multi-channel retailing chains and multi-format extension. By encouraging increased scale and a higher degree of horizontal firm-level integration, MOC has facilitated efficiency gains in the traditional retail value chain in China as well as the e-commerce value chain.

Legislative developments are also noteworthy. Recent developments include the “Price Law”, “Anti unfair Competition Law”, “Anti-Monopoly Law”, “Direct selling regulations” and “Regulations on the Administration of Commercial Franchise”. New Departmental-level rules include “Foreign Investment in Commercial Fields”, “retailers-suppliers fair trade management approach” and “retail sales behaviour management approach”. The Anti unfair Competition Law is now being revised and is expected in its next iteration to also cover the internet-based industries including e-tail and e-payments.

## **6. NEW BUSINESS AND REGULATORY CHALLENGES AND FURTHER STRUCTURAL REFORM**

The retail landscape is becoming more complex and dynamic and new business models, as well as new regulatory challenges are emerging.

### **6.1 TECHNOLOGICAL AND CONSUMER PREFERENCE CHALLENGES FACING TRADITIONAL RETAILING**

Chinese consumers' attitudes toward products and brands are changing, and individual consumer behaviour is more pluralistic. A decade ago, packaged consumer goods had only a handful of optional sales channels: supermarkets, convenience stores, hypermarkets and traditional small and large retailers. Now, consumers demand more product and brand choice, with different sizes, packaging, and sales methods. And e-commerce and m-commerce is providing more numerous options with respect to payment and delivery processes.

These shifts call for a rethinking by retailers to the traditional go-to-market approaches. The more knowledgeable about customer needs and preferences the retailer is, the smarter and more focused retailers can be in managing their own value chain to effectively deliver both variety and value for money to the consumer. As retailers move to cover more retail channels, they need to simplify trade terms and promotional spending. Adapting to the fragmentation of marketing channels has stimulated many companies to innovate in managing more digital merchandising and communications paths. Data and analytics capabilities now play an important role in managing costs in today's consumer environment. Retailers increasingly focus on key capabilities such as building a comprehensive dataset of sources on consumer, brand, product, and competitive behaviour and developing analytical skills, tools, and routines to use the data in ways that are critical for the specific business.

In the more competitive environment, consumers tends to be more price sensitive with price often being a determining factor in the choice of retail channel. Convenience is also cited as a key consumer motivator, together with growing desire for a wider range of varied products including unique, individual or bespoke items. The shopping experience itself is increasingly important, including the ease of payments and delivery processes. Online retailing is becoming important for brand positioning and consumers are spending more online.

#### **6.1.1 Consumer responses to innovative media messaging**

Consumers' use of media has fragmented with the rise of digital content and the proliferation of online devices. Each channel - from the web, mobile, and social sites to radio, TV, and print - has its own technical requirements, audience appeal, and economics, needing specialized attention. But at the same time, media campaigns need to be closely coordinated for effective consumer messaging.

Chinese consumers are becoming highly interacting online, visiting web forums and discussing and researching brands on the internet, either via their PCs/tablets or on the go, via their mobile smart phones. Digital media therefore is playing an increasingly significant role as it enables brands to interact with both existing and potential consumers. Social media is popular, with many consumers turning to celebrities, influential bloggers and also their own social online

communities for direction and pointers on what to buy. Consumers actively engage with online campaigns, post online product reviews and provide direct feedback.

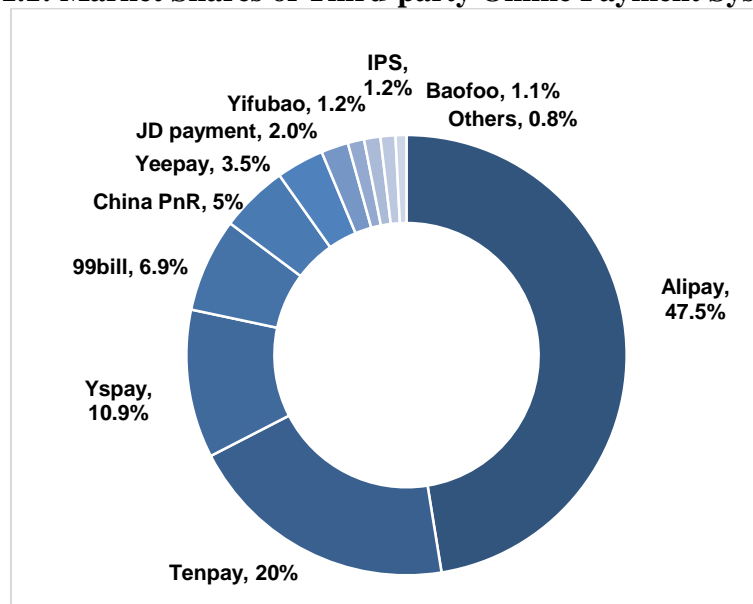
With almost instantaneous feedback and easy-to-use interfaces, social media platforms such as Weibo (microblogging website – akin to a hybrid of Facebook and Twitter with a market penetration similar to Twitter in the United States, launched by Sina Corporation in 2009 and with over 100 million users per day in 2016) and WeChat (stand-alone messaging app launched by Tencent Holdings in 2001 with over 700 million active users in 2016) are identified by Chinese consumers as the top choice for information, followed by friends and word-of-mouth. Online consumers under 35 are more likely than older shoppers to rely on peer opinions, either in user reviews, or via word-of-mouth. As consumers spend more on products that receive reviews from trusted and familiar sources, Brands need to be able to fully integrate social media platforms as part of their overall retail strategy in China.

### 6.1.2 Consumer responses to online payments systems

Consumer preferences are shifting towards transparency and flexibility as they are looking for better, more proactive solutions around life events. The online payments market has grown in importance in recent years as a result of the boom in e-commerce and consumers have shifted from paper based payment mediums to online payment mediums. China's third-party online payment platforms confronts increasing fierce competition.

Third-party online payment platforms are facing increasingly fierce domestic competition. In 2015, the gross market value of China's third-party online payments totalled 11.8 RMB yuan trillion, 47 percent more than the previous year. Alipay held a 47.5 percent share of the total market. Tenpay had gained a 20 percent share due to its open cooperation platforms and comprehensive set of financing scenarios including through WeChat and QQ with integrated online mobile options. JD, with 7 payment-based businesses, had ramped up its efforts to develop third-party online payment options for e-commerce and achieved a market share of 2 percent.

**Figure 6.1.1: Market Shares of Third-party Online Payment Systems, 2015**



Source: iResearch 2016

The three major payment services providers are China UnionPay, Alipay, and Tenpay. UnionPay, established in 2002 with approval of the State Council and the People's Bank of China, has been the only inter-bank network in the market, and is the largest credit card scheme in the world by number of cards issued. UnionPay is a vital part of the payments mix, and particularly important for reaching shoppers who do not have an Alipay or Tenpay account. In June 2016 China moved to implement reforms announced as a result of a WTO ruling in 2012 that it was discriminatory to bar foreign e-payments processors from handling RMB Yuan – denominated transactions. This opens the market to foreign credit cards such as Visa and Mastercard, officially ending Union Pay's monopoly.

Alipay is the largest single payments platform in the market, with around a 48 percent share and an even bigger slice of the fast growing mobile pie. Its dominance is due to its integrated linkage with online shopping platform Taobao, founded by Alibaba Group in 2003 and now one of the world's top 10 most visited websites. Tenpay is integrated with Tencent QQ, an instant messaging software service that includes not only group and voice chat but also shopping, gaming and microblogging. Tenpay has 20 percent of the market, with most transactions originating from their own webstores such as WeChat webstore.

Chinese consumers are becoming more familiar with foreign brands, and they have access online to price information for products selling overseas. There has been an evident preference, when they find foreign retailers offering what appear to be the same luxury products in China but at much higher prices, to buy those products overseas, or purchase them through "daigou" agencies whereby overseas Chinese make purchases "on behalf of" residents. Many foreign retailers have recently found themselves at a tipping point, facing high tariffs on luxury products, competition from undetected counterfeit products purchased online, reluctance to design products specifically catering for the China market and a slowdown in sales growth. Retailers targeting the mid- to high-end markets are facing particular challenges.

China's new e-commerce law implemented in April 2016 seeks perhaps to respond to some of these as well as a range of other consumer protection issues but in ways which have drawn much response from stakeholders.

In May 2016 a State Council Circular on IP infringement and shoddy products introduced a crackdown on on-line sales of shoddy products, especially popular foods, medicine, agric. goods, household appliances, construction materials, auto parts and children's products. It also calls for establishment of a tracing system for fake goods traded through cross-border e-commerce, including online piracy and infringements, especially in on-line literature, music, videos, games, comics and software.

New differentiated "parcel taxes" have also been introduced on foreign goods purchased online. And the publication of a "positive List" of cross-border e-commerce goods that have central government approval for import (including a broad range of fashion, footwear, toys, cosmetics, and home appliances, as well as more sensitive items such as infant formula) has begged a number of questions about goods not on the list. Cross-border e-commerce is now a hot topic in China.

## **6.2 ONGOING AND POSSIBLE FUTURE DIRECTIONS FOR POLICY AND REGULATORY REFORM IN CHINA**

The Chinese government has been very supportive on the development of the retail sector, playing an important role as the economy moves towards a consumption-driven economy. In recent years, a number of new rules and regulatory guidelines have been issued to promote retail development. Other regulatory changes are foreshadowed, including in response to the technological and consumer preference driven developments highlighted above.

### **6.2.1 Consumer protection law**

One of the most significant initiatives was the promulgation of the new Consumer Protection Law in March 2014. This aimed to provide more comprehensive rights for consumers in a rapidly evolving business context and with changing consumer behaviour. It has heightened obligations and liabilities of retailers and expanded protection of online consumers, enabling them to return products purchased online within seven days without explanation. Moreover, the new law provides that businesses need to respond to a consumer complaint within seven working days instead of two to four weeks, as required under the previous legislation. Penalties imposed for contravention have increased from 1-5 times the earnings to 1-10 times earnings. If no earnings arise from a transaction, the penalty has been increased from the previous 10,000 RMB yuan to up to 500,000 RMB yuan. In addition, compensation for the consumer has increased from 100 percent to 300 percent of the given sales price.

Food safety has also seen recent policy focus. In May 2016 the State Council issued a Plan to tighten supervision on food safety, calling for improved laws and regulations on food safety, including the Quality and Safety Law for Agricultural Products. Heavier criminal sanctions were imposed on fake products & an origin tracing system will be established to root out illegal actions. Tightened supervision planned on overseas sources of food and agricultural products. Standards for construction and operation of cold chain logistics will be improved to ensure higher standards of food safety.

### **6.2.2 Online payments regulation**

The Chinese government has granted over 200 licenses to domestic non-bank third party payment services providers in order to expand the payments ecosystem and promote the development of the online payments industry. This will help to bring greater choice and competition to the domestic payments market.

Policy measures that enable development of open and market-driven electronic payments solutions for consumers as well as provide a level playing field for acceptance and issuance of licenses for electronic payment companies, merchants, and the banking sector have become essential in today's retail environment. A sustainable payments system is not just about technology, but about driving incentives for others to participate in it and derive value from doing so. Encouraging the growth of electronic payments gives consumers and merchants greater choice and increases competition. When economies allow for competition and a level playing field, consumers benefit.

### **6.2.3 Transport, logistics, express delivery regulation**

A State Council document of 26 October 2015 sets out the Government's approach to accelerating development of the express delivery industry, including building international



competitiveness of China's local express delivery industry. The government plans to establish a safe and efficient delivery network that provides quality service to both urban and rural areas with advanced technology by 2020. The network will cover the whole economy and connect with foreign economies. The new policy aims to tackle problems rough development modes, undeveloped infrastructure facilities and various safety and security concerns.

The State Council policy goals include significant enhancement to air transportation owned by delivery enterprises, building of a batch of new domestic and international cargo terminals, and cultivating key enterprises with international competitiveness. The objective is to ensure express items between major domestic cities can be delivered within 48 hours, and to improve the speed of international services and the economy coverage.

In June 2016, the NDRC announced an Action Plan to promote integrated development of transportation & logistics. This Plan establishes targets to be reached by 2018, with a "one waybill" transportation system (sometimes described as "one data") and a railway system covering over 80% of China's large ports and logistics parks.

#### **6.2.4 Labour market regulation**

The online retailing ecosystem is providing new flexible employment opportunities for those who would otherwise not participate in the job market but can now more readily find structured jobs that can be done at home and/or during flexible hours. This taps into the pool of ageing workers, mothers who might choose to stay in the labour market if lower-intensity jobs are available, as well as mobility-impaired workers who can perform more easily from home. E-tailing is uniquely suited to offer this type of flexibility.

In China, part-time workers are popular in the online retailing sector. 54 percent of market place-based e-tailers operated their online stores on a part-time job basis. Many mini retailers with fewer than five employees use family members on a part-time basis as well. It is also quite common for large-scale e-tailers to employ part-time workers to work remotely as online customer service assistants. The Chinese giant retailers recruit talent overseas.

China's labour market is relatively dynamic and retail industry employees change jobs even more frequently than most of their counterparts. China's retail industry employees tend to receive an annual pay rise of between 5 and 10 percent and expect a 25 percent salary raise when they change jobs. High staff turnover is a challenge. The annual turnover rate for the retail industry as a whole is between 30 to 40 percent; for some segments, such as junior staff, the turnover rate can be as high as 70 percent. Many retailers indicate that it is hard to recruit and retain staff, especially junior sales associates.

Skills shortages could impede the further growth of the retailing industry in China. There is a need for the Government to consider adoption of a range of more flexible employment policies to further facilitate this type of part-time labour pool expansion, as well as employee skill development and attract more talent from overseas. For example, the government provides tax incentives and specifies a required percentage of mobility-impaired workers.

### 6.2.5 Competition policy

According to the MOC<sup>6</sup>, phased progress has been made in eliminating regional blockades and breaking trade monopolies. A series of regulations that hampered fair competition have been overhauled. An intensive review process took place in which 235,721 government regulations, normative documents and other documents were examined in the provinces, autonomous regions and municipalities, among which 476 were amended, abolished or announced invalid. At least 27 local documents providing for favourable tax treatment and conflicting with other relevant regulations were abolished or amended. Coordinating mechanisms were introduced among related departments to ensure bidding regulations were comprehensively cleared, and 33 administrative and institutional fees at the central level and 314 at the provincial level were cancelled or exempted.

Law enforcement supervision has been strengthened, and fair competition promoted in the market. A special campaign was conducted to rectify competition abuses on TV shopping channels. Over 50,000 enforcement personnel were dispatched, more than 770,000 advertisements monitored and 691 cases of violation brought. Penalties were imposed on 316 enterprises and broadcast organizations and 265 websites, 16 illegal TV shopping channels were closed, and 7,803 advertisements were deemed to be illegal and forbidden. After the special campaign, the number of illegal TV shopping advertisements dropped 84 percent.

The MOC also strengthened its supervision of retail and supply transactions, and investigated the pricing policies of Beijing Wumart, Beijing Jingkelong and Jinan Suning. Management procedures were strengthened for commercial prepaid cards. A special inspection was carried out to urge local registered enterprises to more strictly implement the business reporting systems and safeguard measures on pre-collection funds. To date, as many as 4,503 enterprises which issue single-use cards have completed registration.

Capacity for competition law enforcement supervision needs to be strengthened further.

With respect to e-commerce, the Government has remained relatively silent but China's Anti-Unfair Competition Law is currently under revision and is expected to provide clearer guidance with respect to internet-based industry in future.

Meanwhile, in May 2015, the State Council published an Opinion on Striving to develop E-Commerce and Accelerating the Cultivation of the New economic Engine which is focused on competition specifically in the e-commerce market, emphasising curbing monopoly agreements and abuse of market dominance and reviewing the concentration of undertakings. This policy guideline did not have legally binding status nor did it solve any specific anti-trust issues in the e-commerce sector. But it did identify the relevant authorities as NDRC, SAIC and MOC and tasked them with issuing specific policies in the near future.

Based on competition law principles, there are two separate markets involved; the online B2C market where the e-commerce service is a platform and media tool and the e-commerce service market where the platform operator offers both the platform and other services both B2C and B2B. Concentrations of undertakings are potentially present in both markets (eg the transactions between Didi and Kuaidi, 58 Tongchen and Ganji as well as Ctrip and e-Long.)

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<sup>6</sup> <http://www.mofcom.gov.cn/article/ae/ai/201501/20150100882509.shtml>

Trans-market issues are also arising. Platform operators such as Yihaodian and Jingdong engage in direct sales and hence compete directly with the online business operators by selling direct their own commodities and services on their platforms.

In China, as in other APEC economies, the mix of pro-competitive and anti-competitive effects of exclusive arrangements and MFN clauses in price-setting between online platform providers and online business operators is now under discussion, with questions arising regarding potential vertical monopoly outcomes.

There was one competition enforcement case in 2012, when Walmart acquired the control of online platform operator Yihaodian's online direct sales business, where MOC considered that Walmart might leverage its offline competitive strength into the online environment and the post transaction entity may foreclose competition in the value-added telecommunications sector, consequently imposing some restrictions of the scope of the transaction and on the post-transaction operation.<sup>7</sup>

In the fast changing technological environment, and development of the O2O business, many platform operators are now focussing on mergers with offline enterprises, for example Alibaba's equity acquisition of Intime Department Store. Meanwhile an increasing number of offline businesses including even logistics companies, are entering into the e-commerce market. In the future there will likely be more trans-market concentrations of undertakings with considerable market power, drawing the attention of competition enforcement.

## **6.2.6 Development of social and business credit systems and other financial services**

The process of building a business credit system has deepened including a regulatory regime for integrity payments systems has been introduced. The MOC introduced a Planning Outline for Social Credit System Construction 2014-2020 (No. 21)<sup>8</sup>, and Opinions on Promoting the Operation of the Business Credit System (No. 772). A targeted promotional plan is being implemented, with a first batch of 87 enterprises and institutions in Beijing, Shanghai, Jiangsu, Zhejiang and Guangdong identified.

Development and promotion of the credit trading sector is underway. A project oriented to awarding credit insurance to SMEs for domestic retail trade has been implemented, with subsidy funds of 98.62 million yuan covering 23 provinces. The factoring industry has been promoted and is flourishing, with factoring agencies established in Tianjin, Shanghai, Shenzhen, Chongqing, Zhejiang and Beijing. Consumer discipline and community integrity of payments systems has become stronger. The government could focus more on encouraging chambers of commerce and industry and other business associations to themselves conduct business credit evaluation.

In June 2016, the State Council issued a Guideline to establish a better social credit system. The idea is to build a credit-focused market, to facilitate streamlining of administration and delegation of government authority. Government at all levels is to put all credit-related information of market entities on the government website, providing more opportunities to enterprises with good credit records. Punitive measures will be imposed on those with low

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<sup>7</sup> King&Wood Mallesons

<sup>8</sup> The social credit rating system is being designed to assign credit ratings to all citizens, including based on their online behaviour.

credit. The guideline urges establishment of an online sharing system across the economy, promoting a cross- region, cross-sector all-of-government department credit system.

### **6.2.7 Retail channel regulation**

Fundamental structural change has taken place and continues to take place in retail. Consumers are demanding a variety of modern retail channels which provide convenient, affordable, safe, green goods and increasingly also services.

During the last 5 years, there has been keen competition in the retail sector in the first and second-tier cities. Due to a sharp rise in operating costs and a significant increase in rent and labour costs, the pace of retail expansion in the first and second-tier cities is now slowing. Some regional retail markets have also become saturated but most third and fourth-tier cities still have large potential demand. Low rents and labour costs, coupled with implementation of the "Ten Thousand villages" marketing project by MOC, together with other preferential policies, has intensified the pace of multi-channel retail development and encouraged a number of large chain stores to move to medium and small cities and rural areas to extend their retail channels, including establish retail outlets in towns and rural areas. This process is also contributing to accelerating the pace of urbanisation.

In the future, retail will involve multi-channels for both traditional and online retail. Integration of offline and online retail is being encouraged. The online retail chain will continuously be encouraged to radiate to small cities and rural markets.

The Chinese government has also encouraged retail enterprises to actively engage in retail business model transformation, reducing costs to enhance efficiency across the entire supply chain in the interests of all participants. Some local commentators have called for the government to provide incentives for retailers to enhance the degree of office automation by installing up to date Point-of-Sale and Enterprise Resource Planning software, Management Information Systems, financial management software systems and other digital technology.

### **6.2.8 Provision of e-commerce support services for SME retailers**

According to MOC<sup>9</sup>, in 2014, in line with the policy principle "the governments supporting the agencies, and the agencies supporting the enterprises", the MOC started developing pilot programmes to provide e-commerce support services for SME retailers. The Government is playing a direct role in driving SME e-tail development by helping to connect enterprises with government services to provide information technology consultancy, financing, market intelligence, personnel training and development of e-commerce applications.

To date, the pilot project covers 48 cities in 26 provinces, autonomous regions and municipalities, the construction phase is basically complete, operations have commenced and the government service offerings and modes have been well received by enterprises. Following the principle of "servicing while constructing", local government departments identified the common elements of SME needs via surveys, and a comprehensive range of services have been established to meet actual SME needs. Personalized services are available through service alliances and introductions are also being made to professional services organizations. A coordinating mechanism has been established among various departments, financial support

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<sup>9</sup> <http://www.mofcom.gov.cn/article/ae/ai/201501/20150100882509.shtml>

policies are in place, and SME retailers are benefitting, including gaining in terms of market recognition.

The programme of SME support will be revised in light of experience and benefits will be enhanced as required. The MOC and related departments will strengthen supervision and performance evaluation, and promote establishment of similar SME e-tail assistance platforms on a nationwide basis.

### **6.2.9 Other enabling policies to enhance the competitiveness of retail services**

The Government has recently introduced a variety of other policies designed to enhance competitiveness and help ensure an enabling business environment for the continued development of the retail sector. Not all of them can be covered in detail but it is worth mentioning specifically the recent efforts with respect to upgrading of transport infrastructure, development of e-commerce standards, protection of intellectual property and development of innovation and technological transformation policies.

Looking forward, the Government is showing awareness of the need to improve digital connectivity between the urban and rural areas and hence reduce the gap in access to modern retail and other services. The Government also needs to do more to ensure international digital connectivity. Some highlights of recent policy action include the following.

In **November 2014**, State Council Guidelines were issued to promote the development of domestic trade and distribution. Efforts are being made to improve the business environment by reducing administrative approval procedures and tax burdens. Loans from commercial banks and other policy support were made available for certain enterprises to build them into globally competitive retailers, wholesalers and logistics companies. Publication of a blacklist of companies that default on promises is taking place in a bid to establish a business credit evaluation mechanism.

In **August 2015**, the State Council commenced a Pilot reform programme in nine cities - Shanghai, Nanjing, Zhengzhou, Guangzhou, Chengdu, Xiamen, Qingdao, Huangshi and Yiwu - oriented to establishing a more efficient, more unified domestic distribution system, including a more integrated law enforcement system, strengthening of the credit system, and a generally more enabling business environment. The programme involves overall planning of urban and rural commercial network construction for an agricultural, and industrial bi-directional flow distribution network.

Municipal governments were assigned tasks in four areas: to explore an innovation-driven mechanism for developing the distribution system, highlighting the role of e-commerce; to establish a business environment that adheres to basic regulations, and upholds the supervisory and credit systems; to guide the construction of infrastructure catering for different modes in the distribution process, including wholesale farm produce markets, community service outlets and large-scale shopping centres; and to improve government management. Following a one year trial, the nine cities are expected to share their experience in terms of innovation, regulation, infrastructure development, and government management, to lay a solid foundation for building a unified domestic market and provide insights for China's overall reform of domestic trade and distribution.

State Council Opinions were also issued in **August 2015** setting out directions for modernization of domestic trade and distribution which is seen as a critical new engine for economic restructuring and transformation of the development model. The Opinions focussed on the importance of eliminating market segmentation and breaking industry monopolies to reduce distribution costs. Development plans cover the Bohai rim region, Yangtze River Delta and Pearl River Delta, and geographic belts such as Shenyang-Changchun-Harbin, Zhengzhou-Wuhan-Changsha, Chengdu-Chongqing, Xi'an-Lanzhou-Urumqi, where distribution-related industries cluster, to construct a series of high-potential interworking cities that would connect domestic and global markets. The domestic distribution sector will also be opened to foreign capitals, with an emphasis on advanced technology, management expertise and commercial models.

**September 2015** also saw issue of Guidelines from the State Council on Promoting Online-to-Offline Interaction to Accelerate Innovative Development, Transformation and Upgrading of Commercial and Trade Distribution and on Promoting Modernization of Domestic Trade Circulation and Business Environment for Rule of Law<sup>10</sup>. The State Council Opinions on online-to-offline interaction encourage retailers to provide community services and diversify the purchase experience of consumers. Physical stores are encouraged to cultivate new online-offline links, such as exhibiting and selling products online while improving offline services such as delivery, to optimize the consumption chain. Internet companies are encouraged to cooperate with physical stores to efficiently connect the information on supply and demand. Attention is drawn to the changes which should also be expected to take place in wholesaling, logistics and other services industries with the increasingly widespread application of mobile internet, big data and cloud computing. The document calls for the creation of smart business areas in cities that can offer interactive online-offline experiences to consumers. E-commerce enterprises are also encouraged to expand in rural markets to help facilitate the free flow of agricultural products to cities and industrial products to the countryside. Financial and fiscal support was made available to boost this initiative.

In **November 2015**, State Council Guidelines were issued to promote targeted development of open, orderly, reliable and environment-friendly e-business specifically in rural areas by 2020, promoting entrepreneurship and employment of rural residents and alleviating rural poverty. The Guidelines go well beyond e-commerce to e-businesses of all kinds. Supporting policies and measures will be introduced by the government.

In **April 2016**, State Council Guidelines were announced for implementation of the Internet Plus Distribution Action Plan. The objective is to promote innovation and transformation in distribution services, including e-commerce in rural areas. The guidelines call on promoting the transformation and upgrading of distribution by utilizing technology relating to the Internet of Things and Big Data to achieve online-offline interactions in marketing, payments and after-sales services. The guideline urged strengthening of supply-chain management to achieve cost saving and productivity improvement in the distribution sector.

Some commentators have also called for further digital infrastructure investment and support for a productivity push. The government could consider incentives to expand broadband and 4G+ or even 5G+ infrastructure, especially in rural areas. Consumers have already shown clear enthusiasm, but the technology is lacking in remote areas.

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<sup>10</sup> China Foreign Trade and Economic Cooperation Gazette [Issue No.61 and 65 2015]

Standards development is an important aspect of improving the business environment for e-commerce. The State Administration for Industry and Commerce (SAIC) has issued e-commerce model specifications and internet trading services specifications (SB/T10519-2009), both of which are voluntary industrial standards and drafted Administrative Measures for Online Commodities Trading and Related Services. The proposed measures specify criteria and procedures for online business registration, including protection of trademarks and company names, and task SAIC with monitoring online goods and services transactions.

Recent e-commerce regulations also lay out directions for the different categories of retailers targeted for development. These include online-only retailers that provide apparel, audio-visual products, books, home appliances, and home furnishings; multi-channel retailers that have traditional stores and offer online shopping services; and third party e-commerce platforms that provide C2C or B2C services that help SMEs and individuals to conduct business online.

Looking forward to an increasingly digital retail system, cities already anticipate decreased need for physical storefronts. Shopping districts and malls often serve as the anchors of civic life in advanced economies. But they may not play the same role in China's emerging cities. This is already posing new challenges for local government and opening new possibilities in urban planning. Smaller cities are having to invest in expanding warehousing and air cargo capacity, trucking routes and other logistics infrastructure. Lack of infrastructure beyond tier-1 and tier-2 cities otherwise risks reducing the willingness of consumers to purchase. The private sector will have to undertake much of the required investment, but the Central Government is providing encouragement and both the central and regional governments at all levels are exploring specific mechanisms to incentivise the process, including land release.

Some commentators are also calling on the Government to consider introduction of incentives for investment in information technology R&D and innovation and to facilitate university-industry collaborative partnerships in technology development.

Finally it is worth mentioning that in June 2016, the State Council issued a Guideline for establishing a censorship mechanism designed for fair competition in an open market system. The mechanism is to be re-oriented to achieving more rapid construction of a standard open market system. Government actions are themselves specifically required to conform to laws and regulations.

In summary, the Chinese government is making efforts on a number of fronts to ensure a fair competitive domestic environment for both online and offline retailers, and promoting coordinated development of traditional and e-commerce business entities.

## **7. POLICY IMPLICATIONS AND LESSONS FOR APEC MEMBERS**

Regulatory policies and practices that are put in place to counter market failures of various kinds, as well as to protect consumers and meet other social goals, have a powerful influence on competitiveness in any services sector and good regulatory policies and practices are vital ingredients in an enabling business environment for services. Regulatory reform can reshape an industry's characteristics, scale and rate of growth and influence the kinds of innovations brought forward. This is true in the retail industry everywhere. This case study demonstrates it to be the case in China.

Studies of structural transformation are necessarily medium- to long-term in nature. This particular case study spans a period of more than 2 decades in which far from slowing, the pace of technology-driven change is actually now intensifying. During the digital disruption taking place in this particular sector, an important task of regulatory work is to ensure that any changes in existing regulations continue to allow indeed to stimulate a beneficial environment for on-going retail innovation.

It is also important to take fully into account that the retail sector does not exist on its own and retailers are not separate actors; they are not separate from other producers, but certainly not from the all important consumers. Retailers are intrinsically linked to all sorts of consumer goods producers and distributors, as well as other services providers and to society as a whole. Changes in this sector impact visibly on everyone. E-tailing, for its part, has turned out to be rather more than merely a replacement channel for traditional retail – by spurring incremental consumption, it is generating new opportunities for productivity gains through the entire retail sector, and across the whole economy.

Policy and regulatory spill-over effects can therefore be very important. Regulation of other relevant services such as express delivery services, financial services, telecommunications services and professional services, all have regulatory spill-over on the retailing sector and vice-versa. The more open and competitive these related sectors, the more enabling the business environment will be for retail sector growth.

In drawing out the policy and regulatory lessons from this case study, focus is placed on identifying what aspects of the Government's policy and regulatory position were measurably most beneficial to the growth of the sector and might have application more generally, as well as attempting to propose some areas requiring ongoing attention.

Of particular importance has been the Government's systematic leaning in the direction of allowing retailers to innovate and more recently e-commerce to develop without a great deal of domestic regulatory intervention to date. The e-tailing sector has grown to significant size while being relatively less regulated than other sectors in China. The free competition within this ecosystem could continue to work its magic if the Government focuses on the few critical policy levers including with respect to security of e-payments and infrastructure development and trade facilitation for express delivery.

Cross-border e-commerce for goods has meanwhile also become a hot topic in China with the implementation of new e-commerce laws in April 2016 announcing a "positive list" for foreign-sourced products and imposing parcel taxes of different rates on foreign-sourced



products. There has perhaps been insufficient stakeholder consultation resulting in much confusion and lack of transparency and this stands out as deserving immediate and dedicated policy attention.

In summary, therefore, this case study identifies a number of potential lessons for other APEC economies.

## **7.1 LESSONS LEARNED FROM CHINA'S EXPERIENCE**

The retail industry in China has undergone profound transformation since China's accession to the WTO and phased implementation of its comprehensive liberalisation commitments in retail services. In the age of digitization, the retail industry continues to experience profoundly disruptive technology-driven structural shifts, generating a new suite of policy and regulatory challenges, with which governments everywhere are currently grappling. Against this background, China's retail services industry, and through the evolving retail value chains, the entire Chinese economy, has evidently benefitted from:

- Pre-WTO accession regulatory reform experimentation in dedicated Free Trade Zones to reduce the limitations on inward FDI in the retail sector.
- Rapid phasing in of market opening commitments in the WTO in all four modes of delivery, with special attention to significantly reducing regulatory restrictiveness with respect to foreign commercial presence.
- Significant simplification and easing of disorderly bureaucratic processes at all levels of government to provide a more enabling environment for growth in the retail sector.
- Policy guidance encouraging local retailers to benchmark against international best practice; scale up, modernise, adopt new technology and business practices to deliver customers with wider higher quality choice and value-for-money and to consider "going-out" strategies of their own.
- A relatively light domestic regulatory touch oriented to enabling innovation and the consequent "savage" growth experienced in e-commerce.
- Policy monitoring and research with respect to potential regulatory spill-overs across related sectors along the value chain, including telecommunications, financial services and express delivery
- Dedicated attention to designing a comprehensive suite of policies to assist SMEs in the transformation to e-commerce

Areas identified in the study as currently needing ongoing attention include:

- Collaborative innovation policies to encourage the uptake of new technologies at SME and MSME level.
- Job market policies to encourage greater labour market flexibility and address skills shortages in retail.
- Infrastructure development, including through public/private partnerships to facilitate express delivery and help build international competitiveness.
- Widespread stakeholder consultation on the need or otherwise for new regulations, on e-payments and m-payments services providers, and their relationship with online shopping platforms, for example to protect the consumer, enhance financial security, facilitate market entry and enforce competition.

- Clarification of anti-unfair trade regulations and enforcement with respect to e-commerce and the online-offline retail business environment, especially potential vertical monopolies and trans-market concentrations of market power.

## **7.2 GENERAL LESSONS LEARNED FROM CONDUCTING THE STUDY**

There is no doubt that for such an inter-connected sector, value-chain mapping can be a valuable analytical tool, not only for the business community where such tools are generally applied, but also for policy makers and regulators. Especially now that the retailing landscape is increasingly complex and dynamic, the regulatory regime is best considered and designed with a value chain perspective so that the predicted impact of proposed regulatory changes can be traced through to other sectors of the economy and considered in their entirety.

It is similarly important, in identifying the full extent of trade restrictiveness in any industry, to take into account restrictions affecting other industries intrinsically linked into the value chain. Strategies for structural reform in any one industry need to be developed in keeping with this economy-wide perspective. Over time, use of the TiVA data offers a new opportunity to trace the impacts of regulatory changes through to their international trade effects.

The retail industry has many different sub-streams. Each of them faces its own unique regulatory challenges. But regulators need to remember that undue regulatory compliance costs experienced at any point along the way, will impact cumulatively along the entire value chain. To undertake a full cost benefit analysis and avoid unintended consequences, regulators need to be able to identify all key parties involved in the retail value chain, identifying the inputs and outputs at each link of the chain and at each point of regulatory intervention.

This study has shown, moreover, that the traditional retail pathway to market is morphing and new and differentiated forks are appearing along the path, even for the same product, and retailers need to accommodate and manage all these different channels. Regulatory polices similarly need to be sufficiently flexible to help deal with the greater variety of potential market failures, consumer protection and other social policy goals, which arise along a morphing value chain.

## ABBREVIATION LIST

B2B	Business-to-Business
B2C	Business-to-Consumer
CAD	Computer-aided design
CCFA	China Chain Store and Franchise Association
CNNIC	China Internet Network Information Center
CR	Concentration Ratio
3DP	3D printing
DVA	Domestic Value-added
e-commerce	Electronic online commerce
e-payments	Electronic online payments
E-tail	Electronic retail
FIE	Foreign-invested Enterprise
FVA	Foreign Value-added
GATS	General Agreement on Trade in Services
H&M	H & M Hennes & Mauritz AB
JV	Joint Venture
LVMH	Moët Hennessy Louis Vuitton SE
m-payments	Mobile payments
MOC	Ministry of Commerce, China PRC
MOFTEC	Former Ministry of Foreign Trade and Economic Cooperation, China PRC
NDRC	National Development Reform Commission, China PRC
NPC	National Peoples' Congress of China, PRC
O2O	Online-to-offline
OECD	Organisation for Economic Cooperation and Development
SAIC	State Administration for Industry and Commerce, China PRC
SETC	Former State Economic and Trade Commission, China PRC
SEZ	Special Economic Zone
SOE	State-owned Enterprise
SME	Small and medium sized enterprise
STRI	Services Trade Restrictiveness Index
TiVA	Trade in Value-added
UNCTAD	United Nations Commission for Trade and Development
WTO	World Trade Organisation

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## APPENDIX 1: CHINA'S WTO COMMITMENTS ON RETAIL

The services sectoral classification list (MTN.GNS/W/120) defines “4. Distribution services” as “A. Commission Agents’ services; B. Wholesale Trade services; C. Retailing services; D. Franchising; and E. other”.

		Mode 1	Mode 2	Mode 3	Mode 4
<b>Commission Agents’ Services and Wholesale Trade Services (excluding salt, tobacco)</b>	Limitation on market access	Unbound	None	Phase in commitments 1	Unbound except as indicated in horizontal commitments
	Limitation on national treatment	Unbound	None	None	Unbound except as indicated in horizontal commitments
<b>Retailing Services (excluding tobacco)</b>	Limitation on market access	Unbound except for mail order	None	Phase in commitments 2	Unbound except as indicated in horizontal commitments
	Limitation on national treatment	Unbound except for mail order	None	None	Unbound except as indicated in horizontal commitments.
<b>Franchising</b>	Limitation on market access	None	None	Within 3 years after accession to the WTO, none	Unbound except as indicated in horizontal commitments
	Limitation on national treatment	None	None	Within 3 years after accession to the WTO, none	Unbound except as indicated in horizontal commitments
<b>Wholesale or retail trade services away from a fixed location</b>	Limitation on market access	None	None	Within 3 years after accession to the WTO, none	Unbound except as indicated in horizontal commitments
	Limitation on national treatment	None	None	Within 3 years after accession to the WTO, none	Unbound except as indicated in horizontal commitments

Source: WTO documents GATS/SC/135, 14 February 2002, GATS/SC/135/Corr.1, 20 February 2003, and GATS/SC/135/Corr.2, 30 November 2004.

**Note 1:** Within 1 year after China's accession to the WTO, Foreign Service suppliers may establish joint ventures to engage in the commission agents' business and wholesale business of all imported and domestically produced products, except those products that immediately follow. For these products, foreign service suppliers will be permitted to engage in the distribution of books, newspapers, magazines, pharmaceutical products, pesticides and mulching films within 3 years after accession, and to engage in the distribution of chemical fertilizers, processed oil and crude oil within 5 years after accession. Within 2 years after accession to the WTO, foreign majority ownership will be permitted and no geographic or quantitative restrictions will apply within 3 years after accession, except for chemical fertilizers, processed oil and crude oil within 5 years after accession.

**Note 2:** Foreign services suppliers may supply services only in forms of joint ventures in 5 SEZs (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) and six cities (Beijing, Shanghai, Tianjin, Guangzhou, Dalian and

Qingdao). In Beijing and Shanghai, a total of no more than four joint venture retailing enterprises are permitted respectively. In each of the other cities, no more than two JV retailing enterprises will be permitted. Two JV retailing enterprises among the 4 to be established in Beijing may set up their branches in the same city (i.e. Beijing). Upon accession, Zhengzhou and Wuhan will be immediately open to JV retailing enterprises. Within 2 years after accession, foreign majority control will be permitted in JV retailing enterprises and all provincial capitals, Chongqing and Ningbo will be open to JV retailing enterprises. Foreign Service suppliers will be permitted to engage in the retailing of all products, except for the retailing of books, newspapers and magazines within 1 year after accession, the retailing of pharmaceutical products, pesticides, mulching films and processed oil within 3 years after accession and retailing of chemical fertilizers within 5 years.

**None, within 3 years after accession, except for:** retailing of chemical fertilizers, within five years after accession; and- those chain stores which sell products of different types and brands from multiple suppliers with more than 30 outlets. For such chains stores with more than 30 outlets, foreign majority ownership will not be permitted if those chain stores distribute any of the following products: motor vehicles (for a period of 5 years after accession at which time the equity limitation will have been eliminated), and products listed above and in Annex 2a of the Protocol. The foreign chain store operators will have the freedom of choice of any partner, legally established in China according to China's laws and regulations.



## APPENDIX 2: OECD STRI FOR DISTRIBUTION SERVICES, CHINA

	Distribution Services: China		Score	Total
			24	0.330561292
Category Code	Category	Weight	Score	Total
DS.1	Restrictions on foreign entry	54.18406	10	0.179291869
DS.2	Restrictions to movement of people	7.07145	3	0.019152749
DS.3	Other discriminatory measures	8.415172	2	0.022110396
DS.4	Barriers to competition	19.74419	4	0.054323245
DS.5	Regulatory transparency	10.58512	5	0.055683033
Measure Code		Weight	Score	Contribution
1_1_1	Maximum foreign equity share allowed (%) (retailers)	0.063746	0	0.003321164
1_1_1	Maximum foreign equity share allowed (%) (wholesalers)	0.063746	0	0.003321164
1_1_3	There are limits to the proportion of shares that can be acquired by foreign investors publicly-controlled firms	0.015936	0	0.000830291
1_2_1	Legal form: JVs required	0.015936	0	0.000830291
1_2_11	Legal form: other restrictions	0.015936	1	0.015936488
1_4_1	Board of directors: majority must be nationals	0.015936	0	0.000830291
1_4_2	Board of directors: majority must be residents	0.015936	0	0.000830291
1_4_3	Board of directors: at least 1 must be national	0.015936	0	0.000830291
1_4_4	Board of directors: at least 1 must be resident	0.015936	0	0.000830291
1_4_5	Manager must be national	0.015936	0	0.000830291
1_4_6	Manager must be resident	0.015936	0	0.000830291
1_5_1	Screening explicitly considers economic interests	0.015936	1	0.015936488
1_5_2	Screening exists without exclusion of economic interests	0.015936	1	0.015936488
1_5_3	Memo: thresholds for screening projects	0	0	0
1_9_1	Conditions on subsequent transfer of capital and investments	0.015936	1	0.015936488
1_10_1	Restrictions on cross-border mergers and acquisitions	0.015936	1	0.015936488
1_7_1	Acquisition and use of land and real estate by foreigners is prohibited or restricted	0.015936	0	0.000830291
1_20_1	Service provision is reserved for statutory monopoly or granted on an exclusive basis (retailers)	0.015936	0	0.000830291
1_20_1	Service provision is reserved for statutory monopoly or granted on an exclusive basis (wholesalers)	0.015936	0	0.000830291
1_25_1	Memo: Monopoly in the sector value between 0 and 1, e.g. for 50% enter 0.5)	0	0	0
1_6_18	Quotas or economic needs tests are applied in the allocation of licenses (wholesalers)	0.015936	0	0.000830291
1_6_18	Quotas or economic needs tests are applied in the allocation of licenses (retailers)	0.015936	1	0.015936488

1_6_181	Licenses for department stores or large-store formats are subject to quotas or economic needs tests	0.015936	0	0.000830291
1_14_18	Zoning regulation discriminates foreign suppliers against domestic competitors	0.015936	0	0.000830291
1_15_18	The number of sales outlets per firm is limited	0.015936	1	0.015936488
1_16_18	Commercial presence is required in order to provide distribution services.	0.015936	0	0.000830291
1_17_18	A license is required for e-commerce	0.015936	1	0.015936488
1_18_18	Restrictions on franchising	0.015936	1	0.015936488
1_19_18	Restrictions on direct selling	0.015936	0	0.000830291
1_50_1	Other restrictions on foreign entry	0.015936	1	0.015936488
2_1_1	Quotas: intra-corporate transferees	0.00544	0	0.000283402
2_1_2	Quotas: contractual services suppliers	0.00544	0	0.000283402
2_1_3	Quotas: independent services suppliers	0.00544	0	0.000283402
2_2_1	Labour market tests: intra-corporate transferees	0.00544	1	0.005439577
2_2_2	Labour market tests: contractual services suppliers	0.00544	1	0.005439577
2_2_3	Labour market tests: independent services suppliers	0.00544	1	0.005439577
2_3_1	Limitation on stay for intra-corporate transferees (months)	0.010879	0	0.000566804
2_3_2	Limitation on stay for contractual services suppliers (months)	0.010879	0	0.000566804
2_3_3	Limitation on stay for independent services suppliers (months)	0.010879	0	0.000566804
2_50_1	Other restrictions to movement of people	0.00544	0	0.000283402
3_1_1	Foreign suppliers are treated less favourably regarding taxes and eligibility to subsidies	0.00935	0	0.000487145
3_2_1	There are limitations on foreign participation in public procurement	0.00935	1	0.009350191
3_3_5	Do national standards for distribution services deviate from international standards?	0.00935	0	0.000487145
3_4_18	Foreign firms are discriminated against on trademark protection	0.00935	0	0.000487145
3_5_18	Local sourcing requirements	0.00935	0	0.000487145
4_17_81	Retailers can set up their own recycling systems	0.011614	0	0.000605101
3_7_18	The pre-packaging of products is subject to mandatory nominal quantities	0.00935	0	0.000487145
3_8_18	Labelling provisions go beyond information requirements	0.00935	0	0.000487145
3_9_18	Consumer credit licenses are available to foreign retailers	0.00935	1	0.009350191
3_50_1	Other restrictions in other discriminatory measures	0.00935	0	0.000487145
4_1_1	Decisions by the regulatory body can be appealed	0.011614	0	0.000605101
4_2_1	Firms have redress when business practices restrict competition in a given market	0.011614	0	0.000605101
4_3_1	The government controls at least one major firm in the sector	0.011614	1	0.011614231

4_4_1	Publicly-controlled firms are exempted from the application of the general competition law	0.011614	0	0.000605101
4_6_1	Minimum capital requirements	0.011614	1	0.011614231
4_8_18	Vertical agreements: Resale price maintenance is subject to regulation	0.011614	0	0.000605101
4_8_28	Vertical agreements: Territorial or customer group sales restrictions are subject to regulation	0.011614	0	0.000605101
4_8_38	Laws or regulations impose restrictions on the nature or content of contracts	0.011614	0	0.000605101
4_8_48	Firms are required to disclose confidential information	0.011614	0	0.000605101
4_12_18	Price regulation: minimum prices	0.011614	1	0.011614231
4_12_8	Large retailers are subject to specific taxes (retailers)	0.011614	0	0.000605101
4_13_8	Seasonal sales periods are regulated	0.011614	0	0.000605101
4_14_81	Regulation imposes an upper limit on shop opening hours	0.011614	0	0.000605101
4_15_81	Regulations limit the range of products a retailer may carry	0.011614	0	0.000605101
4_16_81	Retailers or wholesalers are subject to restrictions on advertising	0.011614	1	0.011614231
4_50_1	Other restrictions in barriers to competition	0.011614	0	0.000605101
5_1_1	There is a legal obligation to communicate regulations to the public prior to entry into force	0.010585	1	0.010585122
5_2_1	There is a public comment procedure open to interested persons, including foreign suppliers	0.010585	0	0.000551485
5_3_1	Range of visa processing time (days)	0.010585	0	0.000551485
5_4_2	Construction permit: time to complete all the procedures necessary to legally build a warehouse (in calendar days)	0.010585	1	0.010585122
5_5_2	Construction permit: official costs associated with completing the procedures necessary to build a warehouse (% of warehouse value)	0.010585	1	0.010585122
5_6_2	Construction permit: all procedures that are necessary to build a warehouse (number)	0.010585	1	0.010585122
5_8_1	Time taken for customs clearance (days)	0.010585	1	0.010585122
5_9_1	Licenses are allocated according to publicly available criteria	0.010585	0	0.000551485
5_10_1	Restrictions related to the duration and renewal of licenses	0.010585	0	0.000551485
5_50_1	Other restrictions in regulatory transparency	0.010585	0	0.000551485

Source: OECD

### **APPENDIX 3: TiVA ANALYSIS FOR WHOLESALE, RETAIL AND HOTELS, CHINA**

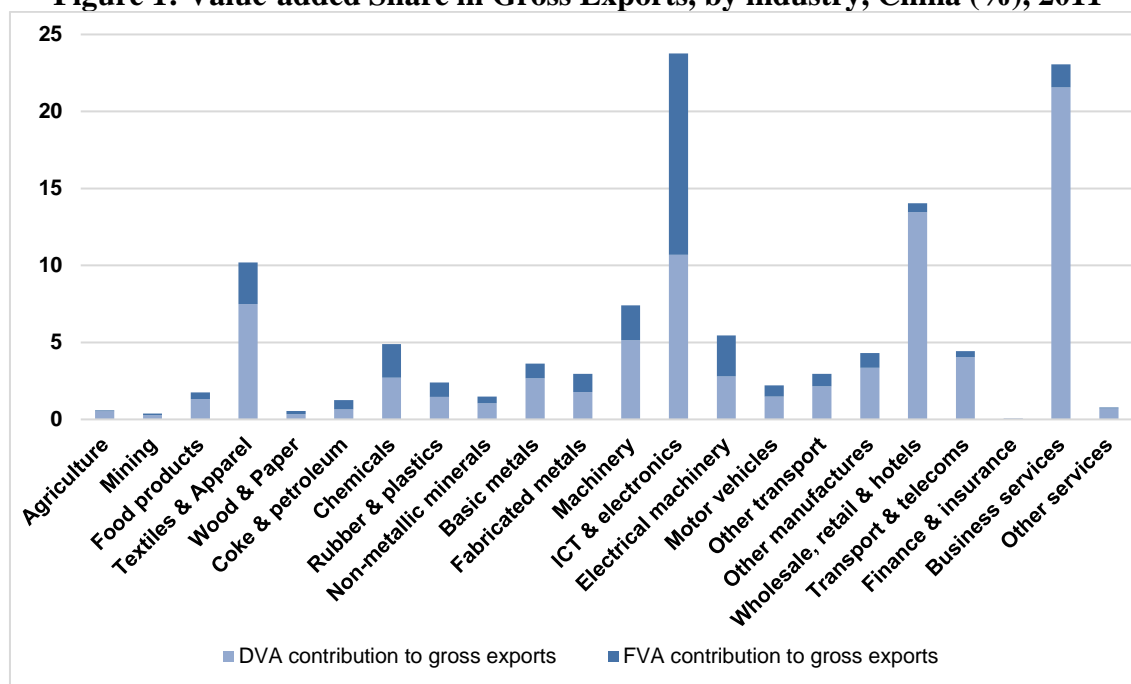
The OECD/WTO Trade in Value-Added (TiVA) dataset offers the potential for analysis of individual industry sectors of the value added inputs and outputs between different sectors of the economy and can be usefully employed to quantify the inter-relationships between industry sectors connected along the value chain, both goods and services.

The TiVA data can also provide an early signal of a potential structural shift in services intensity in any sector; this is useful given the positive correlation between services intensity and value-added. A drop in foreign services value added content in any exported goods sector, if not more than matched by an increase in local services value added content, can signal a prospective decline in international competitiveness. If the data is sufficiently timely, this can be a useful early warning of a regulatory inefficiency in the services sectors.

Unfortunately analysis of the retail sector is handicapped by the fact that in the TiVA data, retail is aggregated with wholesale and also with hotels and these are each very different activities with different roles in trade transactions. It is nevertheless worth considering the extent to which other industry sectors are contributing inputs into the wholesale and retail sector and to what extent and to track the changes occurring over time. The data also shows whether these intermediate B2B inputs are domestic or foreign and if foreign, from which trading partner they are sourced.

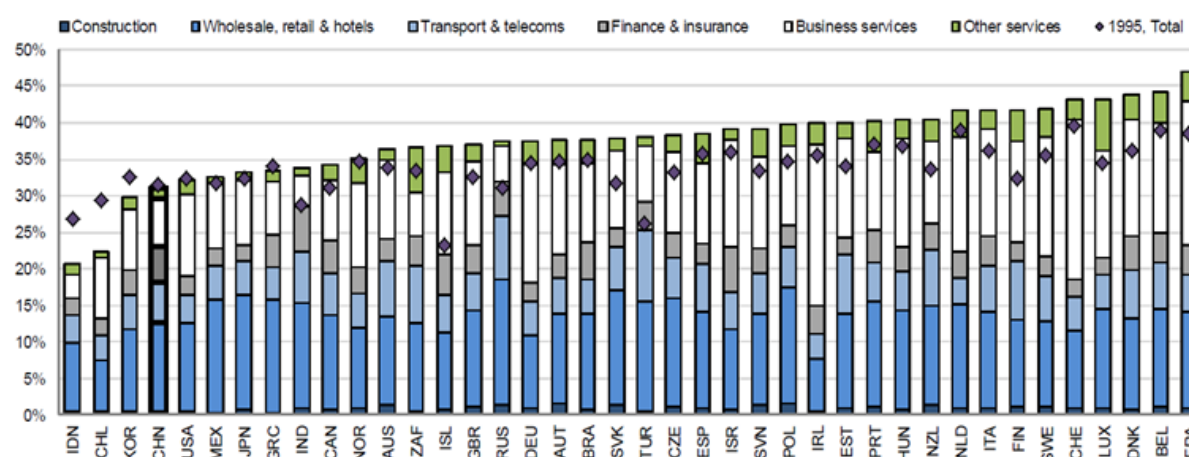
The TiVA indicators similarly enable estimates of the extent to which retailers (aggregated with wholesalers and with hotels) are contributing value added content to total final demand of all the other sectors of the economy. In addition, TiVA indicators show how all this translates into gross exports. The TiVA data shows the trends in the retail industry's share (aggregated with wholesale and also with hotels) of exported domestic value added (DVA). It also shows the extent to which foreign value added (FVA) in retail (and wholesale and hotels) is contributing or not to gross exports and the trends over time.

Figure 1 shows how importantly the combined retail, wholesale and hotels sector figures in terms of domestic value added (DVA) content contribute to China's gross exports. This aggregated industry grouping actually ranks number 1 in terms of contribution of DVA to gross exports, contributing around to 13.5 percent, followed by ICT and electronics (11 percent) and textiles (7.5 percent). In terms of total contribution to gross exports, wholesale, retail and hotels rank second only to ICT and electronics.

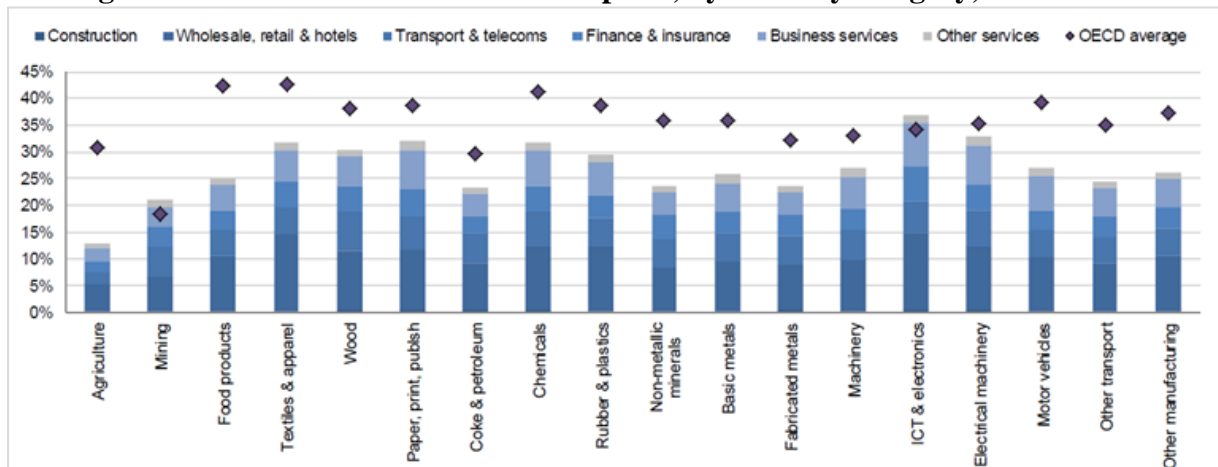
**Figure 1: Value-added Share in Gross Exports, by industry, China (%), 2011**

Source: OECD-WTO TiVA database 2015

Figure 2 shows that 31 percent of the total value of China's exports of manufactured goods now reflect services sector value-added (still low by most standards). Of this share, the wholesale, retail and hotels sector accounts for as much as 12.2 percent of total gross exports, with Business services and Transport & Telecommunications accounting for 6.6 percent and 5.6 percent respectively. Inputs into individual manufacturing sectors are in Figure 3.

**Figure 2: Services Content in Gross Manufacturing Exports, by economy, 1995 and 2011**

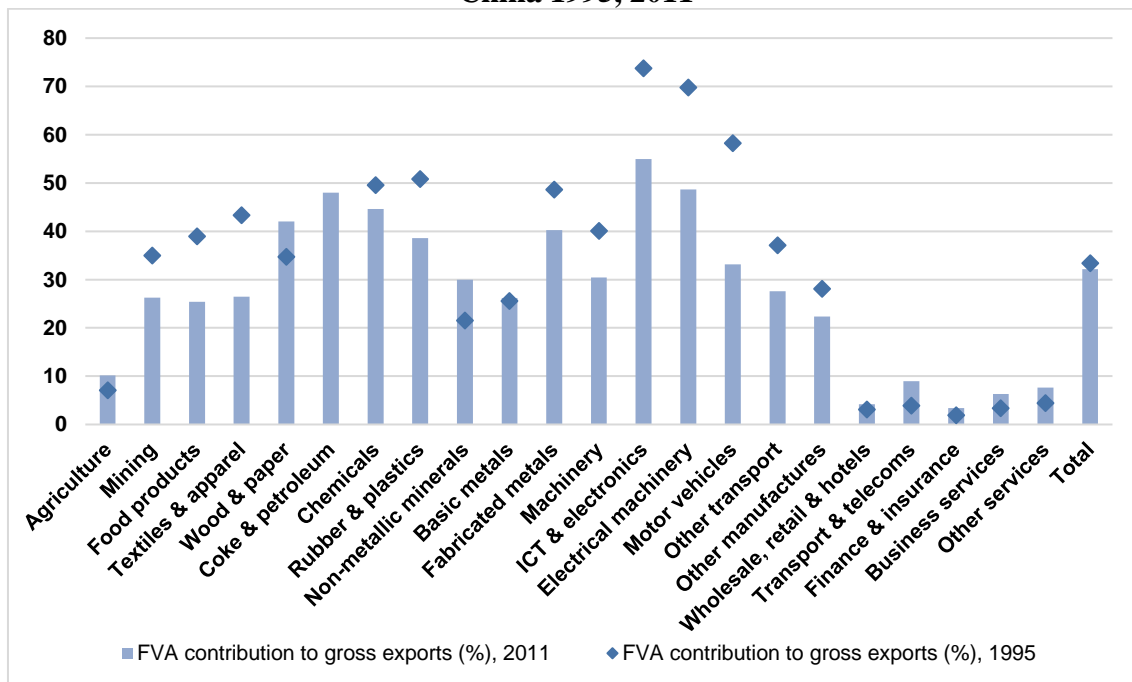
Source: OECD/WTO. October 2015. "Note on Trade in Value-Added: China"

**Figure 3: Services Content of Gross Exports, by industry category, China 2011**

Source: OECD/WTO. October 2015. "Note on Trade in Value-Added: China"

China's wholesale, retail and hotel sector is nevertheless not particularly export oriented itself. The 2011 data shows that of the total domestic value added (DVA) in wholesale, retail and hotels, only about 30 percent is driven by foreign final demand and this has dropped about 5 percentage points since 2008.

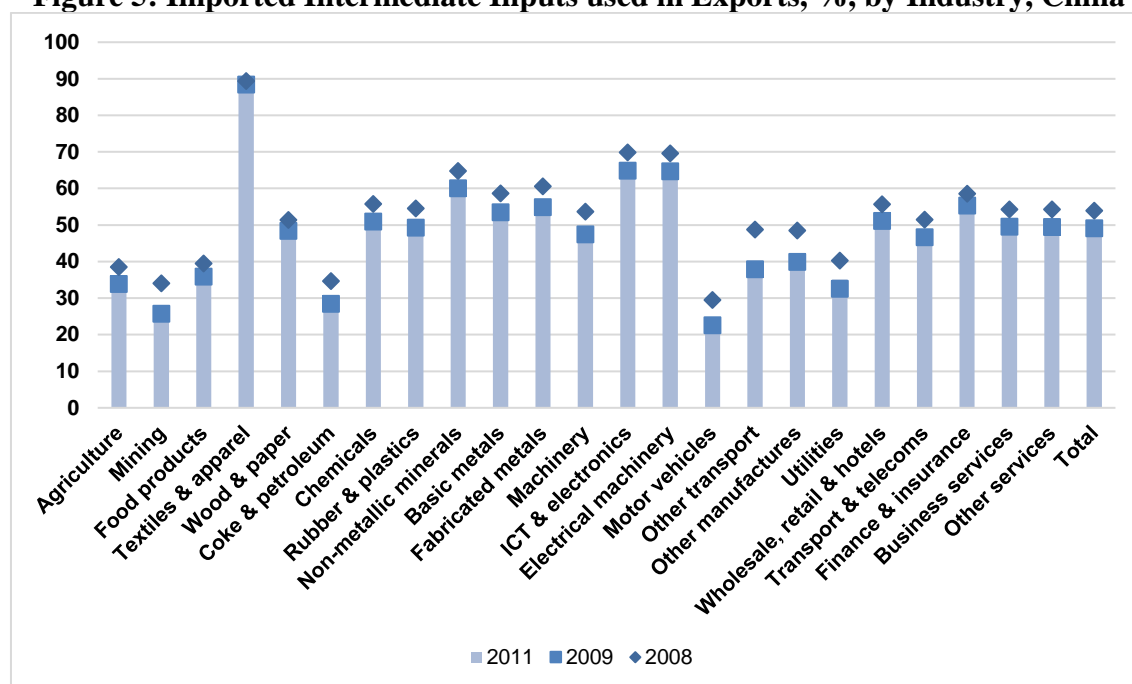
Figure 4 on the other hand shows that the foreign value added (FVA) share is very small at less than 1 percent and has experienced no significant increase since WTO accession. It is worth noting that this is true also for the share of foreign value added in China's total gross exports. This is fully consistent with the data provided in Chapter 2 which showed that foreign owned firms did not have a strong export performance but tend to be more focused on the domestic market.

**Figure 4: Foreign Value-Added Content of Gross Exports, by Industry, China 1995, 2011**

Source: OECD-WTO TiVA database 2015

But the TiVA data adds a new dimension to that earlier conclusion, as it suggests that some local services upgrading has taken place and that other services intermediates contributing to exports in this aggregated industry group are also being provided in a competitive manner by local services firms. This is further confirmed by Figure 5 which shows a small but steady decline over 2008-2011 of imported inputs going into exports of wholesale, retail and hotels.

**Figure 5: Imported Intermediate Inputs used in Exports, %, by Industry, China**



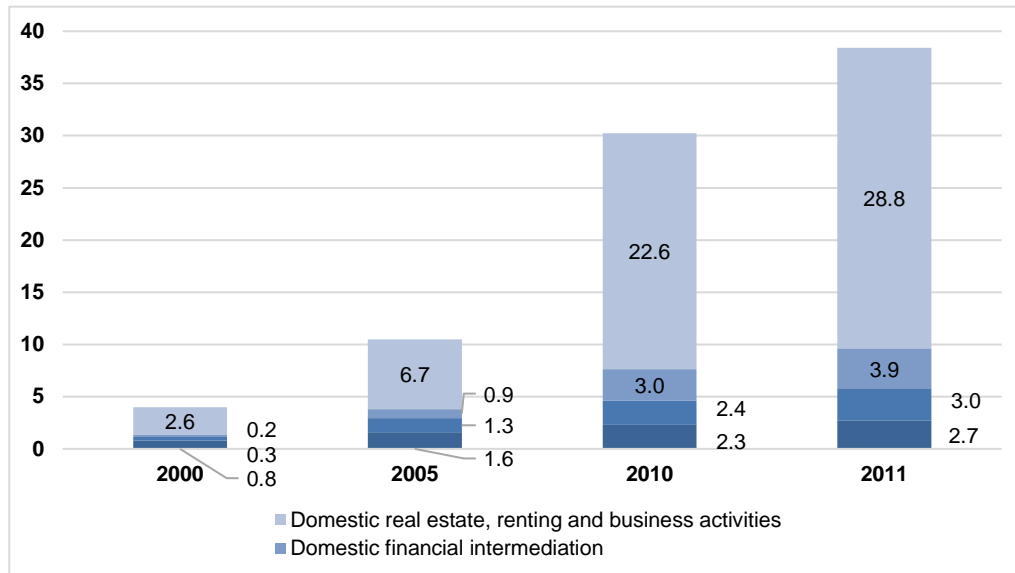
Source: OECD-WTO TiVA database 2015

In its own recent analysis, the OECD concludes that the overall TiVA data for 2011 provides important signals that China is moving upward in the value-chain as the contribution from processing services declines and domestic services providers integrate upstream. Retail is a high value-added upstream services activity. Although the overall figures seem relatively small, it is important therefore to try to dig deeper still to ascertain exactly what the newly contributing local services activities in China's wholesale and retail value chain include. And what the various imported inputs are, and especially which other services inputs are dominant among them and from which region they are sourced.

While the data does not necessarily provide all the ingredients for a full analysis, it certainly allows some deeper insights. The data identify a relative overall importance for the wholesale, retail and hotels sector of value-added content from Real Estate, Renting & business activities, Financial Intermediation, Post & Telecoms and Transport & Storage.

The figures also tell a potentially policy-relevant story. Within the wholesale retail and hotels sector, as shown in Figure 6, domestic financial intermediation value-added saw an increase of more than 16 fold over the decade to 2011 (compared with just under 16 fold for foreign value added). Foreign Post and telecommunications providers saw a well over 9 fold increase in value added, a slightly greater increase than for domestic value-added. For foreign real estate, renting and business activities grew more than 11 fold (roughly the same as domestic value-added). The domestic value-added contribution from Transport and Storage more than tripled over the decade to 2011 - but foreign value-added more than quadrupled.

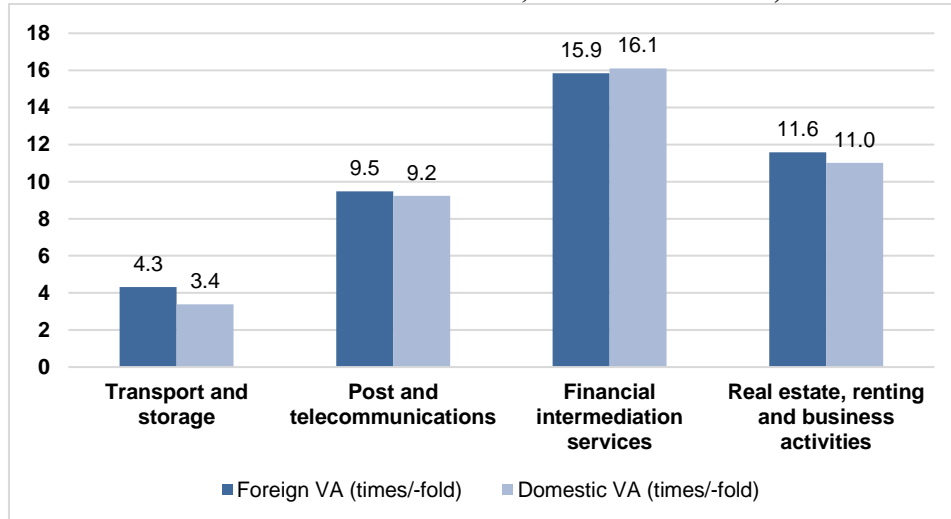
**Figure 6: Domestic Services Content in China's Final Demand for Hotels, Wholesale and Retail Services (USD billion), 2000-2011**



Source: OECD-WTO TiVA database 2015

These growth outcomes are plotted visually in Figure 7. Financial intermediation stands out as one services sector where growing local value-added participation in the wholesale, retail and hotel value chain is apparent. But foreign value added is growing slightly more in some other key services inputs.

**Figure 7: Increase in Key Services Sector Domestic and Foreign Value Added in China's Final Demand for Wholesale, Retail and Hotels, 2000 to 2011**



Source: OECD-WTO TiVA database 2015

It is especially relevant to the discussion of reform in the retail sector, and recent developments in e-commerce, to note that in 2011, only 10.5 percent of China's total final domestic consumption reflects foreign content with as little as 2.1 percent from Europe, 1.4 percent from NAFTA, 3.4 percent from East and Southeast Asia, 0.7 percent from South and Central America and 3 percent from other region.