

# CAUTIOUS AND SKEPTICAL SHOPPERS

## *Exploring Special Participant Behavior in China's C2C Market*

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**Keywords:** Consumer-to-consumer, China, Consumer behavior, Market analysis, Localization strategy.

**Abstract:** Despite the growing body of literature on consumer behavior in electronic markets, previous research has focused on western customers and cultures rather than upon China, the world's largest netizen community. In this paper we conduct structured in-depth interviews with 15 experienced buyers and sellers in China's consumer-to-consumer electronic market. Based on the interview results, we characterize the special behavior of sellers and buyers in China, specifically focusing on the level of market maturity and economic status. We further analyze the economic foundation of their behavior and use the eBay and Taobao case to illustrate the importance of understanding the behavior.

## 1 INTRODUCTION

By the end of 2008, the number of Internet users in China has reached 290 million and become the biggest online population in the world. With more than 130 percent growth rate, online retail sales in China exceeded one hundred billion RMB in 2008 and accounted for one percent of total yearly sales for retail and food services (iResearch, 2008). Eighty million Internet users shop online and boost China's emerging consumer electronic market.

Attracted by the promising future, many international companies such as Amazon and eBay invested heavily on China's e-business markets. However, these dominant e-commerce market makers in the United States face many challenges when they try to replicate their success in China.

Previous research compared the differences between international and local firms at the

This research is funded by the National Innovation Foundation of Chinese Science and Technology Committee, and subject to the project "Internet supervising system based on behavior analysis" (No: 08DZ1191000).

corporate level (Lin and Li, 2005; Li, et. al. 2009). However, few studies focus on the behavior of participants in consumer-to-consumer (C2C) markets, especial the consumer behavior in the big emerging C2C markets in China.

In this research, we conduct structured in-depth interviews with 15 persons who are experienced buyers or sellers in online C2C markets. The results characterize the different behavior of C2C participants in China.

In following sections, we first review the general business environment in China. Based on the interview results, we characterize the sellers and buyers' behavior in China's C2C market, specifically focusing on the level of market maturity and economic status. We further analyze the economic foundation of their behavior and use the eBay and Taobao case to illustrate the importance of *understanding the behavior*.

## 2 STRINGENT BUSINESS ENVIRONMENT IN CHINA

Since 1978, following the Reform and Open Policy, China has been in the transition from the planning economy to the free-market economy for thirty years. Although China's GDP has been growing at the highest rate among all countries in recent years, the business environment in China is still unfledged. As to online business, it is an interesting but a quite different story compared to developed countries. To understand China's C2C market, we first briefly review China's overall business environment from both the business side and the consumer side.

### 2.1 Constraints on Small Businesses in China

Although investment climate in China has been improving dramatically in recent years, restricted government regulation, heavy taxation, the shortage of financial and professional services, and lack of credit systems greatly Constraints the growth of many brick and mortar small businesses.

China has one of the most complicated systems of business registration. Many arising small businesses have been stranded by strict registration polices and tedious approving procedures. Business registration and licensing are required for many informal and flexible jobs such as shoe polishers, handymen, and booth sales. In some cities, the labor work and even scavengers need to be officially registered; otherwise they will be treated as illegal. As a comparison, in developed countries, self employed individuals can work without registration, as long as they follow the rules and pay taxes.

According to World Bank's "Doing Business 2008" (World Bank, 2007), in China, registering a company requires 13 administrative procedures, taking an average of 35 days at a cost of 8.4% of income per capita compared to 6 procedures, 6 days, and 0.7% of income per capita in the United States. Furthermore, the minimum capital of 190.2% of income per capita becomes a high entry-barrier for many entrepreneurs.

During the business operation, small firms face very heavy taxes and fees including 33% corporate income tax, 17% value added tax (VAT), 5.5% business tax, and additional taxes (Kim, et. al. 2006). The corporate income tax leads to double taxation for many proprietors and business partners as their incomes are subject to personal income taxes. In addition to the taxes, some government agencies collect miscellaneous fees from non-state owned

firms. For example, in a survey in a small city in 2005, 23 firms were charged a total of 12 million RMB fees compared to 3.9 million taxes. Small firms cannot maintain a profit margin for a sustainable growth

In China, professional services such as financial, accounting, and payment services are difficult to find. Among those, the biggest problem is lack of capital and investment. Although bank loan and credit are the major form of new capitals for small businesses, the shortage of co-signers and collaterals makes it hard to get the loans. Moreover, due to the limited operational power of local government institutes, many start-up funds and project contracts designed to support small businesses can hardly reach the entrepreneurs in need. For example, one government agent only approved ten uncollateralized small loans for startups in five years.

Currently the free-market economy in China is still unfledged. Personal and corporate credit systems have barely emerged but not been widely adopted. On the other hand, the business morals inherit from the long time planning economy such as "cheat nobody, neither the old nor the young" and "being honest and keeping promise" have been much weakened because of the intense competition and immature protection by the current laws. In developed countries, either shoppers or buyers cherish their credit so much that they would never leave anything unpaid. There is no such trust and punishment established in China yet. Therefore, the majority of buyers and sellers would rather use cash, even for online transactions.

### 2.2 Low-end Consumers

Base on the data published by National Bureau of Statistic of China, the net annual income per capita in 2008 is 15,781 RMB (\$2,321) in urban area and 4,761 RMB (\$700) in rural area. Despite of the high growth rate of income per capita in China, its absolute income level is still quite low compared to that in developed countries.

Cheap labor costs in China have been well explored in the past two decades. In the last few years the government signed a series of labor laws to protect worker's right such as the minimum hourly rate. But compared to developed countries, the absolute labor cost in China is still low. For example, the part time hourly rate in Beijing where the labor rate is the highest among all other cities is 9.6 RMB (\$1.41) per hour.

Based on the statistics from China Consumer's Association, consumer's time and money spent for rights protection is much higher than the actual compensation. The low compensation rate cannot enforce the punishment to sellers who broke the laws. According to officials in China Consumer's Association, even a consumer won a lawsuit, the average compensation he or she can get is only 700 RMB (\$103), which is extremely low. While in the U.S., the average compensation per case is \$350,000 in 2007, about 3,700 times more than it in China. Series of the consumer rights protection laws need to be revised to keep up with the market change. Besides the low compensation in money, consumers who sue a company usually are overwhelmed by the tasks to get evidence, make a complaint following proper procedures, and push through the process of investigation, lawsuit and final settlement. The time of the whole procedure is quite long. Even though a consumer won a case, he or she actually lost more. Practically, considering the time, money, and energy spent in rights protection, consumers are better off to do nothing.

### 3 EMERGING C2C ELECTRONIC MARKET

Online electronic markets in China quickly boom in the past few years. Compared to set up a brick and mortar business in China's stringent business environment, it is much easier and efficient to set up a business online. Invested by Alibaba, the largest B2B company in China, Taobao.com was founded in 2003, focusing on the C2C market. In 2007, the total revenue for online C2C transaction in China reached 5.18 billion RMB (740 million dollars), while Taobao alone accounted for 84.9% of it (iResearch, 2008). Despite the large proportion of the C2C market share, Taobao does not make attractive profits itself. Even though, attracted by the potential of this huge, emerging value added market, other major players such as Baidu.com, TOM-eBay China, and Paipai.com also launched their marketplaces and intensified the competition in the C2C market.

There are 1.05 million active online stores in China's online market. 850 thousand of them, eighty percent of the online stores, are on Taobao. Among 1.17 million online sellers, 1.05 million are on Taobao's platform (iResearch, 2008). However, the average monthly income of the sellers is not high though, about 2,080 RMB (\$300) per month. As

shown in Figure 1, 42.7% of the sellers have monthly income between 800 to 1,500 RMB and 30.5% are between 1,500 to 2,000 RMB. Only top 1.3% earned more than 6,000 RMB per month. Based on a sales survey, about 90% of the sellers are small and they only contribute to 20% of total sales. For example, more than two thirds of the sellers have monthly sales lower than 2,000 RMB.

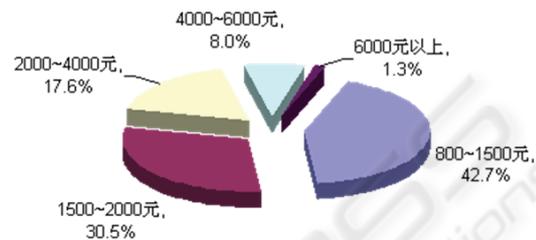


Figure 1: Monthly incomes of C2C sellers (in RMB).

The majority of buyers in the online C2C market are white collar workers, middle class employees, and college students between 18 to 35 years old. Without high annual incomes, they have spare time and energy to explore opportunities in online markets. Female is the main body of online shoppers in China's C2C market. In large volume transactions, such as apparel, cosmetic products, and jewelry, the number of female buyers always surpass the number of males. Other female dominated product categories include nutrition supplements, kitchen, home, body and bath products, toys, baby and kids' products, as well as pets and pet related products. Most buyers live in urban and sub-urban areas in big cities such as Beijing, Shanghai and Guangzhou. People with higher education, especially college students, contribute a great part to C2C online transactions.

In this paper, we use orientated structured in-depth interviews method to study the behavior of buyers and sellers. We developed a survey online in December 2008. Based on the survey results, we selected fifteen individuals who are mostly qualified for this research and made an in-depth interview with each of them. Among the interviewees, there are seven buyers, three common sellers, and five professional sellers; six females and nine males; eleven college or graduate students and four full time workers. They are aged between 20 to 26 years old. Ten of them do the online transactions on Taobao only, and five have been using both Taobao and eBay, but not other platforms. This distribution reflects the market share of Taobao and eBay.

The in-depth interview is one to one in person and lasts about 30 to 90 minutes. We developed two

survey questionnaires, one for professional sellers, one for buyers and common sellers. The questionnaire for professional sellers includes detail questions such as personal information, online shopping history, professional selling history, and the choice of platforms; buyer's questionnaire includes personal information, online shopping history and experience, and the choice of platforms. The questionnaire for common sellers is the almost same as buyer's questionnaire except for additional questions on selling experience.

Based on interviews, we find three most important characteristics in the marketplaces: there are many professional sellers, both sellers and buyers are price sensitive, and lack of trust to sellers.

### 3.1 Professional Sellers

Professional sellers who take online sales as their career are very active in China's C2C market and for many of them online stores are the only business opportunities. In China, there are many people who are not wealthy but have urge to make money. To open an online store, what they need is just a computer and the Internet. iResearch (2008) shows that one quarter of C2C online sellers are consist of unemployed workers, college students, or fresh graduates. They have no or very low income, relatively weak working skills, but plenty of time. They could be frightened by the hurdles of setting up brick and mortar stores in China's stringent business environment, or tired of endless registration procedures and all kinds of fees. Online C2C platforms have provided them a low threshold, low risk, and a feasible starting point for a small business.

The main source of income for the professional sellers is from online transactions. They usually start as common sellers and explore a new way of making money online. Based on the interviews, some college students who had no cash investment due to their financial situation usually started as agent. They set up an online store, post photos and product details from other online stores with their permission. They will pass all orders to the upstream online stores and pay for the orders as soon as they receive payments from their consumers. Or they might even find upstream providers from the online B2B market and order from there directly to make more profit.

Not all common sellers became professional sellers. Actually most of them just stayed as common sellers being aware of how much time they need to put in as professional sellers and the

intensity of competition among the online stores. Many of these beginner sellers are opportunistic. For them, to become a professional seller or not depends on the profit and risk factor.

The nature of transactions made by professional sellers and common sellers are different. Without cash investment, common sellers sell second hand products, coupons, or products from their upstream channels. For professional sellers, their profit comes from the price difference between wholesale and retail. However, compared to offline retailers these professional sellers do not need to register as a company, rent an office physically, and pay numerous taxes and fees. There is not much to lose if they shut down the online stores. These characters are very attractive for online retailers. The most active online stores in the C2C marketplaces are operated by these professional sellers. Although the sellers operate the stores as their career, the businesses are usually too small to be considered as the real Business-to-Consumer scenario.

We are focusing on the professional seller behavior in the following part through the analyses on the characteristics of their operations.

*Investment and Risk:* Professional sellers need to purchase stock from wholesalers. They have to use push system rather than pull system to lower the cost per product. In another word, they need to stock up. This means risk. A professional seller who used to be an agent said during the interview, "Compared to the offline business, I don't need an office for operation. But I do need to stock up. This is risky. But otherwise the benefit is marginal." She is not satisfied with her previous experience as an online agent. "As an agent," she said, "I cannot physically access and examine the products I am selling and if any problem arises, it's hard to resolve. It's also very difficult to coordinate the shipping in time." But the key reason why she changed to be a professional seller is that the price she got as an agent was pretty high.

*Time and energy:* It is critical that sellers can be reached at the time of a potential transaction in China's C2C market. Due to the culture difference and lack of reliable credit systems, buyers usually contact sellers online for verification before submit any order. Like one Taobao seller mentioned, if a seller cannot be reached at the time of sales, buyer usually will not wait but just switch to another seller. Therefore professional sellers need to be online most of the time to answer buyers' questions and avoid any sales loss. Some professional sellers even hire others for 24x7 online support.

*Advertising and publicizing:* Advertising and publicity are the key to boost sales because thousands of sellers are selling similar products on the Internet. Most of the sellers just wait passively for consumer's visits which have a very low possibility. Others advertise their products through paid publicity on Taobao.com or replying questions in C2C discussion boards to get their names around. One of the professional sellers from the interview who sells both on Taobao and eBay said that the Advertising especially pay-per-click on C2C platforms is really rewarding.

*Product variety:* To increase the overall revenue and to lower the cost, a professional seller usually increases the variety of products sometimes through multiple online stores.

### 3.2 Price, Price, Price

Sellers' degree of sensitivity of the fees on opening an online store and on transactions is highly related to their profit levels. Professional sellers can take the fees as their operational costs. During the interview, when asked for the fees, one professional seller said "if Taobao starts to charge fees, I will keep selling and transfer the fees to buyers." Common sellers who do not live on the income from online sales have less frequent transactions and they sale mainly just for experience. Therefore, they are more sensitive to the setup costs compared to professional sellers (Li, et. al. 2009). For the same question about the fees, a common seller said, "I just sell some personal belongings and not for making money. If Taobao charges fees, I will definite switch to another free site... If all C2C sites charge fees, I will go back to bulletin boards, a free place."

Due to the low income level, buyers are very sensitive to online prices and they are willing to spend more time on searching and comparing to get a better deal. Therefore, they have following special shopping behaviors: use many price comparison websites to find the lowest price; choose sellers in the same geographical region to save shipping cost; buy multiple items from one seller to reduce the shipping fee per item; buy from the same sellers again to get discounts; use instant messaging tools to negotiate with sellers.

Bargaining as a traditional habit in offline Chinese stores also appears in online markets. The root cause of the bargaining phenomenon is the low income level. With relative low value of time, consumers are willing to spend more time to get lower prices. To some people, the process of bargaining and getting a good deal becomes a game

and a pleasant experience. For this reason, the "Buy it now" is the most popular form of pricing mechanisms in Chinese C2C websites and only a few auction sites. The announced prices provide an opportunity for offline negotiations: buyers often shop around, compare prices, and contact sellers for better prices. Most of consumers love the achievement of getting a good discount and do not like the uncertainty of raising prices in auctions. A buyer in the interview said, "I only have one auction experience in which the bids raised from 100 to 300 RMB. I didn't feel comfortable with the final price. Auctions could inflate the prices. I like 'Buy it now' more."

The pricing transparency and buyers' price sensitivity greatly reduce sellers' profit margin. Therefore their only strategy is low price competition. One seller said, "The key factor for an online store is price because that is the reason most of buyers shop online. Many buyers are very young and have no stable income, they are pretty demanding on price." Another seller said, "Products in my store usually are 60 to 70 RMB cheaper compared to offline stores. For the item with a 100 RMB price tag offline, you need to offer it at 30 to 40 RMB to attract people." Some sellers may get compensated from volume discounts on shipping. One seller said, "Usually shipping companies will approach me and offer discounts. I can earn one RMB from five RMB standard shipping fee."

### 3.3 Trust Crisis

Similar to the offline market, credit deficit, a lemon market full of counterfeit and ersatz products, and high costs of consumer right protection widely create a chaotic online market. Buyers do not trust sellers and rely more on word of mouth and reputation systems when select online stores. Serious sellers understand the importance of credibility and start building their reputation. An informal credit system is gradually developed to improve the business environment in China.

Counterfeit and ersatz products are widespread in the offline market and it is even worse in the online market. Based on an investigation made by China Association of Fragrance Flavor and Cosmetic Industries in May 2008, 90% of cosmetic products sold online are fake and low quality products swamp the whole market. Similar situations occur in other product categories. For instance, smuggled cell phones with new design and low prices attract many consumers and bring sellers considerable short-term profit. However, in long run, the lack of service

support and regulation damage the relation between buyers and sellers.

Compared to offline stores, it is much easier to sell illegal products and avoid being detected and punished because of the difficulty of monitoring and law enforcement for online transactions. The technologies to identify anonymous sellers, investigate online, obtain digital evidence, and regulate online activities are ready to deploy.

Due culture, social, and historical heritage, in China, buyers generally take a skeptical attitude towards sellers. Extensive counterfeit and ersatz products and the difficulty of return and dispute make buyers very cautious to shop online. Based on a survey on 3119 individual online customers in 2007, 50.7% interviewees have no faith before they could physically inspect the products and 49.5% worry about after sales services. As previous research revealed, lack of trust is the major hurdle in China's C2C online market (Peng, et. al. 2006; Wang, et. al. 2006; Li, et. al. 2009). We illustrate the detail representation of the lack of trust in the following instances in China's C2C market.

- Transactions made online are usually for cheap products. For products with higher value, customers usually buy offline to avoid the uncertainty and risk. One buyer said during the interview, "There is no guarantor or warranty for online purchases. I would buy cheap products online only for convenience."
- People tend to buy from the same seller again if they have previous satisfactory experiences, which establish the trust on the seller.
- Buyers will intentionally investigate questionable product categories and avoid purchase in the market for lemons.
- Because of poor return policies, some buyers prefer to investigate the same products in offline stores before making online purchases.
- Reputation scores have a key impact on buyer's trust. Buyers use reputation scores to estimate the quality of products and after sale services. One buyer in the interview expressed that she would not buy from a seller with more than two negative feedbacks. One hundred percent positive feedbacks make her feel comfortable to make purchasing decisions.
- Buyers usually chat with sellers online to verify the detail information on size, price, and quality before submit an order. Taobao takes online chat history as evidence to protect buyer's right.

Customers tend to be influenced by word of mouth from friends and family members. Buyers trust the personal recommendations more than advertising due to the poor credibility of some businesses and the high cost of consumer's right

protection. Many buyers in the online C2C market in China made their first online purchase based on friends' reference.

Other than word of mouth, reputation scores are another key factor to choose sellers. Reputation scores capture the history of a seller's transactions. Bad reputation scores will discourage potential customers. To get more positive feedbacks, online sellers tried their best to satisfy buyers such as providing better after sale services or even lower the prices. Taobao encourages sellers to build good reputation scores through series of evaluation rules. The higher a seller's reputation score is, the more windows he or she can use to display produces on Taobao.com.

## 4 CASE: TAOBAO VS. EBAY

On December 19, 2006 eBay, one of the most successful e-commerce companies in the world, announced a joint venture with TOM Online Inc. and indicated the failure in the direct competition with Taobao. In 2003, eBay owned over 70% market shares and had a 10 times more advertisement budget compared to Taobao. What were the reasons leading to the overturn of market shares in three years? Based on the analysis above, Taobao's business strategies on market targeting, service fees, and online payment systems were better aligned with the special participant behavior in Chinese C2C market and therefore won the battle in short time.

### 4.1 Market Targeting

As illustrated above, eBay and Taobao, although both serve the C2C market in China, have different target markets. eBay committed to the second hand market and friendly community; Taobao aims to serve as an online trading platform for about 10 million owners of small and medium-sized enterprises, which account for 95% of companies in China and still mainly use traditional procurement and distribution channels. It is hard for them to build their own websites for online sales due to the lack of technical support and financial investment (Peng, et. al. 2008). Taobao provides an easy e-commerce platform for these small businesses as well as start-up companies and common sellers. Different market targeting later leads to different focuses of service pricing strategies.

## 4.2 Service Fees

As a rule of thumb, price and fee sensitivity is negatively correlated with income levels. The less people earn, the more sensitive to the prices and fees they are, and vice versa. For the low income level of buyers and sellers, a small change in prices and fees can bring tremendous changes in demand. Therefore Taobao's free strategy not only makes fee-sensitive storeowners switch from eBay, but also attracts the majority of buyers.

## 4.3 Online Payment Systems

Before Alipay, Taobao's online payment system, buyers and sellers mainly use banking systems to finish transactions. Once a buyer finds a product online, the buyer and the seller will discuss the detail of the transaction by telephone or instance messaging. Then the seller will ship the product after the buyer deposits the payment to seller's bank account electronically. Although the process is simple, buyers make the advanced payment with the risk of being cheated, e.g. receiving defective items or no shipment at all. The uncertainty of transactions and lack of trust on sellers precludes many potential online shoppers.

eBay provides PayPal to facilitate payment and resolve dispute. However PayPal's transaction framework does not fit into a financial environment without established credit and trust. PayPal operates purely based on its own authority as a moderator and the protection of fully fledged credit card systems in the developed countries. If a seller failed to fulfill the agreement, the buyer can file a chargeback with his or her card issuer or submit a claim to PayPal. Cheating sellers will be punished by PayPal and have bad records in the future. Personal credit systems are essential to enforce the trust during transactions. Therefore, with immature credit card payment and personal credit systems in China, it is difficult to replicate this mechanism (Li, et. al. 2009).

For this reason, Taobao designed Alipay as a trusted middleman connected to existing banking systems. A typical Alipay transaction is: when a buyer deposits the payment into his or her Alipay account, Alipay will ask the seller to ship the order; after the buyer receives the order and instructs Alipay to finish the payment, Alipay will transfer the money to seller's Alipay account and the seller can withdraw it through his or her bank. Banks rather than online payment websites serve as the fundamental payment infrastructure. In China, major

banks have very low default and bankruptcy rates due to the support from the government. Consequently, they are trusted and preferred by the customers for the payment method.

Similar to the letter of credit in the international trade, Alipay constructs the trusted relation between buyers and sellers via banking systems. Although buyers need to pay first, they can get refund if they are not satisfied with the products. On the other hand, sellers can get compensation for the shipping for returned products.

Alipay changed the payment preference of online consumers in China. According to our earlier interviews in 2005, two years after Alipay was introduced, most of online shoppers preferred searching products online and finished the transactions offline through cash-and-carry or cash-on-delivery. However, during this study in 2008, most of shoppers are comfortable with online payment. Alipay has established the reputation and facilitated the trust in the online market.

## 5 CONCLUSIONS

This paper analyzes China's C2C market from the perspective of participants' behavior. Although the Internet and globalization greatly reduce the national barriers, the behavioral differences of consumers in different countries are still tremendous. The electronic markets in China form a unique type of bazaars, not an auction based market. Both sellers and buyers exhibit special behaviors for their social and economic status. Recognizing these behavioral characteristics is the first step for international companies to understand Chinese online market and consumers and design their localization strategies.

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