

# NIKKEI ASIAN REVIEW

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## Peter Fuhrman -- Cheap shipping hidden key in Alibaba's success



Procter & Gamble's staple brands, including Crest, Tide, Head & Shoulders, Pantene and Pampers, dominate the mass-market premium segment in China just as they do in the U.S.

At a local Wal-Mart supermarket in China, just about everything costs more, in dollar terms, than it does at Wal-Mart in the U.S. Shop online, though, and China wins hands down.

[Alibaba Group Holding](#)'s Taobao marketplace deserves part of the credit. Its 10 million merchants, mostly small traders with limited inventory, offer goods at prices well below those of brick-and-mortar shops.

But the biggest savings for shoppers comes from ridiculously low overnight shipping costs in China. Alibaba doesn't directly arrange shipping for Taobao merchants. It's up to each seller to sort things out with one of the country's big national private courier companies.

There are four giants: market leader Shunfeng, or SF Express, and three almost identically named competitors, YTO Express, STO Express and ZTO Express. These three were started and owned by entrepreneurs from Tonglu, a small county in Zhejiang Province, about 50 miles from Alibaba's headquarters in Hangzhou.

Just how cheap is online shopping for P&G products in China? On Taobao, a 3 kilogram box of Tide washing detergent costs 20.90 yuan (\$3.13) including shipping and takes two days to arrive in Shenzhen by land from Shijiazhuang, a city 1,200 miles north. A box of Tide bought online in the U.S. from the cheapest eBay seller with the same delivery timing via FedEx would cost at least \$53. Of that, at least \$35 would go to shipping.

Chinese labor costs are much lower than in the U.S. But gasoline costs twice as much and highway tolls are exorbitant on the mainland, at as much as 60 cents for every mile a truck travels. Who, if anyone, made any money when that box of Tide arrived in Shenzhen intact and on time?

Even if the Tide detergent was completely phony -- Taobao does have some reputation for hosting vendors selling counterfeit merchandise -- the shipping costs can't be faked. My detergent was shipped and delivered by ZTO.

By some counts, ZTO has now moved ahead of Shunfeng in volume, if not revenue. At the end of 2015, ZTO was said to be delivering 10 million parcels a day. ZTO mainly consists of a network of independent local franchisees, with the parent company owning and operating the main warehouses. ZTO is planning to make an initial public offering sometime soon in Hong Kong. Private equity company Warburg Pincus and venture capital firm Sequoia Capital are both investors.

The other three big courier companies are also well along in planning for IPOs. Each is saying they need billions in new capital. They can't be earning much if anything and continue to plow money into infrastructure. Parcel shipping is still growing by about 30% a year. Every week, courier companies deliver about 500 million packages in China.

### **Planning air delivery**

All four big courier companies are saying they want to buy or lease jets to move parcels around and save on gasoline and tolls. They are also all looking at the possibility of using drones for the "last mile" of delivery to parcel recipients.

As of now, parcels in China are delivered by an army, perhaps as many as 1 million strong, of electric-scooter riding delivery staff. Contrary to what many may think, this

isn't low-paid work in China. You can earn at least double what you'd be paid for factory work. A lot of recent college graduates are taking their first job delivering packages.

The career path for many is to move up from YTO, STO and ZTO, who get most of their business through Taobao, to work for either online retailer [JD.com](http://JD.com) or Amazon.com. Both companies have their own in-house courier staff, with better pay, hours, equipment and snazzier uniforms.

Alibaba doesn't directly own or control a courier company. So far, that strategy has worked out splendidly. As long as the courier companies are competing furiously, products on Taobao will remain dramatically cheaper than in stores.

If the couriers ever decide to seek profits rather than market share, that will certainly put a dent in Taobao's growth. An Alibaba-backed logistics company called Cainiao recently raised \$1.5 billion, at a \$7 billion corporate valuation, to better coordinate the deliveries made by ZTO and the other Tonglu couriers.

E-commerce in China works like nowhere else in the world. Sales are still growing at breakneck speed and are on course to reach \$1 trillion annually by 2017, far higher than anywhere else. Cheap delivery makes it a bargain not only to buy P&G products, but even the lowest-priced goods on Taobao.

For years, Chinese law made it illegal for FedEx and UPS to enter the domestic delivery business in China. The Chinese government finally amended the law two years ago. But the two American giants took one look at the cutthroat competition and ridiculously low prices charged by their Chinese counterparts and chose to stay out of the fray. In the U.S., the average freight rate is \$15.50/kg for two-day ground delivery between distant cities. In China, the going rate is about 4 yuan, or 60 U.S. cents.

It will become clear soon, once IPO prospectuses appear, if ZTO and the others are making any money at all. An IPO will require an audit that meets international standards and full compliance with China's burdensome tax code. This often extinguishes all profit.

E-commerce in China has so far created only two big beneficiaries. Taobao is one. It earns billions a year in ad fees paid by merchants. The other is China's 500 million online shoppers. We save big, and enjoy the luxury of cheap home delivery on just about everything we care to buy.



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