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CHINA UPDATES

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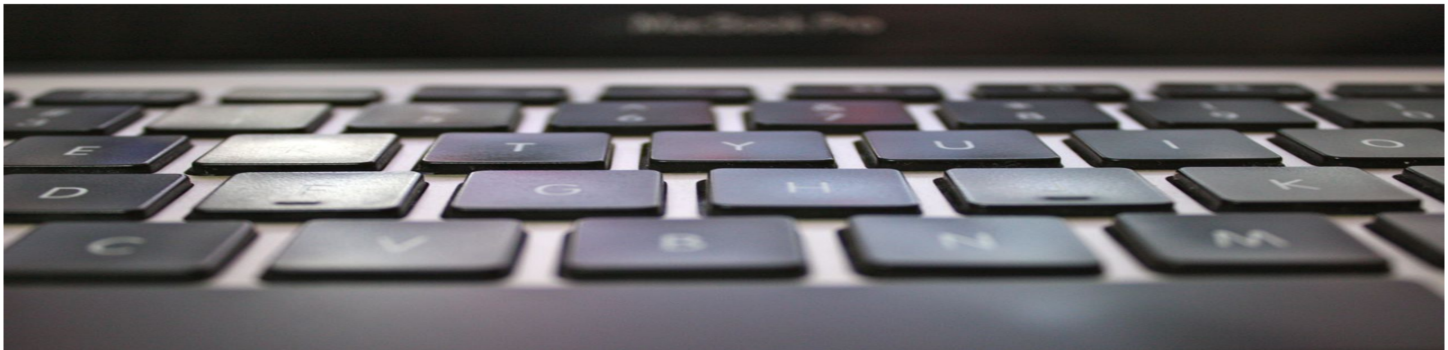

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SPECIAL ISSUE

China Updates is a service provided by U.S.-China Health Products Association. The Newsletters will be issued as relevant material becomes available. China Updates will provide news on regulatory environment, new legislation, association activities and any information related to the natural health products industry in China.

SPECIAL E-COMMERCE ISSUE

Commentary by Jeff Crowther

Below are a series of articles on China's booming e-commerce business. These articles are very relevant to natural health product companies looking to do business in China. This sales channel has grown rapidly over the last five years and is proving to be the preferred destination for many foreign dietary supplement brands.

Just two years ago it was not easy to find foreign dietary supplements on Chinese sites, but now it is quite easy. E-commerce just makes sense for China for a couple reasons. First is price; Internet prices are usually less than their brick and mortar counterparts. Here's an on the ground example. Last week I was shopping for a stuffed animal my son wanted. I found it at a local shop that specializes in all kinds of stuffed critters. The shop owner told me the price was 80 RMB (13 USD). My wife whispered in my ear, "we can probably get the same one online much cheaper". Sure enough, that night she dazzled the keyboard for a few minutes and found the same one for 28 RMB (4.49 USD) and it came with next day shipping for free! When it arrived it was the same stuffed animal, with the same tags and bag. Not every item is going to enjoy this level of savings, but it is worth a look.

The other reason e-commerce makes sense is the simple fact that the over crowded tier one cities like Beijing, Shanghai etc take hours to navigate what would take minutes in other cities. Beijing as an example is infamous for its traffic jams and over crowded subways. The last thing most people want to do after a hard days work is swing by a shopping mall on their way home. This can easily add an hour or more to the journey home. Solution, head home directly, hit the Internet and have your products the next day at a discount or if you're in a rush use your smart phone on the way home. Save money, less stress, more time with your family makes sense to me. For those living outside the tier one cities of China, their product selection at local shopping centers begins to dwindle especially if they are looking to purchase an imported or luxury item. So their only option is the Internet. For those doing business in China, I'm sure you're already online. If not, what are you waiting for? You're losing business.

E-Commerce: the Great Leap Online

By Cui Xiaoling

Clarification: In the below articles retail internet sales refers to Business to Customer (B2C) and E-Commerce refers to customer to customer (C2C), Business to Business (B2B), Business to Government (B2G) as well as B2C.

China, a country with 1.3 billion people, holds the potential to become the biggest market for virtually everything and e-commerce is no exception. E-commerce is surging, opening up opportunities for all companies if they pay close attention to the quickly evolving marketplace.

Of China's 513 million Internet users 194 million (versus 170 million in the United States) shop online. This is more than double the number in Japan and five times that of the United Kingdom.

In 2011, China's online retail sales totaled RMB 750 billion, up by 60% from 2010, according to the Ministry of Commerce of China. The figure will triple to RMB 2 trillion in the next few years. That means by 2015, China may overtake the US as the world's largest e-commerce market — with online sales growing to represent 8 % of all retail sales, Boston Consulting Group predicts.

Business-to-consumer (B2C) component has been the most dynamic segment, accounting for more than 23% of online sales transactions. By 2015, China will be the world's leading e-commerce market, and B2C e-commerce will represent more than 40% of total online sales. In this context, e-commerce has evolved into a must-have for any business aiming to expand in China. Companies are looking to differentiate their e-commerce offerings with emerging innovations such as social media integration, rich user interface, and better service to keep up with customer needs.

The below articles offer insights into China's e-commerce market features, major players, consumer demography and habits, future trends of development and government policies.

China to Be World's Largest E-commerce Market

By Bernice Cui

China is set to become the biggest online marketplace in the world within the next few years, as quite a number of studies showed.

China's e-commerce market brought in $928 billion in trades last year, registering a 29.2 percent year-on-year increase, according to Jiang Yaoping, vice minister of commerce of the country. E-commerce represented 12.5 percent of the country's gross domestic product (GDP) in 2011, the minister said at the 12th China International E-commerce Conference held in Beijing.

China's online retail market took in more than $118 billion, up by 60% from 2010, which accounted for more than 4 percent of the total consumer retail market, Jiang added. By comparison, e-retail in the U.S. grew 16.1% in 2011 to $194.3 billion and accounted for 4.6% of all retail sales, according to the U.S. Department of Commerce.

The ministry released a report in May on the development of e-commerce in China in 2011, which noted the number of online shoppers in China reached 194 million in 2011, more than in any other country. The report also predicted the country would become the top e-commerce market by 2013. If proven true, this would be two years ahead of predictions by the Boston Consulting Group published in November 2011.

Boston Consulting Group predicts that by 2015, China will surpass the United States to become the largest e-commerce market in the world, reaching more than RMB 2 trillion in online retail sales. Consumers in China will be spending $1,000 per year online — the same amount as U.S.'s 170 million online shoppers currently spend annually. By that time, e-commerce would account for more than 8% of all retail sales in China.

The Ministry of Commerce reported that the strongest online growth last year came in sales of food, apparel and jewelry. As in the U.S., web sales in China are growing much faster than sales at physical store sales: China's total retail sales grew in 2011 about 17.1% over the prior year to $2.88 trillion, the ministry reported. Total U.S. retail sales grew 7.9% in 2011 over 2010, the U.S. Commerce Department said.

Factors driving the growth

A number of factors are driving the growth. As Mashable reported, one is the increase of China's middle class, which is expected to balloon from 200 million to 800 million people over the next 20 years, according to Acquity Group. The spread of government-subsidized, high-speed Internet access and Internet-connected cellphones have widened the pool of potential shoppers to 513 million — or about 40% of the population. Broadband Internet access costs around $10 per month, compared to $30 per month in India and $27 per month in Brazil.

The low cost of shipping in China gives ecommerce an ongoing boost. It costs $1 on average to ship a 1-kilogram parcel, versus $6 in the United States. China lacked a reliable and cheap method of shipping packages, so the e-commerce industry has invested in developing one. Shipping prices and reliability have been improved, particularly in urban coastal cities. China's major online marketplace, Alibaba-owned Taobao, is estimated to account for half of all packages shipped in China.

Who are buying?

According to the Boston report, less than 10 percent of China's urban population shopped online in 2006. The figure jumped to 23 percent in 2010 and will nearly double to 44 percent by 2015.

An astonishing 30 million additional Chinese consumers are expected to shop online for the first time every year until 2015.

Within five years, most of today's online shoppers in China will be spending about $980 per year, twice what they are today. That's close to the U.S. average of $1,000.

According to a survey of 1,000 people across roughly 150 cities last year, people in China shop online for three main reasons: First, greater product selection. The survey by BCG found that a quarter of Chinese shoppers buy online because they can't get the products they want at brick-and-mortar stores. Second, the ability to compare prices across vendors: 65% of respondents said they compared retailers before making a purchase. And finally, convenience.

The relationship between search engines and retail sites is different in China. In most markets, shopping begins with a Google search. In China, online retailing marketplace Taobao.com blocks the spider of the top search engine, Baidu.com. Therefore, most shoppers start their search within Taobao, which accounted for over 70 percent of China's e-commerce volume. "Chinese shoppers are developing the habit of not relying on search engines to find products online," said Jeff Walters, a Beijing-based principal at BCG and coauthor of the report.

Largely because of consumer wariness and distrust of merchants, Chinese consumers are the most likely in the world to check for product recommendations on social networking sites as well as on-line shopping websites. Forty percent of online consumers in China say they've read and posted reviews — more than double the rate in the United States. Conversely, only 19 percent of consumers in China go to official brand or manufacturer sites, compared with 41 to 60 percent in Japan, the United States, and the European Union.

Still, e-commerce is a young industry in China. Although more people are shopping online in China than the U.S., penetration is much lower, relative to the population; only 14% of China's 1.3 billion residents shop online, compared to about 54% in the U.S. Chinese shoppers are also gravitating towards lower-priced items.

The major players

The three big Internet companies in China are Alibaba, Baidu and Tencent, which dominate three different categories of the market: e-commerce, search and messaging, respectively, according to Mashable.

The vast majority of online transactions in China — 80% as of 2010 — take place between consumers, according to AK Kearney's estimates. Approximately 90% of those transactions are executed on Alibaba-owned Taobao, frequently described as the "eBay of China."

Like eBay, users on Taobao can purchase and sell new and used goods at fixed or negotiated prices, as well as through auction-style listings. Unlike eBay, most goods are new, and there are no listing or transaction fees — the majority of Taobao's revenue comes from advertising. Next year, the company will bring in $716 million in pre-tax earnings and will be worth $14.3 billion, according to estimates from Goldman Sachs.

Business-to-consumer retail is quickly gaining steam online as well. AK Kearney estimates that B2C transactions will make up 40% of the market by 2015.

About half of B2C transactions currently take place on Taobao Mall, or Tmall, another Alibaba property. It features products from 70,000 brands, half of which operate their own stores on the site. The company says it has 25 million registered users. Unlike Taobao, Tmall charges businesses fees for transactions. An estimated $16 billion in sales was generated on Tmall in 2011, a figure BCG expects will double this year.

Together, Taobao and Tmall were responsible for 81% of online transactions by dollar amount in 2010. Forty-eight thousand products were sold per minute on Taobao that year, more than the number sold by China's top five brick-and-mortar retailers combined.

More than 60% of buyers on Taobao and Tmall pay for their transactions using Alipay, a payment system comparable to PayPal. Twenty percent of transactions on B2C sites are also paid for using Alipay.

Other players in the space include 360buy.com, a multi-brand retailer often described as the online, Chinese equivalent of Best Buy. It is the second largest B2C site in China, generating around $5 billion in sales in 2011. Individual brands are also setting up shops to sell directly to consumers.

Challenges ahead

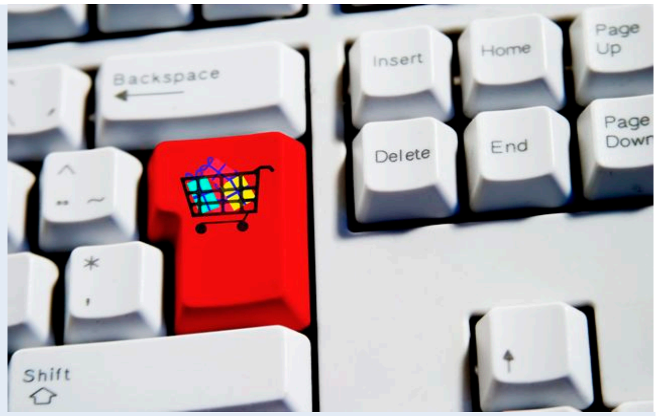
The biggest problem holding back China's e-commerce for years was a lack of trust. Consumers worried that online firms were cheats, or that their credit cards would be abused, or that purchases would get swapped for counterfeits during shipment. Alibaba overcame this by creating Alipay, a clever online arrangement that — unlike eBay's system — releases payments to vendors only after clients confirm that they are satisfied.

But still, Chinese e-commerce websites are targets of hackers and on-line shoppers often fall victim.

Although shipping infrastructure is improving in China, it still has a long way to go, particularly outside major cities. Literally thousands of Tier 3 and Tier 4 cities do not have the logistics or supply chains to make products easily available locally.

Chinese Online Retailers Struggling to Be Profitable

By Cui Xiaoling



With online retail sales exploding in China, many Chinese e-retailers are investing heavily, in some cases accepting losses now in hopes of gaining a larger share of what could soon be the world's largest e-commerce market. And the escalating price wars this year have further eaten into their profits, if there is any.

Therefore, most of the major e-commerce players are still struggling to become sustainably profitable. "For every dollar they earn, they spend four," Li Guoqing, DangDang's CEO, commented on 360Buys's business model.

Struggle to make ends meet

Many of China's online retailers are investing heavily in distribution centers and other infrastructure projects, and as a result many are only marginally profitable or losing money, according to an Internet Retailer report.

"The profit of almost every e-retailer was very low because they are investing lots of money into infrastructure and hoping to grab more market share," said Jingwen Ruan, chief operating officer of iResearch. "At this stage, they are caring more about sales volume rather than profits. In addition, online retailers need to improve a lot in the management capability, such as supply management and channel management, and need many experienced online shopping professionals as well. All need lots of investments to support their further development."

Among the major investments Chinese web retailers reported last year were Tencent Group, which is moving to catch up with earlier e-commerce players, spending $1 billion on a new e-commerce platform, distributions centers and delivery services. Suning also said it invested $1 billion in its e-commerce operations. Slow delivery during peak holiday periods has plagued Chinese e-retailers, and many are investing in improved shipping services.

In a recent report, iResearch estimated that 360Buy, China's No. 2 web retailer lost $170 million last year. While the report said No. 1 e-retailer T-mall turned a profit, it said No. 3 and 4, Amazon China and Suning, lost money.

According to iResearch, T-mall's sales totaled $16 billion in 2011, 360Buy $4.9 billion, Amazon China $952 million and Suning $936 million.

360Buy initially sold electronics online, but later diversified into a wide range of other consumer goods. The company says its web sales last year more than tripled from $1.62 billion in 2010. Suning is better known as a brick-and-mortar electronics retailer that has aggressively expanded into e-commerce in the last 2 years.

Amazon started its Chinese business by buying domestic Joyo.com for $75 million in 2004 and named it "Joyo Amazon." Last year, the name changed to Amazon China. Amazon's China based e-commerce site, Z.cn, now provides more than 5 million SKUs in 28 categories, including apparel, computers and books. Amazon China operates 11 fulfillment centers and offers same-day delivery in 17 cities; in another 53 cities, the retailer promises next-day delivery.

Amazon does not break down financial results by country. But iResearch ranks it No. 3 in terms of online sales in China, generating $465 million in web sales in 2010.

Escalating price wars

With more and more brick-and-mortar home appliance retailers tapping the e-commerce market, the online price wars have been escalating more fiercely in the Chinese market.

Since the beginning of 2012, a life-or-death year for e-commerce, major Chinese online stores including Suning Appliance Co., Ltd and Jingdong Mall (360buy.com) have been mired in comprehensive price wars.

Started by Suning in April, the first round of price wars involved major business-to-customer (B2C) retailers including Guomei, Dangdang, T-mall, and 360Buy. The second round of wars was waged by 360Buy in June on its founding anniversary.

The third round of price wars is quick on the trigger after Suning announced to allocate one billion yuan in August on the occasion of its third anniversary to further compete on price.

Statistics showed that major e-commerce companies spent as high as seven billion yuan in May and June on price wars, said home appliance industry expert Liang Zhenpeng.

He predicted that the price wars will not stop until some online businesses are marginalized due to huge losses.

After rounds of head-to-head price battles among the online companies, some escaped narrowly from death while others went to the dogs.

Industry insiders said that although the promotions or tactics have raised sales volume, the price cuts squeezed the already limited profit margin, making many companies hogging the limelight at the expense of profits.

Statistics showed that 360Buy's gross margin was only seven to eight percent annually, while U.S. online retailer Amazon's gross margin was above 20 percent. Price wars are thus believed to bring bigger losses to those more adventurous online companies.

Chinese netizens said for the time being price wars play an important role in the e-commerce market, but for the long run, service and reputation will be the major factors to win customers.

Subject to government investigation

China's e-commerce industry descended into full-scale war in August: Suning, Gome, and 360Buy vowed to undercut each other on electronics and appliance sales, with several other sites taking sides, mostly against 360Buy. The price war was supposed to benefit consumers, but turned out to be a promotional stunt. A government investigation finds many of the original promotions were a sham.

Jack Ma, founder of Alibaba was conspicuously absent from the microblogging ping pong between China's ecommerce executives. Ma said the latest so-called price war is bad for consumers. He added that sellers should be grateful to their partners and customers, and recognize the latter are savvy enough to know a good deal when they see one, according to a Buy Buy China report.

Concurrently, China's National Development and Reform Commission is investigating irregularities in "wartime" pricing and distribution. So far, the NDRC has found that some of the competitors raised their prices before announcing price cuts; goods were listed as out of stock despite being available; and products sold "at cost" were sold at a premium.

The NDRC is yet to publish a final verdict, but it is likely to impose fines on some or all of the parties involved. Regardless of who gets punished, China's ecommerce industry is now one step closer to consolidation. Sometimes, even a fake war breeds real casualties.

The Future of China's E-commerce

By Lesley Cui

Analysts believe that in several years, Chinese online shoppers will experience an evolution from being "price sensitive" to "experience sensitive". B2C online retailers that specialize in specific product categories with good service and branding will challenge the dominance of Taobao C2C websites.

As a result of fierce competition, a large number of B2C and C2C retailers were knocked out in the industry shakeup. The online to offline model is likely to be the right direction for companies to profit from the explosion of e-commerce.

E-commerce will have a bright future in China, not only for its strong growth momentum, but also for full government support and exemption of monopoly by State-owned enterprises suffered by traditional industries.

Phasing out the discount model

Alibaba Group's Taobao websites are virtually synonymous with online shopping in China, but that may not always be the case, according to a Wall Street Journal report.

In China e-commerce is all about discount shopping, said Hurst Lin, general partner at venture capital firm DCM and former COO of Chinese web portal and microblog operator Sina, but that won't last. Mr. Lin believes that in several years, Chinese consumers will have more discerning taste and that online retailers with the best design and branding will challenge the dominance of Alibaba Group's Taobao websites.

A Bain & Company survey found that while price remains the primary motivator for shopping online, convenience and variety now are major considerations for a surprising segment of shoppers. Online consumers have started to diverge, with a significant number evolving from "price sensitive" to "experience sensitive."

"Today, what you're looking at is discount," Mr. Lin said. "That's what Taobao is all about — the cheapest stuff, comparison shopping." What Taobao websites offer is similar to what eBay offered to online shoppers in the 90s, he said.

Growing competition has recently begun to erode Taobao's market share. Its share of online purchases in China slipped to 71% by value in the second quarter from 75% a year earlier, according to Analysys International.

But analysts said that "eBay is declining" in the U.S. and though Taobao is still on an upswing, its dominance will eventually decline as well. Venture capitalists are now looking for trends that will pick up two or three years down the line. Taobao "will have their heyday for another four to five years, then eventually consumers will go to online retailers that specialize in specific product categories", Mr. Lin said, adding: "Taobao better go public."

Alibaba chairman Jack Ma said the company doesn't have plans for an initial public offering of Taobao, but that he wouldn't rule out an IPO for Alibaba Group. The value of transactions on Taobao had doubled last year to hit 400 billion yuan ($63 billion). Taobao didn't disclose transaction numbers this year, but Mr. Ma said he expects the number to reach a trillion yuan in 2012.

Experts believe e-commerce companies, rather than simply competing on price, will eventually have to differentiate themselves by offering better design, more entertainment value and services that increase margins. For example, Lin cited flash sales websites that add a sense of urgency by setting time limits for people to keep purchases in their virtual shopping carts or a website that offers buyers the ability to do swaps with other buyers if they have a last-minute change of heart after placing an order.

360buy.com, also known as Jingdong Mall, another Taobao challenger, has done well to attract consumers with low prices and fast delivery service. But it's still unclear how the company will make money given its low profit margins. Analysts believe 360buy needs to go one step further, as online sale should not be all about discounting. As consumers become less price sensitive, retailers will need to deliver superior customer service and find ways to cultivate customer loyalty.

An Alibaba Group spokesman said the company is addressing the changing tastes of Chinese consumers with Taobao Mall, which "is focusing on service quality" and with its shopping search engine eTao which "provides info other than pricing," including "product guarantees, user reviews, shipping options, etc."

Expansion of B2C

Consumer-to-consumer (C2C) online marketplaces such as Taobao.com lead with a 77% market share compared with just 23% of business-to-consumer (B2C) sites. But explosive B2C growth is underway, fueling the expansion of China's entire e-commerce industry. By 2015, China will be the world's leading e-commerce market, and B2C e-commerce will represent more than 40% of total online sales, according to iResearch Inc.

"Business-to-customer e-commerce will become the main driver of China's online shopping industry," said Ding Jiaqi, an analyst with the domestic information technology research company iResearch Inc.

Many big traditional retail names are gearing up to seize the opportunity, including Wal-Mart, which is opening up its China e-commerce headquarters in Shanghai. Meanwhile, Taobao is using its 370 million user base to feed traffic to Tmall, its entry in the B2C market. In 2010 alone, it quadrupled sales, serving as a major profit generator for Taobao.

From clicks to bricks, online to offline

As the number of Chinese Internet users surges, investment opportunities in the online to offline sector are being pursued by angel and venture capital investors, as reported by China Daily.

O2O, also called offline e-commerce, means netizens and mobile Internet users are able to see discounts and service booking information from stores on websites that encourage them to visit real rather than virtual outlets.

The Bain & Company survey found that China's e-commerce ecosystem — including sourcing, payment and delivery — has developed to the point where retailers can quickly build and grow their own e-commerce sites. By leveraging their brick-and-mortar stores and other offline resources, these retailers will create a threat to online-only players.

"O2O investment has great potential," said Wang Xiao, founder of Unity Ventures and a former senior executive at Baidu Inc.

For instance, Unity Ventures and another angel investment institution Zhen Fund, invested in a food order website this year. Its software can be installed in cell phones and users can find the restaurant on a map and order food.

There are similar websites abroad such as JustEat.com and GrubHub.com. They are global market leaders in the online ordering of takeaway food.

According to Wang, O2O business provides dealers with free online stores, more clients and orders, as well as marketing. Customers find it more convenient and have more choices and can see comments left by other customers.

Every sector will be changed by O2O," said Ling Daihong, an angel investor and founder of Infotech Printing Machine Co Ltd.

Ling has been an angel investor for more than a year, having put money into 15 O2O companies. One of them sells discount branded spectacles online. People can select several designs. The company then sends out an assistant to the prospective customer's home or workplace with the selection. If he or she chooses to buy any of the glasses, the company will package pristine originals and send them to the customer.

In China, Ctrip.com, established in 1999, is one of the earliest O2O companies. It delivers information online but payment and services are completed offline. Group-buying companies deliver information and process payments online.

Globally, car rental, travel and information service companies were among the first businesses to make use of O2O.

Zero2IPO Research Center believes car rental, food, travel and hotel accommodation have enormous potential in the O2O sector in China.

Government aims to double e-commerce sales

China aims to double the value of its e-commerce sales to 18 trillion yuan ($2.86 trillion) by the end of 2015, according to an E-commerce 12th Five-Year Plan (2011-15) released by the Ministry of Industry and Information Technology, the nation's top industry regulator.

The ministry said the government will encourage large companies to move their businesses online. Besides, it will foster the development of third-party purchasing systems online to encourage small and medium-sized companies to adopt e-commerce.

"Shopping centers, whole sale markets and supermarkets should create online stores to reduce their costs and develop product-tracking systems," the ministry said.

E-tickets are something else that the government will place a greater emphasis on to improve the country's public transport system.

The plan also says the ministry is targeting markets overseas.

Even so, there are some difficulties in the market, the ministry said. Online shopping services and legislation need to be improved.

China sought public opinions recently for its first law regulating the e-commerce market in a move to curb trade in counterfeit goods and further protect consumer rights.

The law aims to enforce registration and licensing among numerous sellers in China's booming online business, a group largely untracked by authorities, said Cao Lei of the China E-Business Research Center, an entity authorized by the State Administration for Industry and Commerce of China to draft the legislation.

There may come a new type of license exclusively for online sellers, Cao said. Without the licensing, fake goods go rampant.

The law, which is expected to be enacted within the year, will address the mounting complaints of consumers unfairly treated in ill-regulated online transactions.

More Foreign Brands Use Taobao for E-commerce

By Cui Xiaoling

More foreign brands like Adidas and Gap are expanding their reach into China's market by tapping the user base of the country's largest online retailer Taobao.com, according to an IDG News Service report.

Taobao, launched in 2003, has risen to dominate China's online retail market, with more than 370 million users, according to the Chinese company. The site's vast customer base has made it a far-reaching marketplace for Western brands wanting to sell to Chinese consumers. "We've definitely seen increasingly more interest from overseas companies exploring Taobao Mall as an avenue to reach Chinese consumers, particularly those residing beyond Beijing and Shanghai," said Taobao spokeswoman Justine Chao. About half of all transactions on Taobao come from areas outside of China's major cities.

Taobao Mall, the company's business-to-consumer platform, currently has more than 70,000 brands. While a majority of the brands are domestic, some well-known international brands have decided to set up their own online stores on Taobao Mall.

One of the latest foreign brands to have a store in Taobao mall is U.S. clothing retailer Gap. It decided to do so, even as it had already launched its own Chinese e-commerce site.

"We are launching on Taobao to expand our reach to Chinese consumers given Taobao is the most visited e-commerce site in China," Gap said in an e-mailed statement. "Our presence on Taobao is complementary to our own e-commerce site, which is doing well, along with our stores."

A few other major brands with online stores on Taobao Mall include Levi's, Samsung and Uniqlo. In August 2010, sportswear manufacturer Adidas also established an online store on Taobao Mall, making it the company's sole e-commerce provider in China.

Adidas said while most of its sales still come from its storefronts in China, the company's online sales in the country has seen "rapid growth."

"Taobao allows us to reach millions of consumers in a very direct way, many of whom we could have difficulty reaching through brick-and-mortar storefronts," Adidas said. "The decision was also an acknowledgement that Chinese consumers are increasingly turning to the Internet to do their shopping."

Taobao, which started as a consumer-to-consumer platform, rose to the top of the China's online retail market after beating out e-commerce rivals like eBay in the country. The company launched its Taobao Mall platform in 2008 as a way to expand into China's growing business-to-consumer (B2C) market.

While partnering with Taobao can come with opportunities, launching a store on the site can also present challenges, according to Bestseller, a Danish clothing company that owns brands such as Vero Moda and Jack & Jones. Bestseller currently has 4,000 stores in 300 cities in China, but has also set up an online store on Taobao Mall.

The company said that part of the motivation to launch a store on Taobao was to stop the selling of counterfeit goods on the site, according to Dan Friis, Co-CEO of Bestseller.

Bestseller hasn't been the only one to point out the problem. A U.S. government report recently called Taobao a "notorious market" for allowing its merchants to sell counterfeit goods. The report, however, noted that Taobao was making "significant efforts" to stop the illegal activities.

Taobao responded by saying that it had stepped up its efforts to stop the sale of counterfeit products on the site. The company has removed a great number of counterfeited product listings. It has also launched a "covert buying operation" to purchase and examine suspected counterfeit products to check if they are genuine. Hundreds of sellers have been penalized in the operation, Chao said.

Besides Taobao, foreign companies are entering the Chinese e-commerce market through Amazon and by investing in local B2C websites. As the Wall Street Journal reported, Macy's Inc. has invested $15 million in Chinese online retail company VIPStore. The deal will allow Macy's to sell merchandise through a dedicated section on the website, Omei.com, in spring 2013, a luxury site operated by VIPStore.

Macy's move comes after Neiman Marcus Group Inc. invested $28 million for a stake in Chinese site Glamour Sales Holdings Ltd., allowing the company to tap Chinese demand for luxury goods without having to invest in bricks and mortar stores.

Wal-Mart has recently received conditional approval from Beijing to acquire a 51% majority stake in e-commerce merchant Yihaodian, which sells more than 180,000 products ranging from groceries and electronics to clothing.

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