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Price Wars: Innovation or Doom for E-business Development?

--Legal Analysis of the Price War among Internet Retailers in the PRC

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Abstract: Price wars are often used to promote products by competitors in the same business field. A price war started by 360buy.com in August 2012 has again aroused public concern and debate about price wars in China. In the short run, price wars are good for Internet customers to get products at lower prices and good for big e-commerce companies to enhance their corporate image. However, some behaviors in a price war may lead e-business to its doom in the long run. The behaviors in the price war between 360buy.com and other online retailers show that price fraud is illegal under the Price Law. The online retailers which conduct price fraud are subject to punitive damages under the Law on the Protection of Consumer Rights and Interest. False advertisements that mislead customers in the course of a price war are prohibited under the Advertisement Law. Retailers are also potentially liable under the Law against Unfair Competition and Anti-Monopoly Law. These legal risks arising from a price war are lessons to all of the online retailers that are interested in adopting this strategy. Price wars could play a positive role in the development of the e-business industry on the condition that the e-business companies act strictly in accordance with the laws.

Keywords: price wars, innovation, doom, e-business, online retailers, legal analysis, PRC

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 have been mired in comprehensive price wars. [1] Verbal battles between e-commerce competitors, crowds of onlookers, and angry complaints from online customers flooded the Internet for a while. Although the role of a price war in the e-business industry is still being debated, some behaviors of the online retailers may be harmful to the development of the e-business industry because the behaviors are prohibited by law. Which laws may be applicable to the price war and what kind of conduct may be illegal in a price war? It is important to make a legal analysis of this price war among Chinese online retailers to find the answers.

1. INTRODUCTION TO THE PRICE WAR BETWEEN 360BUY.COM, SUNNING, AND GOME

The new round of price wars was started by a micro blog posted on August 14, 2012 by Liu Qiangdong, CEO of 360buy.com, also named Jingdong Mall, one of the biggest online shopping platforms in China. Liu announced that, “360buy.com will get a zero percent gross margin from large home appliances sales in the next three years….I guarantee you that the prices of large home appliances sold on Jingdong will be at least 10 percent lower than those in the Gome and Suning stores.”

Responding to the written challenge to war from 360buy.com, Suning and Gome soon hit back. Suning posted on their official micro blog that, “We promise any product sold by Suning, including home appliances, will be cheaper than 360buy.com.” Gome declared that, “We promise the price of any product sold on the Gome online shop will be 5 percent cheaper than 360buy.com.”

With the three largest online home appliance retailers in China kicking off the confrontation, other smaller
online retailers, including DangDang and 51buy, also got involved in the war. 51buy announced that, “All prices will be reduced from 9 a.m. Starting from September, we promise any product sold on 51buy will be cheaper than 360buy.com.”

The price competition among online retailers attracted thousands of netizens glued to their computers. They closely tracked follow-ups in the price war for the sake of getting a real bargain through price comparisons among the online retailers’ websites. Netizens’ participation built a booming business atmosphere in the field of e-commerce for a moment. Price wars are a rather complex phenomenon. Observers appreciated that a price war is an innovational strategy that can greatly promote e-commerce development. At the same time, some experts doubted the function of a price war and pointed out it may lead e-commerce industry to its doom in the long term. From a legal perspective, some actions taken in this price war among online retailers may be illegal and might put the retailers involved in trouble.

2. IS A PRICE WAR AN INNOVATION FOR E-BUSINESS DEVELOPMENT?

A price war is regarded as a marketing strategy for online retailers. It is an innovational tool to get much more attraction from the market in cyberspace. The positive effects of a price war include following four points.

Firstly, price wars are good for Internet consumers, who can take advantage of lower prices. When one competitor lowers its price, then others will lower their prices to match. If one of them reduces their price again, a new round of reductions starts. So long as Internet consumers closely keep track of the latest prices posted by online malls, they could get one or two products at a very reasonable price. That is why the price war between 360buy.com and other home appliance retailers was a boon for online customers.

Secondly, price wars are also good for big companies in the e-business industry. Only those powerful online retailers would be able to deal with low profits or even losses from cutting prices for a long period. When smaller firms cannot compete and have to close, the remaining firms absorb the market share of those which have closed. The survival of the fittest gives high-quality online businesses opportunities, and this is good for the e-commerce industry as a whole.

Thirdly, price wars are a good way to enhance corporate image and influence. Especially in cyberspace, business information spreads at an unprecedented speed. The characteristic of information dissemination provides online retailers with convenient channels of promotion to enhance their visibility. It was reported that, during the price war, hits on the official websites of Suning, Gome and 360buy.com increased exponentially. Both entries have been re-tweeted more than 100,000 times. Even smaller online shopping platforms received attention from customers and let customers know about their websites. Hence, the price war played a significant publicity role for the online retailers.

Fourthly, price wars are good to attract more potential off-line customers to shop online. According to data from the China E-Business Research Center, as of December 2011, there are 203 million online customers in China. Considering China has more than 5 hundred million netizens, online retailers should take more measures to develop the market of online shopping. Price wars are helpful to increase potential offline customers’ interest in shopping online. For existing online customers, their habit of online shopping could be consolidated and strengthened continuously by means of price wars.

3. DO PRICE WARS SIGNAL DOOM FOR E-BUSINESS DEVELOPMENT?

Obviously, customers greatly welcome price wars. But price wars may also make customers lose in the long term. This is because lower prices reduce profit margins and can threaten the warring companies’ survival. With fewer firms in the industry, prices tend to increase, sometimes higher than those before the price war started.
“A price war will serve as a trump card in the initial stage of expansion, but the model of sacrificing reasonable profits in the long run is not a sustainable model,” warned Shi An, founder of Goottime Technology, a service provider in the IT industry. [6] Yes, the price war between 360buy.com, Suning and Gome witnessed some behaviors with a negative influence on China’s e-business development and may lead e-business development to its doom if those behaviors are out of control.

Behavior 1, make up false original prices. As “Quality, competitive price and express delivery” is the wording by 360buy.com [7] on the advertising billboards, customers were awaiting for good products at lowest cost from 360buy.com. However, the fact is that all three online giants had made up some false original prices. That means the price of some products is even higher than the lowest price within 7 days prior to the price war.

Behavior 2, break the promise of zero gross profit. 360buy.com promised that they would get a zero percent gross profit margin from large home appliances sales in the following three years. In fact, as noted by one government agency, the gross profit margin of some products in a promotion is as high as 10%. [8]

Behavior 3, remove some products from the price war. After declaring a price war, many products on the promotional list showed “out of stock” within a very short time. However, these products were actually in the warehouse.

Behavior 4, low overlap ratio of the products. Some products are sold in only one online mall and cannot be found in other online malls, which makes it is not possible for customers to get a lower price by price comparison. Because the overlap ratio of the products is too low, online customers doubted that it was a mere coincidence for the online retailers in the price war presented different products for sale.

4. LEGAL ANALYSIS OF ACTIONS TAKEN IN THE PRICE WAR AMONG ONLINE RETAILERS

4.1 From the view of the Price Law: Price fraud is illegal

The Price Law of 1998 is a special legislation to regulate prices in the PRC. Article 14 of the Price Law prohibits eight unfair price acts by operators. One of the eight unfair price acts is luring consumers or other operators to conclude transactions with it by employing falsified or misleading price means. This kind of price act is also called price fraud and it seems to be what happened in the price war among 360buy.com, Suning, Gome, etc.

As mentioned before, most of the online retailers did not indicate true original prices of some products during the course of the price war. The online retailers intentionally marked some products with a falsified high original price as well as a comparatively low discounted price. This so-called “huge price difference” lured thousands of customers to order online. The customers finally realized that the actual value of the products was not as that high as the original price showed.

Hence, 360buy.com and the other online retailers that engaged in price fraud may be punished under the Price Law. Retailers involved may face the following punishments: (1) to make a rectification, to have their illegal gains confiscated, and to be concurrently fined less than five times of the illegal gains; or (2) to make a rectification, to receive a warning, and a fine; or (3) suspension of business operations, or revocation of their business license where the circumstances are serious. For the price war between 360buy.com and Suning, it is a challenge for the administrative authority to fix the amount of the illegal gains, which makes it hard for the authority to fix the amount of a fine because they may not get the true figure from the retailers.

4.2 From the Perspective of the Law on the Protection of Consumer Rights and Interests: Punitive Damages

Where the above-mentioned price fraud activities are proved, the retailers are subject to punitive damages under the Law of PRC on the Protection of Consumer Rights and Interests. Article 49 of the Law provides that business operators engaged in fraudulent activities in supplying commodities or services must, on the demand of
the consumers, increase the compensation for victims’ losses. The increased amount of compensations is two times the cost that the consumers paid for the commodities purchased or services received. This clause establishes a punitive damages mechanism, which is employed mainly in the common law system, with the aim to give the injured person enough compensation as well as punish the law-breakers. In this online price war, the customers who were cheated by the false original price and bought the commodities in the online retailers’ websites may request punitive damages from the relevant online retailers based on the Law on the Protection of Consumer Rights and Interests.

Besides the punitive damages clause, the Law further offers an administrative remedy for consumers to seek. According to Article 39 of the Law, consumers may demand the competent administrative departments to punish the advertising agents who release false advertisements. Although this clause does not provide the injured customers with any monetary compensation, it is really helpful to improve the advertising market environment and perfect the advertising market order.

4.3 From the view of the Advertisement Law: Misleading customers is prohibited

Further to the analysis of false advertising under the Law on the Protection of Consumer Rights and Interests, it is necessary to look into the Chinese advertising rules to find out to what extent of administrative penalties.

In this price war, many promotional slogans like “90% off”, “zero gross profit margin” and “@ ¥0”, etc. were used to attract customers to the websites but the customers got nothing in the end. These slogans are kind of advertisements in essence and should be regulated under the Advertisement Law of the PRC. The Law has two articles which may applicable to this price war. One is Article 4, which stipulates that an advertisement may not contain any false and deceptive information, and may not cheat or misguide consumers. The other one is Article 38, which provides that where publishing of a false and deceptive advertisement cheats and misguides consumers, and thus infringes on and damages the lawful rights and interests of consumers who buy the commodity or accept the service, the advertiser must bear civil liabilities in accordance with the law.

The retailers, i.e. the advertiser in this case, which have published false advertisements, infringed on the lawful rights and interests of consumers who bought the commodity for so-called low price. Because advertisers are subject to only civil liabilities rather than administrative liabilities, nobody knows how many customers who suffered losses from the price war will ask the retailers for compensation. Another issue is the legal basis. What the Advertisement Law stipulates is “the advertiser shall bear civil liabilities in accordance with the law”, but there are no more details to instruct which law should be used by the customers to ask the retailers to bear civil liabilities.

As to the administrative punishment mentioned in 4.2, there are corresponding clauses under the Advertisement Law in respect to advertising agents. Where an advertisement agent releases false advertisements in terms of price, quality, origin, quantity, etc., the advertisement agent may be ordered to cease publication of the advertisement and to publish a correction. The advertising fees may be confiscated by the authority. The agent may also be fined not less than the amount of its advertising fees and not more than five times the amount of its advertising fees. So, according to the Advertisement Law, the infringed customers in the price war have the right to request the competent advertisement authority to cease publication of the false advertisements by 360buy.com or other relevant online retailers and even to impose a fine upon the retailers.

4.4 From the View of the Law against Unfair Competition: Hard to Prove it is Illegal under this law

If we need to describe the price war among 360buy.com, Suning, Gome and other online retailers with only one word, that word must be “fierce”. All of the retailers tried their best to make good use of almost all the network platforms like websites and micro blogs to propagate their commodities and to break their opponents. Phrases like “If 360buy.com sells the commodity at ¥1, we will sell it at ¥0.”; “the speed of Suning.com is
too slow to login to, let’s go to 360buy.com” made customers too dazzled to choose between the different online malls. The question whether these competitive actions are illegal from the view of the Law against Unfair Competition is worth analyzing carefully.

Article 11 of the Law against Unfair Competition provides that an operator must not sell their commodities at prices lower than cost for the purpose of pushing out their competitors. There is no question that all of the companies involved in the price war are competitors in the field of electronic commerce. The reason for them to participate in this price war is to sell more commodities quickly in the short run and to force incompetent or inefficient online companies from the field. So, price cutting may illegal from a subjective point of view. It is more complicated when we compare the cost to the price. According to the law, selling commodities at a price lower than the cost is one of the elements to prove illegal unfair competition. However, what is cost? It is still an open question. For a specific commodity, should we calculate its cost on the basis of average cost in the industry or on the cost basis of the product itself in each company? The complicated calculation makes cost not only a legal question but also an economic question. [10] Luckily, however the authority calculated the cost in this price war, the authority found that the retailers still made a profit by selling their commodities at an unbelievable low price, implying that the selling prices were higher rather than lower than the costs.

Although the online retailers may escape punishment under the Law against Unfair Competition, they are potentially liable under the Price law and the Advertisement law due to their boasting of low prices and the falsification of the original prices.

4.5 From the View of the Anti-monopoly Law: a dominant market position is the key.

Because the Anti-monopoly Law of PRC also regulates the conduct of selling commodities at prices below cost, which was suspected in the price war between 360buy.com and the other online retailers, there is a question as to whether the retailers violated the Anti-monopoly Law by selling commodities at prices lower than cost.

How the law regulates the conduct is very important to resolve this issue. Article 17 of the Anti-monopoly Law prohibits seven actions by a business operator with a dominant market position. One of them is selling products at price below cost without any justifiable cause, which may lead us to the answer YES if the online retailers did sell their products below cost. But if we pay more attention to the clause, we could find that WHO does the act is the key point. Under the Law, a business operator with a dominant market position may not sell products at a price below cost without any justifiable cause. That means a seller who is a small company with little influence in the market may not be punished for selling the products at prices below cost.

The Law further stipulates the criterion for deciding the element of dominant market position. Where a business operator is operating under any of the following circumstances, it may be assumed to have a dominant market position:

(1) The relevant market share of a business operator accounts for 1/2 or above in the relevant market;
(2) The joint relevant market share of two business operators accounts for 2/3 or above; or
(3) The joint relevant market share of three business operators accounts for 3/4 or above.

A business operator with a market share of less than 1/10 will not be presumed as having a dominant market position even if they fall within the scope of the above second or third items.

Statistics from the China E-Business Research Center show that up to December 2011, Tmall.com had retained its No.1 ranking in the Chinese B2C online shopping market, 360buy.com was No.2 with 18.5%, and Suning ranked No. 3 with 3.3%. [11] If the Chinese government adopts these statistics, all of the online retailers involved in the price war may be released from the limitation under the above-mentioned clauses of the Anti-monopoly Law because none of them has a dominant market position in the online B2C market.
5. MEASURES TAKEN BY THE CHINESE GOVERNMENT

5.1 Law enforcement is under way

The Chinese government, including the National Department and Reform Commission (NDRC), the Ministry of Commerce (MOC) and the Sate Administration for Industry &Commerce (SAIC) has kept an eye on the business conduct in the price war since 360buy.com triggered the war.

The investigation by the NDRC has found that all the three giants, 360buy.com, Suning and Gome have fabricated the prices of their goods. Their “on-sale” prices were higher than the lowest prices over the previous seven days.

Besides the prices, a spot check of 15 products of 360buy.com found that the gross profit margin was from 4 percent to 22.4 percent rather than the zero profit promised by 360buy.com at the beginning of the price war.

Many internet users also found that products advertised at low prices were allegedly in short-supply. However, the investigation showed that those products were piled up in the companies’ warehouses.

The three online retailers were requested to examine and correct their illegal conducts by themselves. [12]

The investigation by MOC and SAIC is under way. Other administrative punishments may be imposed on the online retailers involved when all the relevant procedures such as investigations and hearings are done.

5.2 New Regulations are under development.

To be frank, the price war between 360buy.com, Sunig and Gome is not the first price war in the Chinese e-business market and will not be the last one. In addition to the laws analyzed here which focus on post-event-supervision, it is of much more importance to strengthen pre-event-supervision. Regulations specified for the e-commerce field are also needed to build normal e-commerce market order.

In response, the State Council is taking action. It is reported that several new regulations are being considered. For example, one is the Regulation on Supervision of Online Products and Services, a comprehensive regulation in the domestic field. In addition, the MOC is planning to work out some rules and standards for e-commerce transactions such as the Standard of Credit Evaluation of Online Shops, the E-commerce Norms for Promotions and Operations, the Management Ethics for Network Group Purchase Enterprises, the Standards of Credit Evaluation of Network Group Purchase Enterprises, etc.

6. CONCLUSIONS

The price war seems to have ended, filled with the disappointment of online customers. As a promotional strategy, it is indisputable that a price war can improve public awareness of a brand as long as the participating enterprises act in accordance with the relevant laws. Otherwise, rounds of cost-driven price competitions will be definitely harmful to the industry. E-business companies are at great risk of breaking such laws as the Price Law, the Law against Unfair Competition, the Anti-monopoly law and the Advertisement Law.

Because the e-business industry is developing at an extremely high speed in China, a good legal environment and law-abiding e-business enterprises are very important for the sustainable development of the Chinese e-commerce industry. With the online retailers, represented by 360buy.com, paying the price for their illegal actions in this price war, the business environment of e-commerce will be getting better for both the enterprises and customers.

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