



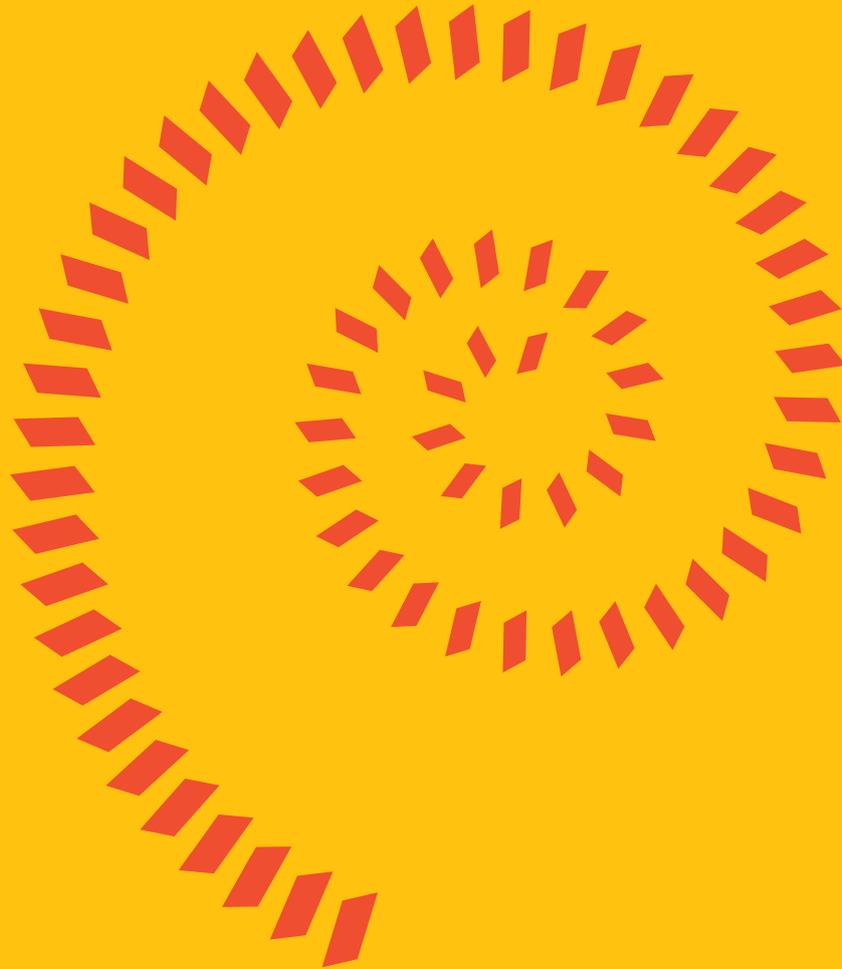
**MARS**



**Economics  
of Mutuality**

# JD.com

An Economics of Mutuality case study



**Responsible Business Forum: The Economics of Mutuality**

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# JD.com

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## **About the Responsible Business Forum Case Studies**

This series of case studies explores how mutual approaches to business can help companies and their partners tackle some of the most pressing global challenges. The businesses featured in this series share a commitment to objectives beyond purely financial performance, as well as a serious intent to implement mutual practices through new forms of ownership, governance, leadership, measurement and management.

In particular, these cases address the measurement of multiple forms of capital, ecosystem shaping approaches, leadership development, business education, and policy formulation through laws and regulation that promote mutual conduct. The authors appreciate the collaboration of participating companies in creating these cases.

These cases were first developed for the annual Responsible Business Forum, the convening event of the Mutuality in Business Project, a joint research programme between Saïd Business School, University of Oxford, and the Catalyst think tank at Mars, Incorporated. The Responsible Business Forum brings together global companies, MBA candidates, scholars and activists to share their experience in confronting key challenges in their ecosystems to generate financial, social and environmental value.

## **Authors' Note**

The conclusions and recommendations of any Saïd Business School, University of Oxford, publication are solely those of its author(s), and do not reflect the views of the Institution, its management, or its other scholars. These cases are based on information provided to the researchers by participating companies.

## **Mutuality in Business**

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# Executive Summary

## JD.com

Founded in 2005, JD.com is China's largest retailer by revenue (\$55.7 billion in 2017), with 292.5 million active e-commerce customers. JD's unrivalled nationwide fulfilment network allows it to provide same- or next-day delivery service to approximately 99% of China's population.

### Ecosystem Pain Point

JD built its business in a Chinese market plagued by counterfeits and poor "last-mile" customer service. An early decision to invest in the fulfilment network and exercise a zero-tolerance policy towards counterfeits allowed JD to overcome the trust deficit between China's online sellers and buyers. Heavy infrastructure investments, however, inhibited profit. The company is now embarking on an aggressive product line expansion to raise margins. Fresh produce and meat sales are expected to boom.

### Strategy Design

Chinese government officials and ecommerce companies see inclusive rural e-commerce as an unrivalled opportunity to eradicate China's last pockets of extreme poverty. JD has launched a stream of programmes designed to bring China's rural farmers into the modern e-commerce economy while simultaneously improving food safety and quality.

In a pilot programme called "Running Chicken," JD supports Hebei Province farmers in raising free-range chickens on government designated land using environmentally friendly practices. JD offers interest-free loans without mortgages, sourcing support for high quality chicks and feed, training, and a purchase agreement for 100% of output as long as farmers follow specified growing standards. A local cooperative oversees programme management and government insurance guarantees the loans. JD has established a dedicated private brand to sell the chickens.

### Performance

In the first year of operations, 30,000 Running Chickens were raised by Hebei farmers and sold on JD's platform. 653 farming families joined the programme, earning RMB 30 per chicken (three times the local average), and raising their annual family income by RMB 3000 each. The local county that hosts Running Chicken has been removed from China's National poor county list. The project is being scaled to add an additional 200 families and 20,000 Running Chickens in 2018.

### Prognosis

JD is investing human capital into farmer training and oversight at present. With the knowledge that this high-touch approach is not sustainable as the programme scales, JD is developing free range farming standards to allow independent farmers to become reliable fresh meat suppliers, while simultaneously assuring food safety and quality.

Work is also underway to launch a "Flying Pigeon" pilot in another Hebei Province county and a "Swimming Duck" pilot in Jiangsu Province.

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# JD.com: Using e-commerce to alleviate rural poverty in china

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## Trust: The foundation of startup success

JD Mall is one of China's two dominant e-commerce giants, capturing 27.2% of the \$600 billion B2C market in 2017 as compared to competitive rival TMall's 56.7%.<sup>1</sup> The two platforms pushed out weaker contenders and emerged as leaders by building trust within a vast and weakly regulated online marketplace that was rife with fraud and deception at the turn of the millennium.

TMall's parent company Alibaba took an early lead in online commerce with a C2C platform similar to eBay. One factor driving the platform's rapid growth was a decision to receive buyers' payments in escrow, and then release the funds to vendors only after confirmation that purchased goods were received. This simple boost to buyer-seller trust triggered a boom in transactions between hundreds of thousands of micro-, small- and medium-sized (MSME) Chinese merchants and hundreds of millions of buyers. Alibaba's third-party (3P) platform model is asset-light, as both the supply of goods and the supporting logistics services are outsourced. This boosts the ecosystem's scale and flexibility, but opens the possibility for deception and tampering (e.g., product or label changes) within the supply chain and delivery channels. Despite efforts in recent years to control these problems, the size and complexity of Alibaba's network make 3P regulation nearly impossible. Indeed, American e-tailer Amazon has seen a similar rise in complaints about counterfeit goods since it opened the platform to 3P Chinese vendors.<sup>2</sup>

When Richard Liu launched JD.com in 2005, he recognised that Alibaba's 3P model didn't go far enough to secure the confidence of buyers seeking high-priced items like cell phones, computers, and consumer electronics – the goods Liu sold in a Beijing bricks-and-mortar store at the time. He therefore set up JD.com as a first-party (1P) B2C retail platform, selling directly to consumers the branded goods he purchased and held in storage. He also took control of "last mile" delivery to assure a high level of service excellence. An early decision to invest in order fulfillment infrastructure and operating systems (500 warehouses, 7000 delivery stations and 65,000 delivery employees as of 2017) yielded an unrivalled ability for JD to reach 99% of China's population with same-day or next-day delivery. By boosting service quality and trust in product authenticity, JD quickly took a commanding lead in online sales of electronics.

By 2008, Liu expanded JD Mall's product mix to include general merchandise, and a competitive race with Alibaba was on. JD differentiates itself from Alibaba on the basis of product authenticity and company trust. This is clearly visible in the brand slogan "Authentic Goods, Delivered Today," and the company vision, "To become the most trusted company in the world, through unrelenting commitment to quality and service excellence."<sup>3</sup>

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1 Compiled from data reported by China Internet Watch <https://www.chinainternetwatch.com/23369/retail-b2c-q4-2017/> and Statista <https://www.statista.com/statistics/323115/market-share-of-b2c-online-retailers-in-china/>

2 <https://www.l2inc.com/daily-insights/amazon-fights-alibaba-to-fight-fakes>

3 "Mission & Values," JD.com, <http://corporate.jd.com/mission-values/>

## The financial returns to trust

As competition heated up, Alibaba followed JD's lead and established an independent B2C platform TMall in 2011 to distinguish offers made by brand owners and authorised distributors from those of the MSME merchants on its original C2C site.<sup>4</sup> JD in turn mimicked Alibaba, opening its platform to 3P sales direct from brand owners to consumers without JD taking ownership. As with 1P sales, however, JD's in-house logistics service prevents tampering within the supply chain and channel. Although TMall's market share lead is still substantial, the gap with JD Mall is starting to close. TMall's enormous customer base (515 million active users versus JD Mall's 292.5 million as of end 2017)<sup>5</sup> will always be highly attractive to brand owners, but a growing pool prefers the security and protections offered by JD's closed logistics system. On the consumer side, there is mounting evidence that JD is preferred to Alibaba by high-spending millennials and also by mature customers with higher incomes.

JD supporters see TMall's recent share losses in the face of JD's continuing gains as an encouraging sign that the investments in trustworthy logistics will yield dividends as Chinese consumers buy ever more

highly valued goods over time. They point out that JD's fastest growing product categories are fashion, baby products, food and other high margin items that sell on the basis of quality and trust. JD's detractors remain skeptical, however, arguing that ongoing infrastructure investments and the high operating costs of last mile delivery will continue to inhibit corporate profitability. In comparison to Alibaba's average group operating margins of approximately 30% in 2017, JD returned a mere 1%.<sup>6</sup> The overall trend was favorable, as margins had climbed up from -11.3% in 2014 and -5.2% in 2015.<sup>7</sup> Nevertheless, JD's finance director openly concedes that profits will remain weak in coming years, as logistics continue to receive heavy investment. A key investment focus currently is warehouse automation – to compensate for China's shrinking low-skilled labor force and delivery drones to lower operating costs – further increase the fulfillment network's market penetration.

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4. "Home," JD.com, <http://corporate.jd.com/>

5. <http://www.alizila.com/alibaba-reports-december-2017-quarterly-results/>

6. YCharts.com, "Companies," <https://ycharts.com/companies>

7. JD Annual Reports

## New pain points for e-commerce in China's countryside

China's online retail sales as a percentage of total retail attained 13.5% in 2016, compared to the global average of 8.6%.<sup>8</sup> Analysts predict China's online penetration will reach as high as 25% of a \$1.7 trillion total retail market by 2020.<sup>9</sup> Unlike the early years of explosive growth in prosperous coastal cities, however, the locus of China's future e-tail growth will be the rural interior where incomes are low and infrastructure is poor. Already an RMB 353 billion<sup>10</sup> market in 2015 with a 94% year-on-year (y-o-y) growth rate, China's rural ecommerce market is viewed as an enormous opportunity waiting to be captured. JD and Alibaba both are moving aggressively to occupy a commanding presence in this new market space.

China's central government sees e-commerce as a solution to rural poverty, which it pledged to eradicate under the 13th Five Year Plan launched in 2016. Central and Provincial government funding has increased each year to support the pledge, reaching a combined total of nearly RMB 100 billion in 2016.<sup>11</sup> In addition, the government designated 158 poverty-stricken counties as rural e-commerce pilot regions where domestic e-commerce companies are encouraged to offer assistance and expertise in targeted economic development programmes. Unlike the general poverty relief programmes of the past 30 years, current programmes are meant to be customised for local conditions. If these pilots are successful, all poor counties will be included in rural e-commerce programmes by 2019.

China's poverty alleviation projects generally include three key components: government funding, farmer training and local third party administration. The third party – which might be a farming cooperative, a local government office, or even a local business owner - often is responsible for distributing funds and helping farmers to improve their productivity and income. In the past, many government projects have failed because all of these stakeholders lack an understanding of markets. The abundant financial resources tied to these aid programmes consequently

fail to leverage local natural and human capitals for financial gain. In essence, the typical government programmes close two ecosystem gaps:

- Financial capital
- Modern farming knowledge and skills

But fail to address additional gaps in:

- IT/Entrepreneurship/Marketing knowledge and skills
- The size of local markets
- Logistics infrastructure, which is needed to bring farm goods to urban markets at a reasonable cost

In 2016, JD signed a Memorandum of Understanding with China's State Council Office of Poverty Alleviation with the intention to close these remaining gaps. A four-pronged programme was established to provide: 1) industry upgrades, 2) employment opportunities, 3) entrepreneurship upgrades, and 4) marketing and branding support.<sup>12</sup> As part of the industry upgrades, JD provides logistics service to 600,000 rural villages and also extends agricultural loans on favorable terms to farmers making capital purchases and investing in the means of production (e.g., seeds, fertilizers and livestock). The World Bank, Dupont Pioneer and a number of local businesses cooperate on these financing programmes. Employment options are offered directly by JD and also by cooperating merchants in the JD e-commerce network. Entrepreneurial training is offered in cooperation with UNDP, China Social Entrepreneur Foundation and other organisations, with an emphasis on boosting e-commerce skills and knowledge. Finally, marketing support is offered on JD's ecommerce platform, where dedicated sites are set up to sell specially designated poverty alleviation products. Consumer awareness and interest in buying these goods are boosted through digital communications on the JD ecommerce site, and also by organising discounted group-buying events.

8. "China E-Market Retail Report 2016," Deloitte.

9. Jim Erickson, "Online Shopping in China to Double by 2020," ALIZILA, 2 March 2017, <http://www.alizila.com/online-shopping-in-china-to-double-by-2020-goldman-report/>

10. Approximately \$55 billion using an average 2015 exchange rate of \$1=RMB 6.4.

11. Approximately \$15.9 billion using 2018 exchange rate of \$1=RMB 6.3.

12. Xue Xiong, Fengying Nie, Jieying Bi and Muhammad Waqar, "The Research on the Path of Poverty Alleviation of E-Commerce: A Case Study of Jing Dong," *Journal of Simulation*, 5:2, May 2017.

## Running chicken: Taking the programme a million steps further

After the first year of operations, the output of JD's four part program was reported as 16,000 direct- and 5000 indirect-jobs created in rural villages, RMB 200 million in loans extended, 50,000 people trained in e-commerce, and more than 10,000 product SKUs sourced from poverty stricken counties.<sup>13</sup> Despite the impressive aggregate metrics, however, the most tangible gains in poverty reduction came from a single village where a highly tailored pilot programmes had run. The pilot was designed to tackle two anticipated barriers to meaningfully raising farmer incomes:

1. Market prices for rurally sourced Chinese agricultural goods are generally low and unstable due to uneven and poor product quality
2. Smallholder farm yields are too small to amass wealth even if prices are high

To solve these problems, JD's "Running Chicken" programme was a deliberate attempt to test the hypothesis that free-range chickens can be sourced at scale from low-income farmers and sold on JD Mall at a premium price. The pilot was situated in Wuyi County – one of northern Hebei Province's poorest regions that nevertheless is endowed with sandy soil and a climate conducive to raising chickens and growing fresh fruits, vegetables and grains for chicken feed. JD worked with the local government to establish a 200-Mu<sup>14</sup> fenced-off farming zone that scales and concentrates chicken farming without detracting from the landscape's beauty. The region thereby remains a viable location for tourism as an additional source of future revenue. The land-use decision removed the problem of fragmentation – a persistent problem that arose when China's communal farms were chopped up and doled out to eligible citizens at the launch of economic reforms in the 1970s, and which remains in place due to the slow pace of legal reforms concerning land ownership and transfers. JD's Running Chicken farm is large enough to graze 15-16,000 chickens at a time, for an average density of less than 80 chickens per Mu.

Farmers are invited to raise chickens at this central facility (typically 100 chickens per family), with a promise that JD will buy them at three-times the average market price as long as strict growing standards are followed. Chief among these is a requirement that chickens run a minimum of one million steps before slaughter, and another that they be fed a healthy diet, including grains twice a day and fresh fruits and vegetables at least three times per week. Growing conditions are digitally monitored via electronic pedometers attached to chickens' feet along with video images from cameras installed at the farm.

In total, the programme engages four principle stakeholders: JD, local farmers, the Chinese government and the local third-party organisation, which in this case is an Internet business owner. JD provides interest-free loans to farmers for purchasing chicks and feed, without demanding collateral. The government insures farmer loans against catastrophic risks, and the local third-party oversees programme administration. Chicks and feed are currently sourced from suppliers in JD's network. The aim is to source from local suppliers eventually, although no direct programmes have yet been established to cultivate those sources. Once chickens meet the minimum growing standards, they are purchased and sold under the proprietary JD brand name "Running Chicken" at three times the price of ordinary chickens. JD is monitoring sales and also farming conditions closely to determine the connection among farming methods, supply quality and market demand.

13. I Xue Xiong, Fengying Nie, Jieying Bi and Muhammad Waqar, "The Research on the Path of Poverty Alleviation of E-Commerce: A Case Study of Jing Dong," *Journal of Simulation*, 5:2, May 2017.

14. Approximately equal to 13 hectares or 32 acres.

## Run, swim and fly into the future

Running Chicken is a winning programme for all external stakeholders. Thirty thousand chickens were sold in the first year, and consumers generally were pleased with the meat's health credentials and good taste. More than 600 families joined Running Chicken in 2017, most of them elderly or sickly farmers with little education and few other viable means of earning a living. After deducting loan repayments and growing expenses, a typical farmer enrolled in the programme realised a profit of RMB 2000-3000.<sup>15</sup> This was sufficient to remove 400 families from the official poverty register,<sup>16</sup> and to remove Wuyi County from the national poverty list. In addition to direct farming income, Wuyi County gained part-time jobs for cleaning the chicken farm and slaughtering the chickens at the end of the growing period. Running Chicken farm will in principle also become a buyer for locally grown fruits and vegetables once a reliable local supply chain is established. Finally, the Chinese government gained a new and more efficient poverty alleviation business model and a tangible reduction in national poverty cases. On the basis of this success, Running Chicken is adding an additional 200 Wuyi families and 20,000 chickens in 2018. Pilots are also underway to replicate the programme in other poverty-stricken counties. If successful, Hebei Province Flying Pigeons and Jiangsu Province Swimming Ducks will join JD's traceable premium poultry product line in 2018.

The benefits to JD are difficult to assess in the short run. Programme managers admit that the high-touch provision of time and JD talent is not sustainable for a profitable long run result. Consequently, they are working closely with government officials and universities to establish agricultural standards for free-range chicken farming and processing. The standards will be based on deep analysis of what works best for raising the chickens as well as building the market demand. Using these standards, local organisations should, in future, be able to pull independent farmers into the free-range chicken supply chain without the need of JD's financial, human and social capital inputs.

For now, JD does not assess the programme's success from the lens of short run profitability. Like many young Internet businesses, the company is spending investors' cash to build market strength and a network that will later be monetised. A successful New York IPO in 2014, and an ongoing stream of investments from institutional ecosystem partners (chief among them Tencent, China's social media powerhouse) fuels the expansion of JD's market presence and ecosystem services. The powerful logistics network will help JD reach deep into China's growing rural e-commerce space, boosting the platform's active user base and adding critical sales volume to offset the platform's low average product margins. At the same time, a high quality, traceable source of poultry will help JD capture the growing Chinese market for fresh meat. Already a \$159.1 billion market in 2015, it has been growing at an annual rate of 6.5% since 2010.<sup>17</sup> JD's own-company online sales of fresh meat grew by 780% y-o-y in 2017, consistent with the overall trend. The Running Chicken programme ties into an overall push toward achieving the company vision of being the most trusted company in the world.



15. \$317-\$476 at 2018 exchange rate of \$1=RMB 6.3

16. "Across China: Run chicken run! Villagers count chickens and cash," XinhuaNet, 15 April 2018, [http://www.xinhuanet.com/english/2018-04/15/c\\_137112461.htm](http://www.xinhuanet.com/english/2018-04/15/c_137112461.htm)

17. "Industry Markets and Trade," Agriculture and Agri-Food Canada, <http://www.agr.gc.ca/eng/industry-markets-and-trade/international-agri-food-market-intelligence/asia/market-intelligence/sector-trend-analysis-pork-trends-in-china/?id=148112666257>

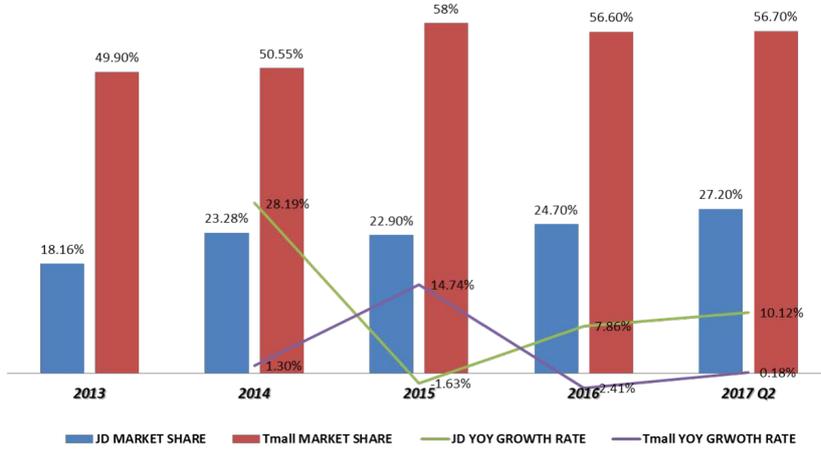


Figure 1. China's B2C Ecommerce Competition: JD (1P) versus TMall (3P) - Source: iresearch; JD company



Figure 2. Running Chicken with Pedometer - Source: Sina.com.cn

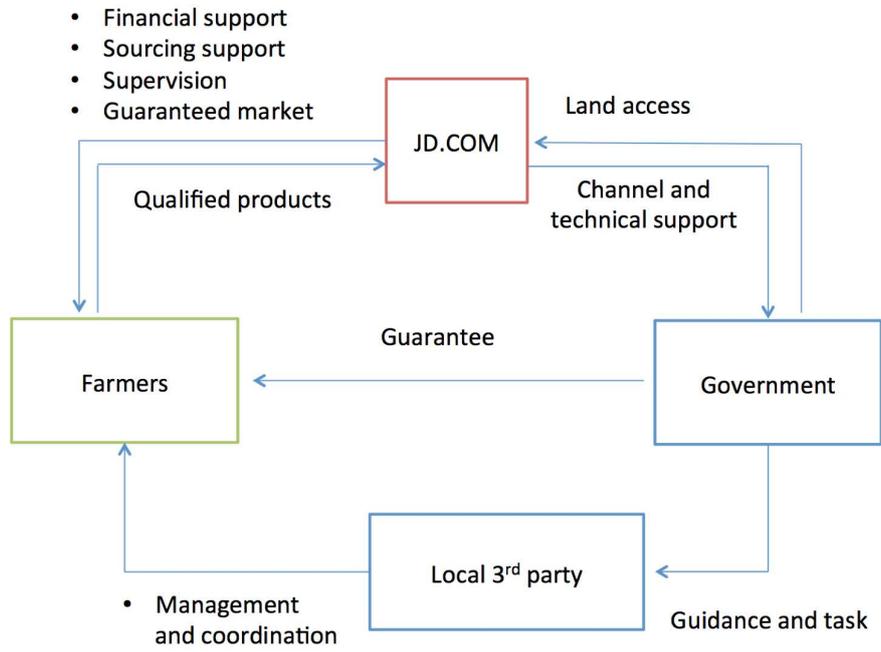


Figure 3. Running Chicken Programme Stakeholders

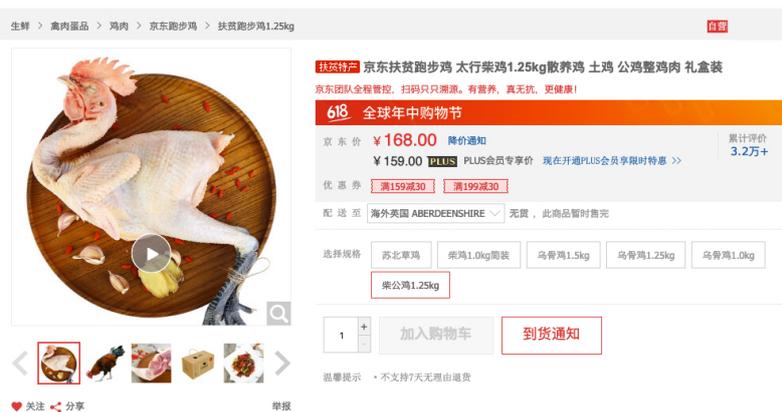


Figure 4. Running Chicken Channel on JD.com



Saïd Business School at the University of Oxford blends the best of new and old. We are a vibrant and innovative business school, but yet deeply embedded in an 800-year-old world-class university. We create programmes and ideas that have global impact. We educate people for successful business careers, and as a community seek to tackle world-scale problems. We deliver cutting-edge programmes and ground-breaking research that transform individuals, organisations, business practice, and society. We seek to be a world-class business school community, embedded in a world-class university, tackling world-scale problems.

### **Mars Catalyst and the Economics of Mutuality programme**

Mars' approach to business has long since been guided by five principles – quality, responsibility, efficiency, freedom and mutuality. Together they inform and guide the actions of all Mars associates every day as they do their jobs and interface with the outside world.

The origins of the Mutuality principle go back to 1947 when Forest Mars Snr, who led and grew the business through the 1920's to the 1960's, wrote a letter to all 500 associates of the company that said "the sole purpose of the company is to create a mutuality of benefits with all stakeholders that the company touches; from suppliers to customers as well as governments and competitors and naturally associates and shareholders." This far-sighted thinking, that the company could only be successful if everyone around the company was being successful, has been a cornerstone of Mars' business philosophy ever since.

Mars has therefore always been interested in how it can best live up to this principle; and to find new ways of driving mutuality with all stakeholders it touches. This led to Mars'

leadership tasking its economic research unit, Catalyst, to start new work into unexplored territory for business; to identify critical drivers of mutuality and, using business pilots, to develop and test new metrics and management practices that can help boost mutuality in business situations. This work has been called the Economics of Mutuality.

This work has established promising links between increasing social, human and natural capital (that can be measured with simple & stable metrics) and a corresponding increase in financial capital – demonstrating how a company can do both good and well at scale. A number of pilots have now been completed in the areas of micro-distribution, the employees of Mars and in agricultural development that suggest that these relationships are true in different places and situations.

### **The Oxford Mars partnership**

On the back of these promising findings, a multiyear partnership with Oxford University's Saïd Business School was established in 2014 to focus on the development of a business management theory for the Economics of Mutuality with corresponding teaching curriculum, new management practices, and case study research. The research programme has combined the pursuit of normative questions – what is

mutuality and how should it be enacted? – with grounded, ethnographic research on current thinking and practices. This has led to the development of field experiments and case studies examining how large corporate actors conceive of and pursue responsible business practices, and how these relate to their financial and social performance.

### **Mutuality in Business**

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