

PART III: COMPREHENSIVE CASES

Case 5 Alibaba in 2011: Competing in China & Beyond

“Alibaba has a first-mover advantage that makes it very hard for competitors to chip away at their lead in the market.”ⁱ

—DICK WEI,

Analyst, J.P. Morgan Securities Inc.,¹ in 2007.

“For us, the goal has been to build a company that lasts 102 years and a company that changes China. We’re only six years old, so while other people may call us a success, we still do not consider ourselves successful yet. We have a long way to go and the intense competition is what keeps us sharp. The success we’ve had so far has not made us lose our edge.”ⁱⁱⁱ

—JACK MA,

Founder and CEO of Alibaba.com, in 2006.

“If there’s a company outside of America that can introduce a new business model to the world, it’s Alibaba.”ⁱⁱⁱ

—MASAYOSHI SON,

Founder and CEO, Softbank Corporation,² Japan, in 2005.

INTRODUCTION

On November 11, 2011, Bloomberg³ reported that China’s leading e-commerce company, Alibaba Group (Alibaba), in association with Softbank Corporation (Softbank), The Blackstone Group⁴ (Blackstone), and Bain Capital⁵ (Bain), was considering making a bid for Yahoo! Inc.⁶ (Yahoo!). While Jack Ma (Ma), founder and CEO of Alibaba, expressed an interest in buying back Yahoo!’s 40 percent stake in Alibaba, Softbank wanted to buy Yahoo!’s 35 percent stake in Yahoo! Japan. Blackstone and Bain were reported to be participating in the bid to buy Yahoo!’s remaining operations in the US.^{iv}

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This case was written by **Hadiya Faheem**, under the direction of **Debapratim Purkayastha**, IBS Hyderabad. It was compiled from published sources, and is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation.

¹ J.P. Morgan Securities Inc., New York City, New York, USA is the non-banking subsidiary of JPMorgan Chase. It focuses on activities related to investment banking.

² Softbank Corporation, headquartered in Tokyo, Japan, is a leading Japanese telecommunications and media company. It has investments in e-commerce, financial services, Internet infrastructure, IT-related distribution services, publishing and marketing, and technology services.

³ Bloomberg is a U.S.-based financial news reporting company.

⁴ The Blackstone Group is an asset management and financial services company.

⁵ Bain Capital is a Boston-based private-equity firm.

⁶ Yahoo! Inc., headquartered in Sunnyvale, California, USA, is an online portal with a network of websites—news, search engine, entertainment, e-commerce, etc. Its primary source of revenues is through online advertising, but it also offers commercial services such as online marketing, etc.

⁷ B2B or Business-to-Business e-commerce is trading between two businesses using the Internet.

⁸ C2C or Consumer-to-Consumer e-commerce is trading between two consumers through the Internet.

Alibaba had several Internet businesses focused on various e-commerce business models such as Business-to-Business⁷ (B2B), Consumer-to-Consumer⁸ (C2C), and Business-to-Consumer⁹ (B2C). It also had a presence in the intensely competitive web search market. In 2010, the company had also launched a transaction-based wholesale platform, AliExpress, for Chinese merchants to sell goods to foreign buyers. Being one of the first companies to enter the Chinese Internet industry, Alibaba played a major role in bringing about an Internet revolution in the country (refer to *Exhibit I* for a brief note on the Internet market in China). Alibaba was launched with the vision of serving the small and medium enterprises (SMEs) in China and across the world. As of 2011, it had 69 million registered users spread across more than 240 countries.^v

According to the Hangzhou-based, e-commerce-information provider China e-Business Research Center, Alibaba had been the clear market leader in the Chinese e-commerce market with a market share of 63.5 percent for the FY 2010.^{vi} However, the company lagged behind in the Chinese online search engine market despite having acquired Yahoo! China’s operations in 2005. The Chinese search engine market was dominated by players such as Baidu.com, Inc.¹⁰ (Baidu) and Google Inc.¹¹ (Google) with market shares of 77.7 percent and 18.3 percent, respectively, in Q3 of 2011, according to iResearch Consulting Group¹² (iResearch).^{vii} In August 2010, Alibaba had acquired Sogou, a search engine of Chinese portal Sohu.com, in a bid to increase its dominance in the Chinese web search market. It also had ambitious plans of investing US\$ 157 million in its shopping search engine eTao

⁹ B2C or Business-to-Consumer e-commerce relates to business transactions between a company and a customer using the Internet.

¹⁰ Baidu.com, headquartered in Beijing, China, is a leading Chinese search engine.

¹¹ Google Inc., headquartered in Mountain View, California, USA, is one of the leading Internet companies in the world.

¹² iResearch Consulting Group is a market research company based in China. It offers companies market research services related to e-commerce, the Internet, online games, etc.

EXHIBIT I Internet Market in China

According to a China Internet Network Information Center¹³ (CNNIC) report in June 2010, China had 363.8 million broadband users.^{viii} As of mid-2011, China was the world's largest Internet market in the world. According to DCCI, the number of Internet users in China had reached 508 million by the end of 2011.^{ix} The Internet users in China comprised only a meager portion of the country's population of 1.3 billion, which meant that there was a huge potential for future growth. China was important for Internet companies not only because of its large market size but also for its vast talent pool.

Apart from the main business activities of Internet companies such as online search, online auctions, online communications, and online advertising, special features like blogging and SMS (Short Messaging Service) were also gaining popularity in China. Blogging was a popular feature, especially among Chinese youth. They were attracted to blogs¹⁴ and the Bulletin Board System¹⁵ (BBS) because of the freedom they offered to them to express their opinions and get to know those of others. These blogs were posted on a variety of topics, like what clothes to buy, what music to listen to, and what movies to watch, product reviews, comparison of products and advertisements, etc. Analysts opined that people expressed their likes and dislikes more strongly in blogs than they would otherwise. Blogs also generated a huge amount of information about customer choices and customer feedback throughout the country, which could be of great use for companies and the government. SMS was another popular practice in China, generating heavy revenue for Internet portals. According to Gartner Inc.¹⁶ (Gartner), messaging via cell phones and hand-held devices was a common practice in China and local Internet companies like Sina Corporation, Sohu.com Inc., and NetEase.com, Inc. received a good amount of revenue from the SMSs delivered through their portals.^x

Despite the huge opportunities it offered, the Chinese Internet market was not without its challenges. The political environment in China had a bearing on the existence and performance of Internet companies in China. The Chinese Internet market was strictly regulated by the government. The government imposed a censorship on pornographic content and content related to controversial topics like Tiananmen Square¹⁷, Taiwan independence¹⁸, the Dalai Lama¹⁹, etc. According to media reports, the Chinese government employed around 30,000 people to ensure that such restricted content did not spread in the Chinese Internet space.

In addition to complying with the government rules, it was important for Internet companies in China to know how to successfully launch a Chinese language website or design a search engine that would suit the complex Chinese language. The Chinese language makes extensive use of pictograms²⁰ and ideograms²¹. The characters are written without spaces between them, which made it hard to distinguish one word or phrase from the next. Due to all these political, cultural, and linguistic factors, many international Internet companies had to seek local help to understand the Chinese consumers and deal with the local nuances. Industry experts felt that many domestic Internet companies had managed to gain popularity and market share because of their familiarity with the local environment and customers. Because of their intimate knowledge of the local language, culture, and dealings with the government, the local players had an edge over their foreign counterparts in the Chinese Internet market.

Source: Compiled from various sources.

¹³ The China Internet Network Information Center (CNNIC) is the state network information center of China, founded as a non-profit organization in June 1997. The Computer Network Information Center of the Chinese Academy of Sciences runs CNNIC. CNNIC looks after everything related to the Internet in China like domain names registration, IP addresses, relevant researches, surveys and information services, and international liaison and policy research.

¹⁴ A blog is a user-generated website where entries are made in journal style and displayed in chronological order.

¹⁵ A Bulletin Board System allows users to dial into the system over a phone and using a terminal program, perform functions such as downloading software and data, uploading data, reading news, and exchanging messages with other users.

¹⁶ Gartner Inc. is a U.S.-based business consulting firm established in 1979. It delivers technology-related insights to around 10,000 clients around the world.

¹⁷ Between April 15, 1989, and June 4, 1989, there were protests in China against the Communist Party of China government. The protests, which were centered at Tiananmen Square in Beijing, were led by students, intellectuals, and labor activists. On June 4, 1989, the Chinese government dispersed the mobs at Tiananmen Square using military force, which led to the deaths of hundreds of protesters. The incident came to be known as the "Tiananmen Square massacre."

¹⁸ For years, the Taiwan independence movement was opposed by China, which described it as a separatist movement that would divide the nation and people. The pro-independence groups described it as a nationalist movement.

¹⁹ The literal meaning of "Dalai Lama" is "spiritual leader." The Dalai Lama is considered the supreme head of Tibetan Buddhism. The 14th Dalai Lama demanded greater autonomy for Tibet, which is under Chinese control.

²⁰ A pictogram is a character that represents an object, a concept, or an activity through a picture.

²¹ An ideogram is a character that represents an idea.

in order to gain a strong foothold in the online shopping market in China.^{xi}

The company was also making efforts to increase its global footprint. In June 2010, Alibaba acquired Vendio Services Inc.²² (Vendio). The site was linked to Alibaba's network of suppliers and buyers. To fuel its global growth, in August 2010, Alibaba acquired Auctiva²³ to reach U.S. businesses and connect with buyers and suppliers outside China.

In December 2011, Alibaba announced that it was testing a social-networking product. This was part of its efforts to expand outside its e-commerce platforms to seek different streams of revenues. Industry experts felt Alibaba was devising strategies to fuel its growth and, with the acquisition of Yahoo!'s stake, it would gain a stronger foothold in China since Internet penetration and e-commerce were rapidly growing in China.

BACKGROUND NOTE

Jack Ma (Ma), founder of Alibaba, was born in Hangzhou, a city in China's Zhejiang province, in 1964. At the age of twelve, Ma developed a fascination for the English language. He began learning English by listening to the Voice of America²⁴ and acting as a free guide to foreigners who visited Hangzhou. Another event that changed Ma was when he traveled to Australia to visit a friend in 1985. He had grown up believing that the world outside China was a terrible place to live in. He was taught that China was the richest country in the world and that the Chinese were the most contented people in the world. According to Ma, "Everything I'd learned in China was that China was the richest country in the world. When I arrived in Australia, I realized it's totally different. I started to think you have to use your own mind to judge, to think."^{xii}

In 1988, Ma earned a degree in English from the Hangzhou Teacher's Institute and began teaching English and international trade at the Hangzhou Electronic and Engineering Institute. In 1992, he founded an English translation agency in Hangzhou and soon built up a good reputation for his language skills.

In 1995, Ma was sent to Malibu, near Los Angeles, by a Chinese businessman. Ma was to mediate in a dispute between the businessman and his American counterpart who had not put in the money he had promised into the man's firm. Ma approached the American ready to mediate but to his shock, he was locked up for a couple of days in the American's house. Ma was released only after he promised the American that he would start an Internet company in China in association with him. Though this joint venture never actually happened, Ma was able to leave. The same year, Ma went to Seattle with a trade delegation as an interpreter. This was to become a turning point in his life. During the visit, a friend introduced him to the Internet. Ma typed in "beer" in the search engine. It yielded results like German beer, Japanese beer, and American beer. Nothing called Chinese beer came up. He then typed in "China" and "beer" but this gave no results. This made Ma decide to start a company to bring

information regarding Chinese companies to the Internet. After returning to Hangzhou, Ma resigned from his teaching job, borrowed US\$ 2,000 from his relatives, and launched China Pages, China's first commercial website, in 1995. About launching this website, Ma said, "At 9:30 we launched the home page, and by 12:30 I had six e-mails. I said, 'Whoa! Interesting!' If I could help Chinese companies list on the Internet and help foreigners find their websites, that might be a good thing."^{xiii} The website contained a list of companies operating in China. The Hong Kong media called Ma the "father of the Chinese Internet" and credited him with bringing about an Internet revolution in China.

In 1998, Ma moved to Beijing to work for the Chinese Ministry of Foreign Trade and Economic Cooperation (MOFTEC) as the Head of the Information Department of the China International Electronic Commerce Center²⁵ (CIECC). He designed a website for MOFTEC. This became the first government website in China.

ALIBABA IN ITS INITIAL YEARS

In 1998, Ma left MOFTEC and returned to Hangzhou to fulfill his dream of establishing his own e-commerce company. He said, "I realized that you can never expect a government company to grow. So I left to set up my own."^{xiv} Ma gathered 18 people in his apartment to explain his vision to them. He warned his colleagues who wanted to join him that his venture was a risky one and that they would be paid only Renminbi²⁶ (RMB) 500 every month. He gave them three days to think it over. He was touched when, finally, all 18 of them decided to follow him to Hangzhou. Ma and his colleagues put in some money. This money, which came up to US\$ 60,000, was used to start Alibaba from Ma's apartment in Hangzhou in March 1999. Asked why Alibaba had been chosen as the name, Ma said, "The name [Alibaba], taken from the Arabian Nights, was chosen because it's universally well known and is easy to spell."^{xv}

In August 1999, the Chinese Bureau of Industrial and Commercial Administration registered Alibaba as a computer company since the company's business could not be classified under any other category. Because of the strict IPO regulations in Beijing, Alibaba was registered in Hong Kong. At the same time, Ma started looking out for potential investors for the venture. But since the business model was new, the investors initially did not believe in the venture.

However, by September 1999, a few venture capitalists approached Ma, attracted by the novel concept of the business. Ma told them frankly that launching Alibaba was a risky proposition and that he expected it to make hardly any profits during the initial years. Some of the prospective investors were still eager to lend. Ma said, "I told them at the very first meeting, 'Don't push us. We know what we are doing.'"^{xvi} Initially, Ma rejected offers from 38 venture capitalists. Later, he accepted an offer from a group of investors including The Goldman Sachs

²² Vendio Services Inc. is a U.S.-based e-commerce site. As of June 2010, it hosted services for 80,000 small businesses in the U.S.

²³ Auctiva offered listing and marketing tools to vendors on e-commerce sites.

²⁴ Started in 1942, Voice of America is an international radio and television broadcasting service of the U.S. government.

²⁵ China International Electronic Commerce Center (CIECC) was founded in 1996 to build and operate a secure network for government communications and commerce. It provided services related to e-commerce and e-government that are used by government agencies in China.

²⁶ Renminbi is the currency of the mainland of the People's Republic of China. Its principal unit is called the Yuan. As of December 4, 2011, US\$ 1 was approximately equal to RMB 6.32.

Group Inc.²⁷ (Goldman Sachs), Fidelity Investments,²⁸ Investor AB,²⁹ Templeton Dragon Fund Inc.,³⁰ and Transpac Industrial Holdings Limited³¹ and was able to raise US\$ 5 million from them in October 1999.^{xvii} In January 2000, Ma successfully persuaded Softbank to invest US\$ 20 million in his venture.^{xviii} Softbank was, at that time, the largest global investor in Internet businesses, owning stakes in hundreds of Internet companies such as Yahoo!, Chinadotcom Corporation³² (CDC), etc. In return, Peter Sutherland, Chairman of Goldman Sachs, and Masayoshi Son (Son), CEO of Softbank, were made members of Alibaba's board of advisors. In 2000, Ma moved the company's headquarters from Hangzhou to a new building in Shanghai.

Alibaba concentrated on small and medium-sized Chinese firms that aspired to go global but found it very expensive to do so. Ma aimed at connecting these Chinese manufacturers with small and medium-sized buyers from across the world. Ma said, "We want to help SMEs from all over the world grow their business and benefit from cross-border trade. Alibaba.com is like the World Trade Organization for SMEs."^{xix} Alibaba's mission was "to help small and medium enterprises (SMEs) grow." Commenting on its focus on SMEs, Ma said, "SMEs are the future of Asia, and the future of China. Many people believe in big companies, saying we should get more money from big companies, we should do transactions with them, et cetera. But I disagree. Asia is Asia. China is China. Unfortunately, in Asia, the market is too fragmented that we have no standard. There is no standard for e-commerce, SMEs, or B2B. Our job is to establish the standard. We cannot create beautiful PowerPoints, but we know how to listen to our customers."^{xx}

During the late 1990s and early 2000s, the Internet had not yet become too popular in China and banks were not networked. Credit card usage was limited and providing logistics service in the country was difficult, to say the least. In this scenario, Alibaba thought it wisest to limit its business model to connecting buyers and suppliers. Suppliers were allowed to list their products on the website while buyers could post their requests on the bulletin boards. Deals were struck through e-mails or offline messages. The services were offered for free and no other value-added services were offered. Ma believed that Alibaba was still in its infancy stage and had to build a loyal customer base before it started charging for its services.

Initially, Alibaba had two websites—www.alibaba.com, an English website for international B2B trade, and www.china.alibaba.com for B2B trade in China. However, the company soon

noticed that despite Japan being China's biggest trading associate, the online business carried out from that country was less compared to enterprises from the U.S., South Korea, India, and Europe. Alibaba therefore launched www.alibaba.co.jp, a Japanese site for Japanese traders, in 2002. According to Ma, "Chinese and Japanese entrepreneurs have a digital ditch on the Internet. We want to help them stride this ditch with Alibaba Japan Website."^{xxi} Also, the Japanese preferred to use the site in Japanese. David Wei (Wei), CEO, Alibaba, said, "They prefer to use the Japanese language as their commercial language, and with China and Japan as each other's second-largest trading partner, there was a big demand."^{xxii}

Ma found that SMEs were hesitant about using the Internet, as they assumed that it would require some expertise in computer use. Ma ensured that Alibaba's websites were simple and easy to browse through. He considered himself a non-technical person, and this, he believed, helped him keep the websites more user-friendly. According to Ma, "I use my computer for two things, e-mail and surfing the Web. Most of our customers are not high-tech people, so we have always tried to make the technology invisible. When a member goes on Alibaba.com to find a supplier, we want the website to be very simple and user-friendly. We have a great engineering team, but their job is to make sure everything passes the 'Jack test.' If I can understand our website, then I am sure our customers can too."^{xxiii} In May 2000, Ma brought in John Wu (Wu), the creator of the Yahoo! search engine, and appointed him as the Chief Technology Officer of Alibaba.

Another major concern for Ma was that many SMEs distrusted the idea of online payments. Ma managed to convince them about the safety of the practice by stressing the fact that Alibaba's system for online transactions was managed in partnership with a leading bank in China.

By the end of the first year in business, Alibaba had become the largest online global trading website in Asia, with about 200,000 members from 194 countries (70 percent of the members were Chinese), and approximately 1,000 new members joining every day.^{xxiv} On the whole, the websites were receiving about 1,500 new subscribers every day.^{xxv} Nearly half the requests were from companies based in the U.S., Europe, and India, while the remaining were from Greater China. In March 2000, Alibaba started catering to the European market and also planned to expand its operations in North and South America, Japan, etc. Buyers from any country could locate and strike deals with sellers in any country or countries across the world.

Alibaba aimed to have a global presence and expand in the U.S. and hence the company's R&D was mainly done at Silicon Valley. It did not spend any money on marketing its website—its membership was the result of the exceptional services that it offered to its customers.

During the early 2000s, the huge manufacturing potential of Asia, especially of China, and the rising popularity of Alibaba attracted a number of other companies to start e-commerce ventures in China. In the early 2000s, Hutchison Whampoa Limited³³ launched a web portal called "www.tom.com." A group of businessmen from Hong Kong partnered with America's B2B major

²⁷ The Goldman Sachs Group Inc., headquartered in New York City, New York, USA, is a leading investment banking, securities, and investment management firm.

²⁸ Fidelity Investments, headquartered in Boston, Massachusetts, USA is an investment products and services company.

²⁹ Investor AB, headquartered in Stockholm, Sweden, is an investment company whose key products include core equity, private equity, operating and financial investments.

³⁰ Templeton Dragon Fund Inc., headquartered in Fort Lauderdale, Florida, USA, is a non-diversified, closed-ended investment company.

³¹ Transpac Industrial Holdings Limited, headquartered in Singapore, is an investment holding company providing venture capital to private companies.

³² Chinadotcom Corporation, headquartered in Hong Kong, China, is a leading provider of business solutions, enterprise software solutions, and mobile and Internet applications.

³³ Hutchison Whampoa Limited, headquartered in Hong Kong, China, is a diversified conglomerate with business interests in ports and related services; telecommunications; property and hotels; retail and energy; etc.

Commerce One.³⁴ Hong Kong–based Global Sources Limited³⁵ (Global Sources) and San Francisco–based MeetChina.com (MeetChina) also announced their plans to enter the Chinese e-commerce market. MeetChina planned an aggressive expansion in Asia. While some of these firms concentrated on particular industries, others such as Commerce One and Ariba³⁶ concentrated on big businesses in Europe and the U.S.

Ma refused to worry about the rising competition. Instead, he set to work to make plans to provide various products targeting the SMEs in various countries. He made several efforts to differentiate Alibaba from others by providing innovative features like wireless access to its services in partnership with Motorola Inc.³⁷ (Motorola). To attract more users, Alibaba also started offering additional services for registered members (registration was free) such as e-mail, etc.

In March 2000, when the dotcom bubble³⁸ burst, a number of dotcom and e-commerce companies filed for bankruptcy. A vast majority of dotcom companies could not withstand the sharp fall in revenues from Internet advertising. Web-based retailers failed to gauge the infrastructure they required to carry on with their retailing activities on the Internet and so many companies were forced to shut down their businesses. Commerce One was also affected and it filed for bankruptcy in October 2004.³⁹ A few companies such as Ariba merged with FreeMarkets Inc.,⁴⁰ a leading B2B in June 2004.⁴¹ Alibaba, however, was able to withstand the dotcom crash since its business was not dependent on advertising revenues.

To deal with the dotcom crash, Alibaba reformulated its strategies. By September 2000, Ma was left with hardly any revenues and so had no choice but to curb his expansion plans. He told his employees that Alibaba would be in trouble if it did not adopt the right strategies. He announced three B2C strategies. These were:

- “Back to China,” under which Alibaba would concentrate mainly on improving its business in China rather than focusing on global markets.

- “Back to Central,” under which the headquarters was moved back from Shanghai to Hangzhou.
- “Back to the Coast,” under which Alibaba would concentrate on improving its presence in the coastal areas, the richest region of China.

In July 2000, Alibaba started selling its advertising space. However, the revenues generated were very limited. Alibaba also began selling reports and statistics on various sellers. For the year 2000, Alibaba’s revenues were just US\$ 1 million and the company had not made any profits.^{xxvi} According to Ma, “The year 2000 was a difficult year. Our team was young—only a year old. We saw things were still going up, but knew it would surely go down. We didn’t know how deep the fall would be, how bad it would be. Besides which, we had virtually no revenue.”^{xxvii}

In early 2001, Alibaba started offering a customized online marketplace for its members called “Alibabies” for a premium. However, this generated only a small amount of revenue—US\$0.3 million a year.^{xxviii} Several analysts were quick to write off Alibaba. They expressed doubts about its survival in the long run in light of the dotcom crash. The increasing competition from other B2B companies targeting the Chinese B2B markets was also building up tremendous pressure on Alibaba to merge or to fall. In the same year, Ma brought in Savio Kwan (Kwan), general manager of GE’s China equipment division, as Chief Operating Officer of Alibaba with the aim of turning around the company. Kwan said, “We need to ground [Alibaba] in reality and make it into a business.”^{xxix}

In late 2001, Alibaba began charging its members for its services. The fee was US\$ 3,000 per year for a membership in “China Supplier”—an online community for qualified Chinese exporters who were verified by third-party credit agencies. In mid-2002, the membership fee was increased to US\$ 8,000.

By March 2002, Alibaba’s members had touched the one million mark (refer to *Exhibit II* for different types of membership). In 2002, Ma set a target of US\$ 1 profit for Alibaba. Commenting on this, Ma said, “We said, ‘Let’s make one dollar in profits for the whole year. We spend five million US dollars, we should make at least one back. If we spend 10 million, we should still earn one dollar.’ So, we spent the whole year trying to make one dollar. When we set the target, everyone said I was stupid. But the whole company had a clear target throughout the year. The young people in the company had never had experience making money. Even if we say we are going to make 10 million dollars, how are we going to make it? But the one dollar target is something we could make if we just saved electricity, for example.”^{xxx}

In March 2002, Alibaba set a TrustPass membership fee of US\$ 299 for companies wanting to join Alibaba, after which they were verified and authenticated. However, this fee did not deter companies from joining; about 200 Chinese companies were registering themselves every day.

BUSINESS PORTFOLIO

Despite its struggles, by the year 2000, the Alibaba Group had emerged as the largest e-commerce company in China and was

³⁴ Commerce One, headquartered in Westbury, New York, USA, was an e-commerce solutions provider and a leading marketplace for B2B transactions.

³⁵ Global Sources Limited, headquartered in Hong Kong, China, is a leading B2B media company.

³⁶ Ariba, headquartered in Sunnyvale, California, USA, is a provider of Intranet and e-commerce solutions. The Ariba B2B Commerce Platform allows online transactions between buyers and suppliers.

³⁷ Motorola Inc., headquartered in Schaumburg, Illinois, USA, is an electronics and telecom goods company.

³⁸ The increase in popularity of the Internet fueled the growth of dotcom companies—firms that provided products and services related to or by using the Internet. They grew rapidly in number between 1995 and 2000 as many individuals started their own companies. Most of these companies offered similar products and services. The uncontrolled proliferation of such companies ended with the bubble busting in March 2000, leading to the closure of many of these companies.

³⁹ Commerce One was later acquired by Perfect Commerce in February 2006. Perfect Commerce is one of the largest providers of On-Demand Supplier Relationship Management (SRM) solutions.

⁴⁰ FreeMarkets Inc., headquartered in Pittsburgh, Pennsylvania, USA, is a leading e-commerce company.

⁴¹ The merged entity was called Ariba Inc. and since then has been a leading provider of Spend Management solutions to help companies analyze, understand, and manage their corporate spending.

EXHIBIT II Types of Membership at Alibaba.com

- **Free Membership:** Free members were offered basic services, free of cost. Sellers registered under this category could post products they wanted to sell, search for buyers, and contact them. Buyers were allowed to post buying leads and send inquiries to the suppliers. However, Chinese companies had to join as “Gold Supplier” members in order to become a seller.
- **TrustPass Membership:** It consisted of supplier members from outside Hong Kong, Macau, and Mainland China. TrustPass Membership was a paid service where the member had to pay US\$ 299. The member would be authenticated and verified by a third-party credit reporting agency.^{xxx} The supplier would then be able to display a TrustPass icon symbolizing credibility to online buyers. However, this facility was available to Chinese companies only if they were “Gold Suppliers.” TrustPass members were allowed to have their own websites that contained information about the company, its products, etc.
- **Gold Supplier:** This membership was primarily for export-oriented suppliers. It consisted of premium suppliers from Hong Kong, Macau, and Mainland China. The process of authentication and verification was more rigorous for such membership. The suppliers were classified into 27 industries which enabled buyers to locate the companies conveniently. The member would display the TrustPass icon and a Gold Supplier icon to symbolize the highest level of seller qualification. Some of the advantages that such members enjoyed were listing of products on Alibaba’s home page and unrestricted access to buyers’ trade leads.

Source: www.alibaba.com

one of the leading players in the international e-commerce market. Alibaba was the flagship company of the Alibaba Group with marketing and sales offices across Beijing, Seoul, Silicon Valley, London, Japan, and Latin America. Alibaba’s business portfolio included the following:

Alibaba China: Launched in 1999, Alibaba China (www.china.alibaba.com) was a website in the Chinese language serving domestic B2B trade in China. As of November 2011, it had a registered user base of 50 million paying an annual subscription fee for posting their products on the website.^{xxxii} The authenticity of the members was verified by a third-party credit-reporting agency.

Alibaba International: Launched in 1999, Alibaba International (www.alibaba.com) was an English website which connected a number of Chinese SMEs with a number of businesses worldwide. It had 18 million registered users from around 200 countries as of April 2011.^{xxxiii}

Taobao: Taobao (www.taobao.com) was launched in May 2003. It was China’s most popular C2C trading site. As of June 2011, Taobao had more than 800 million product listings with 370 million registered users and more than 60 million page views per day.^{xxxiv} According to Ma, Taobao had garnered a market share of 80 percent for the FY 2010.^{xxxv} In 2011, Alibaba Group reorganized Taobao into three separate companies—Taobao Marketplace, Taobao Mall, and eTao—in a bid to capture Chinese e-commerce consumer opportunities. Taobao Mall was Alibaba’s B2C platform. For the Q2 of 2011, the site recorded a 48.5 percent market share in China’s B2B online retail market, according to iResearch.^{xxxvi} In November 2010, Taobao Mall launched Tmall.com as an independent web domain.

AliPay: Launched in 2004, AliPay was an online payment solution that enabled the users to carry out online money transactions easily, quickly, and safely. As of September 2011, AliPay had over 600 million registered accounts with around 11 million daily transactions.^{xxxvii}

Yahoo! China: Yahoo! China (www.yahoo.com.cn) was China’s third most popular search engine after Baidu and Google. It was started in October 2005 after Yahoo! merged its China operations with Alibaba in August 2005. Alibaba had the exclusive rights to use the Yahoo! brand and technologies in China.

Alisoft: In January 2007, Alibaba launched Alisoft, a software services company that catered to the needs of several SMEs in China. Alisoft allowed customers to use various services such as customer relationship management (CRM), marketing information management, sales force management, inventory management, and financial tools. Other services provided were e-mail, information management, inquiries, bookkeeping, and invoicing. Alisoft also provided an instant communication tool called “Aliwangwang,” which was offered to users as TradeManager⁴² on Taobao. As of January 2007, Alisoft had operations in Shanghai and Hangzhou. In July 2009, Alisoft was merged with Alibaba Group R&D Institute.

Alimama: In November 20, 2007, Alibaba launched Alimama, an online advertising exchange company. The company allowed advertisers and publishers on the web to trade advertising inventory online. It was intended to serve the more than one million SMEs in China that accounted for 80 percent of web traffic in China.^{xxxviii} In 2008, Alimama was integrated with Taobao.

⁴² TradeManager is an instant communication tool that is offered to buyers and sellers for interaction.

THE COMPETITION

B2B Market

Alibaba was launched at a time when the Chinese Internet industry was in its infancy. Considering the growth potential of the budding e-commerce market, other players like Global Sources and MeetChina were launched in 1999. These players were expected to intensify competition in the emerging B2B market. Global Sources had an advantage over Alibaba because of its search technology and detailed information about the products listed on its site. Moreover, in 1999 the company had an employee strength of 1,600 people with several salespeople across the world to build its supplier community. There was also the threat of many new players entering this space. In order to gain a strong foothold in the B2B market, Ma announced that Alibaba would not charge any transaction fees. Commenting on Ma's strategy, Craig Pepples, CEO, Global Sources, said, "Some players are focusing on building as much 'community' as possible in a short period of time, usually by giving things away. The problem with this approach is . . . the free sites have very little depth. What customers need is detailed [information] and the tools to slice, dice, and compare."^{xxxix} Unfazed by the competition, Ma said that he was unaware of his competitors' existence. Ma said, "The world is changing so fast, you don't know what each other is thinking about, you don't even know what you are thinking yourselves. How do you know who are your competitors?"^{xl}

Despite several attempts made by Alibaba's competitors to carve out a place for themselves in the rapidly growing B2B market, they failed to make a mark, largely because of Alibaba's dominance in that market. Alibaba, on the other hand, continued to enjoy phenomenal growth. According to Q3 2011 China B2B Market data released by iResearch in 2011, the size of the B2B market in China had reached RMB 3.48 billion in the third quarter of 2011. Alibaba was the market leader in the Chinese B2B market with a market share of 53.8 percent (refer to Table I for market shares of B2B players in China).

C2C and B2C Market

Alibaba's increasing popularity and the burgeoning Chinese e-commerce market attracted several foreign competitors to China (refer to *Exhibit III* for a discussion of the e-commerce market in China). In 2002, U.S.-based eBay Inc.⁴³ (eBay) entered China by acquiring a 33 percent equity stake in the Shanghai-based e-commerce website EachNet.com⁴⁴ (EachNet), at an investment of US\$ 30 million. eBay launched its Chinese site based on its business model in the U.S. By 2002, it had emerged as one of the leading online auction sites in China with 3.5 million registered users.^{xli} By 2003, eBay had cornered a 79 percent market share in the Chinese online auction market.^{xlii}

⁴³ eBay Inc., headquartered in San Jose, California, USA, is the world's largest online auction company. In addition to providing online auction markets, eBay also has an online payment service called PayPal and a communications business under Skype, which offers Voice-over-Internet Protocol (VoIP) services.

⁴⁴ Founded in August 1999 by Chinese entrepreneurs Bo Shao and Haiyin Tan, EachNet was a major electronic commerce company based in China. It was later acquired by eBay in July 2003.

TABLE I Market Shares of B2B Players in China (Q3 2011)

Players	Market Share (in %)
Alibaba	53.8
Global Sources	11.6
Made-in-China.com	3.8
HC360	4.3
Dhgate	3.2
Mysteel	1.7
Global Market	1.6
Toocle.com	1.2
Others	18.7

Source: Adapted from "Market Scale of China B2B Ecommerce Increases to 3.48 Billion Yuan in Q3 2011," www.iresearchchina.com, November 11, 2011.

eBay's success in China and the good prospects offered by the budding e-commerce market, spurred Ma on to team up again with Son to start a rival website to compete with eBay. Ma raised funds of up to US\$ 56 million from Softbank. His decision to team up with Son was due to Son's experience in defeating eBay in Japan by collaborating with Yahoo! Japan. Subsequently, eBay had to move out of Japan in 2002. Ma, in association with his experienced employees, drafted a plan for launching a consumer auction website in his apartment in Hangzhou. Finally, they came up with the idea of launching Taobao, which means "digging for treasure."

In May 2003, Ma launched Taobao as a wholly-owned subsidiary of Alibaba. Taobao aimed to create an online trading platform for both B2C and C2C models. Taobao differentiated itself from rival eBay by allowing free listings on its website. eBay, on the other hand, charged for listings on its website so as to ensure quality. According to Ma, Taobao would have to build up a loyal customer base before it could start charging for its services.

Analysts were uncertain about Taobao's success since the C2C market was still in its infancy in China. On the other hand, Ma was confident and cited the fact that EachNet had only five million users among the 82 million-odd Internet users in China (refer to *Exhibit IV* for the growing Internet usage in China). Ma said, "We launched Taobao not to make money, but because in the U.S., eBay gets a lot of its revenue from small businesses. We knew that some day, eBay would come in our direction."^{xliii}

To gain a strong foothold in the Chinese e-commerce market and combat competition from Taobao, eBay bought the remaining equity stake in EachNet for US\$ 150 million in July 2003. The website was called eBay EachNet.⁴⁵ Yibo Shao, one of the founders of EachNet who remained with eBay, believed that there could only be one big consumer auction site in China and predicted that eBay would win the race against Taobao. Soon after, Ma announced his plans to invest another US\$ 12 million in Taobao. He said that it would be unwise to wait until the market

⁴⁵ eBay EachNet is a subsidiary of eBay Inc. in China.

EXHIBIT III e-Commerce Market in China

Though the concept of e-commerce was introduced in China in 1993, it took some time for it to catch on. But once it did, e-commerce in China began to grow at a frantic pace. For instance, the market scale for e-commerce in China grew from RMB 120 billion in 2001 to RMB 680 billion in 2005.⁴⁶ In comparison to the overall e-commerce market, the C2C market was smaller but had kept pace with the growth in the overall market.

The e-commerce market was a surging market in China. According to iResearch, the online shopping market had reached RMB 197.5 billion for the third quarter of 2011. Despite huge opportunities, the Chinese e-commerce market was not without its challenges. It was influenced by government regulations, logistics, and payment systems. The Chinese government enforced regulations related to Internet access, content regulation, encryption, and domain name.

The government also set certain provisions related to Internet access. There was a four-tier system for accessing the Internet. The first tier consisted of the Ministry of Information Industry⁴⁷ (MII) that acted as the main gateway for transmission of information to and from the World Wide Web. The MII operated an international gateway at the top of this system. The second tier comprised four government-owned Internet Service Providers (ISPs), which were called the interconnected networks. The third tier comprised privately owned ISPs that were linked through the interconnected networks to the Internet. The final tier included the Internet users. The users could gain access to the Internet either through the government or privately owned ISPs. Internet users were instructed to register themselves with local public security authorities as part of Internet security regulations.

The regulations related to security involved censoring the content and preventing dissemination of sensitive information relating to the Chinese economy. Under this regulation, all Internet companies were obliged to censor sensitive content.

Domain regulations required e-commerce companies to register their domain names with the CNNIC. The encryption regulation forced e-commerce companies to obtain approval from the National Commission on Encryption Code Regulations (NCECR), an encryption regulation agency, for using Chinese products and encrypted imported products.

Payment systems were another problem as Chinese consumers were used to paying cash rather than using credit cards. The consumers raised doubts over the security of the payment systems, the quality of the purchased products, and after-sales service.

An inefficient logistics system was considered as another major constraint in the development of e-commerce. This was due to the underdeveloped transportation systems, inadequate use of technology, and inconsistent distribution systems, which resulted in an unreliable logistics system.

Source: Compiled from various sources.

matured and hinted at using the money on building infrastructure, recruitment, and an online credit system for the customers.

Analysts observed that the growth in the Chinese e-commerce market was hampered due to the absence of the trust factor between buyers and sellers while trading online. Buyers refused to send money to sellers before they had received the goods while sellers were unwilling to ship the goods until they had received payment. To counter this problem,

Alibaba launched an online payment platform called “AliPay” based on the lines of eBay’s payment system, Paypal, in 2004. AliPay was an escrow⁴⁸-based payment solution that allowed customers to safely and quickly send and receive money online. Once a deal had been finalized, the buyer paid the money through AliPay. The money was held in an AliPay account and was sent to the seller only after the buyer informed AliPay about the receipt of the product. Alibaba partnered with a number of Chinese banks such as China Merchants Bank, Agricultural Bank of China, etc. to provide AliPay services.

⁴⁶ “China E-commerce Profit Model Report, 2006–2007,” www.researchinchina.com, January 2007.

⁴⁷ MII has the authority to regulate the software and communications industry and is accountable for the manufacture of electronic and information products. It is also responsible for information dissemination related to the Chinese economy.

⁴⁸ Escrow is a financial instrument held by a third party on behalf of the other two parties in a transaction. The funds are held by the escrow service until it receives the appropriate written or oral instructions or until obligations have been fulfilled (source: www.dictionary.com).

EXHIBIT IV Growing Internet Usage in China

Year	Users	% of Population Using the Internet
2000	22,500,000	1.7
2001	33,700,000	2.6
2002	59,100,000	4.6
2003	69,000,000	5.4
2004	94,000,000	7.3
2005	103,000,000	7.9
2006	137,000,000	10.4
2007	162,000,000	12.3
2008	253,000,000	19
2009	384,000,000	28.7
2010	420,000,000	31.6

Source: Adapted from “China Internet Usage Stats and Telecommunications Market Report,” www.internetworldstats.com, March 30, 2011.

Alibaba devised an aggressive promotional strategy for Taobao in order to compete with eBay EachNet. Taobao advertised itself online by placing ads on the websites and through billboards at major city centers. All these promotional strategies were ignored by eBay EachNet. In the first quarter of 2004, eBay EachNet garnered a 90 percent market share in the Chinese online C2C market against Taobao's 9 percent. By the fourth quarter of 2004, Taobao's market share had jumped to 41 percent while eBay EachNet's had declined to 53 percent.^{xliv} While eBay EachNet had about 10 million users,^{xlv} Taobao quickly gained four million users^{xlvi} in 2004. Further, Taobao's easy-to-use features on the website attracted a number of users and resulted in users shifting to it. Taobao provided additional features like e-mail and chat facilities to users on its site. It also allowed the buyers to call the sellers before buying a product while eBay EachNet concealed the seller's identity until the end of the auction and allowed communication only through offline messages that could be left on the site. Another reason cited for users shifting to Taobao was the difficulty they faced while using the new eBay website that was created after it fully acquired EachNet. The number of product listings decreased from 780,000 to 250,000 after the website was changed.^{xlvii} Further, the lack of a secure online payment system like AliPay hindered eBay EachNet's growth.

In 2005, eBay EachNet's market share slipped further to 29.1 percent compared to Taobao's 67.3 percent.^{xlviii} Taobao was ahead of eBay EachNet on various counts. Some of the parameters included the number of page views per user, which was 10.7 for Taobao and 7.4 for eBay EachNet in August 2005. At the same time, Taobao's listings generated a Gross Merchandise Volume⁴⁹ (GMV) of US\$ 120 million compared to eBay EachNet's GMV of US\$ 90 million.^{xlix} Porter Erisman, Vice President, International Marketing, Alibaba,

said in 2006, “The real source of eBay's woes in Asia is its inability to understand local market conditions in this part of the world.”^{li}

According to Ma, eBay's business model might work well in other countries of the world but it would face difficulties in China because the Chinese consumers and their preferences were very different from those in other countries. Commenting on the rivalry with eBay, Ma said, “Taobao didn't win the first battle, but eBay lost it. eBay may be a shark in the ocean, but I am a crocodile in the Yangtze River. If we fight in the ocean, we lose—but if we fight in the river, we win.”^{lii}

In October 2005, Ma announced a new strategy to phase out eBay EachNet from China—the services at Taobao would be offered free of charge for three consecutive years. Challenging eBay EachNet to follow its strategy, Ma said, “We call on eBay to do what's right for this phase of China's e-commerce development and make your services free for buyers and sellers in China. Cutting prices is not enough—it's time to make your services free and affordable for all of China's entrepreneurs and consumers.”^{lii} In response, eBay issued a statement saying that free was not a business model and the fact that Taobao was providing its services for free was proof of eBay EachNet's success in China.

In May 2006, Ma announced the launch of B2C services on Taobao. By then, Taobao had already begun to outshine eBay EachNet by gaining more than 20 million users. According to Ma, the B2C services were launched with the aim of removing the middleman concept by directly connecting large sellers with consumers. For this, Taobao had already tied up with companies such as Motorola, the Haier Group, Nokia Corporation, Adidas Group, etc., and was aggressively planning to expand its product offerings. Taobao expected a large number of Alibaba's members to join its program along with leading global companies.

Sensing the need for the support of a local company to control its declining market share, eBay EachNet entered into

⁴⁹ Gross Merchandise Volume refers to the total value derived from closed listings in the online trading market.

a joint venture (JV) with TOM Online Inc.⁵⁰ (TOM Online) to form TOM eBay in December 2006. Subsequently, the company also stopped charging its sellers listing fees and decided that free was indeed a business model. Despite all these efforts, TOM eBay continued to lose market share. According to Analysys International,⁵¹ TOM eBay's market share plummeted from 16 percent in the first quarter of 2007 to 7.2 percent in the second quarter of 2007.^{liii} In sharp contrast, Taobao reported a market share of 82.95 percent in the second quarter of 2007 compared to its 74 percent market share in the first quarter of 2007.^{liv}

Industry observers opined that foreign companies failed to make a mark in China because of their lack of understanding of the language and culture. Shaun Rein, Managing Director, China Market Research Group (CMR),⁵² said, "Alibaba and Taobao have been much more successful in China than their competitors because they were able to cater their services specifically for the China market. eBay, on the other hand, tried to bring what worked in the United States. But many other global-brand companies, like eBay or Google, run into this problem when they enter China: They simply do not adjust to local realities enough."^{lv}

By the end of 2008, Taobao had 98 million registered users, according to Alibaba.^{lvi} In comparison, eBay recorded 86.3 million users for the same period, according to iResearch.^{lvii} According to industry analysts, Taobao had successfully captured the C2C market in China with a 90.5 percent market share for the Q3 of 2011 (refer to Table II for market shares of C2C players in China).

Alibaba's B2C platform, Taobao Mall, was also ahead of all competitors in the Chinese B2C market. According to iResearch, Taobao Mall recorded a market share of 50.9 percent for the Q3 of 2011 (refer to Table III for market shares of B2C players for the Q3 of 2011).

Web Search Market

After having conquered the lucrative e-commerce market, Alibaba aimed to enter the lucrative Chinese online search market, considered the most popular Internet business. The Chinese web search market was dominated by the strong local company, Baidu, which had mastered the Internet search market in the local language. Even the international leader in the search market, Google, could not crack the Chinese web search market. According to certain estimates by iResearch, around 49 percent of the C2C users visited a search engine before visiting C2C sites.^{lviii}

In August 2005, Alibaba struck a deal to acquire the operations of Yahoo! in China. Alibaba acquired Yahoo! China's main website www.cn.yahoo.com and search engines

TABLE II Market Shares of C2C Players in China (Q3 2011)

Players	Market Share (in %)
Taobao	90.5
Paipai	8.9
Eachnet.com	0.6

Source: Adapted from "Market Scale of Q3 2011 China Online Shopping Market Surges to 200 Billion Yuan," www.iresearchchina.com, November 1, 2011.

TABLE III Market Shares of B2C Players in China (Q3 2011)

Players	Market Share (in %)
Taobao Mall	50.9
360 buy	18.6
Suning	3.4
Amazon	2.9
Vancel	2.3
Dangdang	2.2
Icson	1.4
Newegg	1.4
Coo8	1.3
M18	0.8
Redbaby	0.4
Others	14.4

Source: Adapted from "Market Scale of Q3 2011 China Online Shopping Market Surges to 200 Billion Yuan," www.iresearchchina.com, November 1, 2011.

including www.yisou.com and www.3721.com. Yahoo! invested US\$ 1 billion on acquiring an equity stake of 40 percent in Alibaba. This was the largest investment by a foreign company in an e-commerce business in China. With this deal, Alibaba expected to gain a strong foothold in the web search market while having its presence in the B2B, B2C, and C2C e-commerce segments, as well as the online payments segments through its online payment solution, AliPay. Ma said, "With the addition of Yahoo! China to Alibaba.com's business, we're expanding our services to provide a leading search offering to China's Internet users."^{lix} According to analysts, by defeating its arch-rival eBay and with Yahoo! China's acquisition, Alibaba had become the dominant player in the Chinese Internet market.

In addition to having a presence in the web search market, Alibaba's announcement that it would acquire Yahoo! China came after Baidu had launched an IPO in the U.S. According to Ma, the addition of Yahoo!'s Chinese operations would allow Alibaba to expand in the rapidly growing Chinese search engine market. Further, Ma aimed to use Yahoo!'s search engine to direct customers to its online commerce sites that linked foreign buyers with Chinese wholesalers. Alibaba aimed to expand its search engine by leveraging on its huge customer base coming from its B2B, B2C, and C2C sites.

In August 2005, Ma stopped the operations of Yisou, a search engine built by Zhou Hongyi (Zhou), former President,

⁵⁰ TOM Online Inc., headquartered in Beijing, China was a leading internet company in China.

⁵¹ Analysys International, headquartered in Beijing, China, is a leading advisor of technology, media, and telecom industries in China.

⁵² China Market Research Group is a market research company based in Shanghai. It provides companies with data, strategic recommendations, and analyses that help companies understand consumer behavior and evaluate opportunities for long-term growth (Source: www.researchcmr.com).

Yahoo! China. The search engine offered search facilities to users in addition to the Yahoo! China portal. In the same year, Ma also stopped using 3721, a search engine bought by Zhou in 2003. With all these changes, Ma developed a simple search page that was quite in contrast to the portal-like features offered by Yahoo! China, in order to make Yahoo! China the number one search engine in China. However, this looked an uphill task as Yahoo! China continued to lose market share. Contrary to Ma's beliefs, Yahoo! China's acquisition did not help Alibaba gain a larger portion of the pie in the web search market since it was already dominated by strong players such as Baidu and Google. According to an internal research study by Yahoo! China, Baidu was the most favored choice among college students, and Google and Yahoo! China were preferred by affluent and business-oriented customers.

According to estimates by iResearch in 2006, Baidu and Google were the two most popular search engines with market shares of 46.5 percent and 26.9 percent, respectively, while Yahoo! China had a share of just about 15.6 percent.^{lx} However, Ma dismissed competition from Google and said, "For the search engine, I think Google is very powerful. But it is not that powerful in China now."^{lxi} Commenting on his strategy to defeat Google, Ma said, "We win eBay, buy Yahoo! and stop Google. That is for fun. Competition is for fun."^{lxii}

In September 2006, Ma adopted a new homepage strategy by promoting Yahoo! China's home page as a separate search engine page. Commenting on Ma's strategy, Zhou said, "Now he [Ma] has completely flipped back and wants to rebuild Yahoo! China into a portal. As a result, there's no search strategy. He continues to lose market share. There's brand ambiguity. No one's sure whether it's a search engine or a portal."^{lxiii}

Ma opined that Yahoo! China would have to leverage on its understanding of the Chinese consumers and chart its own path in the online search market. Describing Yahoo! China's future course of action, Ma said, "If you follow Google's way, you will always be a follower ... We have to make the Yahoo! search engine more human, more interactive ... something for the 1.3 billion people in China who aren't technology-oriented, who don't know how to ask the right questions to a search engine—for people who are like me."^{lxiv}

In January 2007, Ma announced his new strategy to reorganize the Yahoo! China portal into a business-oriented search engine. As part of its new strategy, Yahoo! China's search results were to be directed more toward corporate or business-oriented websites. Describing the new strategy, Ma said, "We don't want those not interested in business or making money. They can go to Baidu. Our main focus is the high-end. We don't need to compare ourselves with Baidu in market share."^{lxv} Ma was confident that the new strategy would help Yahoo! China gain leadership and succeed in the highly competitive Chinese Internet market. Industry experts felt that by positioning itself in the high-end segment, Yahoo! China would be on a different platform when compared to Baidu. But it would have to compete with Google, a dominant player in that segment. Baidu too was reported to have initiated efforts to woo the high-end customers.

However, Yahoo! China continued to lose market share to Baidu and Google. But Ma had no plans to give up since the

TABLE IV Market Shares of Players in Online Search Market in China (Q3 2011)

Players	Market Shares (in %)
Baidu	77.7
Google	18.3
Sougou	2.1
Soso	1.4
Others	0.49

Source: Adapted from "China's Search Engine Market Update for Q3 2011," www.chinainternetwatch.com, November 21, 2011.

Chinese web search market had reached RMB 811.7 million in the third quarter of 2007.^{lxvi} Yahoo! China's market share fell from 1 percent in 2008 to 0.3 percent in 2009 while Baidu recorded a 76 percent market share and Google garnered a market share of 19 percent.^{lxvii}

In order to gain a strong foothold in the rapidly growing Chinese web search market, Alibaba bought a 16 percent stake in Sogou.com in August 2010. With the acquisition of the stake in Sohou, Ma aimed to tap the potential in US\$ 1 billion worth of online search market in China.^{lxviii} However, Baidu continued with its dominance in the Chinese web search market with a market share of 77.7 percent for the Q3 of 2011 (refer to Table IV for market shares of players in online search market in China).

In October 2011, Alibaba launched an online shopping search engine called eTao. This was a bid to combat competition from Baidu and also to maintain Alibaba's control in the lucrative B2C market in China.

ANOTHER IPO AT ALIBABA?

In June 2011, Ma expressed his desire to raise an IPO for the Alibaba Group. In a letter to his employees, Ma said, "We won't rule out the possibility of taking Alibaba Group public in the future, as a way to reward our employees and shareholders who support and continue to believe in us."^{lxix} Earlier in October 2007, Alibaba went public on the Hong Kong stock exchange by launching an IPO (refer to *Exhibit V* for Alibaba's IPO in 2007).

In September 2011, Alibaba also announced its plans to spin off and raise an IPO for its Internet application service provider, HiChina Group Ltd. (HiChina). The *International Financing Review*⁵³ reported that Alibaba expected to raise between US\$ 200 million and US\$ 300 million from HiChina's IPO.^{lxx}

OUTLOOK

For the year ended December 31, 2010, Alibaba's revenues grew by 43.4 percent to RMB 5.55 billion as compared with revenues of RMB 3.87 billion for the FY ended December 31, 2009 (refer to *Exhibit VI* for Alibaba.com's three-year financials).^{lxxi} The revenue growth was attributed to

⁵³ The *International Financing Review* is the world's leading source of information related to capital markets for the investment banking community.

EXHIBIT V Alibaba's IPO in 2007

In October 2007, Alibaba Group's Chinese website, Alibaba.com, went public on the Hong Kong stock exchange by launching an IPO. The IPO was arranged (underwritten) by Deutsche Bank AG⁵⁴ (Deutsche Bank), Goldman Sachs, and Morgan Stanley⁵⁵ (Morgan Stanley).⁵⁶ Over 85 percent of the shares in the IPO were marked for institutional investors. The IPO received a very good response from both individual and institutional investors and the individual portion was oversubscribed by 257 times. The response prompted a reallocation of the individual-investor portion to 25 percent, up from the initial 15 percent. The company raised US\$ 1.5 billion from the IPO, the second largest IPO after Google, which had raised US\$ 1.7 billion in 2004.⁵⁷ Alibaba sold a 17 percent stake consisting of 858.9 million shares at US\$ 1.75 per share. Alibaba's shares opened at HK\$ 30 on the first day of trading, almost double the price of their IPO of HK\$ 13.5, and reached HK\$ 39.55, a raise of nearly 200 percent at close. The share closing at HK\$ 39.55 gave Alibaba a market value of US\$ 25.7 billion. The IPO was the most expensive trading stock at the Hong Kong stock exchange, where shares were valued at HK\$ 17.5 billion.⁵⁸ The shares of Alibaba traded almost 155 times the estimated earnings of the company for the next year. In comparison, the shares of Google were trading at 36 times of the estimated profits for the next year during the same period.⁵⁹

With this IPO, Ma aimed to position Alibaba's business model on a global scale. According to Ma, "This is a golden opportunity, one we probably won't see again for another 20 years. Sure we could just be like an easy guy and enjoy life. But by going public now, we have a chance to be a focus of attention—not just from China but from the rest of the world—to say, 'Hey, ecommerce in China can make money; it can help China get to the next stage.' When the time comes, you have to grab it."⁶⁰ Ma had announced that around 60 percent of the earnings raised through the IPO would be spent on acquisitions and enhancing its technologies, another 20 percent on the development of its Chinese and international sites. The remaining was expected to be used as working capital. Ma announced that using the IPO proceeds, the company would expand in Europe considering the growth potential in the European market. According to Wei, "With more than 20 million SMEs, Europe is a very important market for us."⁶¹

Even though the Alibaba IPO was hugely successful, analysts and industry observers criticized it, saying it had been valued too high. Some others opined that Alibaba could justify the high valuation if it could increase its revenues by making its customers pay for its services. Commenting on the high valuation, Rafe Xu, an analyst at Sinopac Securities Asia Ltd., a financial services company, said, "It's a high valuation but if Alibaba can use its leadership position in the e-commerce market to get more Chinese businesses to pay for its services, it will justify it. They have a lot of work to do."⁶² However, the investors justified the price considering the huge growth outlook for the company. Ma also justified the pricing by showing the post-IPO performance of its shares on the stock market. The other senior executives of the company defended the higher valuation in view of the huge future growth potential of the company. Some analysts even attributed the spectacular success of the Alibaba IPO to the rise in the demand for the Chinese companies' shares.

According to certain estimates by Goldman Sachs, the IPO was expected to boost Alibaba's earnings to US\$ 166 million with profits estimated at RMB 1.02 billion in 2008.⁶³ However, they were also of the view that Alibaba had to tap a huge customer base since only a percent of the 24.6 million registered users it had were paying members. The rest were using the services free of charge. With this IPO, Alibaba aimed to focus on increasing its community of users while providing enhanced services to customers who were paying a premium in the range of RMB 2,800 to 60,000. The company had announced its ambitious plans to tap the Asian markets like India and Japan.

Source: Compiled from various sources.

the increasing number of paying members at Alibaba's online trading platform.

With the growth in revenues and paying members, Alibaba was touted to be one of the biggest Internet companies in China in 2011. However, its image took a beating when the company reported a series of frauds that took place through its e-commerce site, in February 2011. It was reported that some

of the vendors had offered small electronic items to buyers at attractive prices. The payments were settled using less reliable methods. According to John Spelich (Spelich), the company's Hong Kong-based spokesman, the employees at Alibaba either intentionally or negligently evaded verification and authentication measures. Industry analysts felt that the fraud cases could hurt the reputation of Alibaba and hamper its ability to attract

⁵⁴ Deutsche Bank AG, headquartered in Frankfurt, Germany, is an international financial institution whose main products include banking and insurance.

⁵⁵ Morgan Stanley, headquartered in New York City, New York, USA, is a leading investment banking and financial services corporation in the world.

⁵⁶ "Alibaba IPO Approved in Hong Kong," www.tagedge.com, October 6, 2007.

⁵⁷ "Alibaba IPO Boosts Yahoo!" www.seekingalpha.com, November 7, 2007.

⁵⁸ Amy Or, Lorraine Luk, and Sky Canaves, "China IPO Frenzy Rolls on with Alibaba.com Debut—Shares of B2B Site Skyrocket as Investors Buy its Growth Story," www.resources.alibaba.com, November 7, 2007.

⁵⁹ Mark Lee and John Liu, "Alibaba Shares Triple in Hong Kong Trading Debut (Update8)," www.bloomberg.com, November 6, 2007.

⁶⁰ Clay Chandler, "China's Web King," *Fortune*, December 10, 2007.

⁶¹ "China's Alibaba.com Aims to Expand in Europe through Acquisitions—CEO," www.forbes.com, December 28, 2007.

⁶² Mark Lee and John Liu, "Alibaba Shares Triple in Hong Kong Trading Debut (Update8)," www.bloomberg.com, November 6, 2007.

⁶³ Mark Lee and John Liu, "Alibaba Shares Triple in Hong Kong Trading Debut (Update8)," www.bloomberg.com, November 6, 2007.

EXHIBIT VI Alibaba.com's Three Year Financials (RMB in Thousands)

For the Year Ended December 31,	2008	2009	2010
Revenue			
International marketplace	1,883,966	2,406,804	3,238,243
China marketplace	1,094,059	1,414,897	1,893,899
Others	26,102	53,027	425,444
Total revenue	3,004,127	3,874,728	5,557,586
Cost of revenue	(400,651)	(534,438)	(931,016)
Gross profit	2,603,476	3,340,290	4,626,570
Sales and marketing expenses	(1,108,129)	(1,623,845)	(2,050,561)
Product development expenses	(214,038)	(384,333)	(580,173)
General and administrative expenses	(322,246)	(409,708)	(568,324)
Other operating income, net	182,637	150,566	109,026
Profit from operations	1,141,700	1,072,970	1,536,538
Finance income, net	239,207	140,941	176,398
Share of losses of associated companies and a jointly controlled entity, net of tax:	(16,087)	(37,492)	(6,479)
Profit before income taxes	1,364,820	1,176,419	1,706,457
Income tax charges	(210,317)	(163,393)	(236,445)
Profit for the year	1,154,503	1,013,026	1,470,012
Other comprehensive income/(expense)			
Net fair value gains/(losses) on available-for-sale investments	—	222	5,640
Currency translation differences	(24,650)	247	(21,533)
Total comprehensive income	1,129,853	1,013,495	1,454,119
Profit/(loss) for the year attributable to			
Equity owners of our Company	1,154,503	1,013,026	1,469,464
Non-controlling interests	—	—	548
Profit for the year	1,154,503	1,013,026	1,470,012
Total comprehensive income/(expense) attributable to			
Equity owners of our Company	1,129,853	1,013,495	1,453,571
Non-controlling interests	—	—	548
Total comprehensive income	1,129,853	1,013,495	1,454,119
Dividend per share	—	20 cents	22 cents
Special cash dividend (HK\$)			
Earnings per share, basic and diluted (RMB)	22.85 cents	22 cents	29 cents
Earnings per share, basic and diluted (HK\$) (Note 1)	26 cents	23 cents	33 cents

Note 1: The translation of Renminbi amounts into Hong Kong dollars has been made at the rate of RMB0.8714 to HK\$1.0000 (2009: RMB0.8812 to HK\$1.0000). No representation is made that the Renminbi amounts have been, could have been or could be converted into Hong Kong dollars or vice versa, at that rate, or at any rates or at all.

Source: "Alibaba Annual Report 2010," http://img.alibab.com/ir/download/201104/2010_AnnualReport_ENG.pdf and "Alibaba Annual Report 2009," http://img.alibab.com/ir/download/201102/e1688_AR.pdf.

global players. It was also reported that the fraud had led to a loss of US\$ 1 billion in market value.^{lxxii} Some experts opined that the fraudulent listings on Alibaba's online trading platform had led to a decrease in the number of members at the company.

On the other hand, the company remained positive about its prospects. According to Spelich, "We are the same company today that our customers have known for the last 11 years, and the whole point of the announcement earlier this week was to demonstrate our sacrosanct commitment to integrity. We believe, over time, our customers will understand that."^{lxxiii} The company said that it was taking measures to boost the quality of services, check its sellers on-site, and offer an escrow service to protect its buyers and sellers through AliExpress, an online trading platform for small-quantity orders.

By the end of June 2011, the number of Internet users in China had reached 508 million, according to Data Center for China Internet⁶⁴ (DCCI). It was reported that the Internet users in China would reach 551 million by 2012.^{lxxiv} Given the attractiveness of the Chinese Internet market, analysts opined that Internet companies that could crack the market would be rewarded handsomely. The growth outlook remained positive for Alibaba considering the potential of Internet market in China, experts felt.

While experts remained positive about Alibaba's future, it posted a 12 percent increase in net profit and recorded revenues of RMB 1.602 million or US\$ 250.4 million for the third quarter ended September 30, 2011.^{lxxv} Analysts attributed these results to a weak macroeconomic climate that resulted in slower customer additions. Alibaba reported that "The third quarter of 2011 presented a picture filled with challenges arising from the weaknesses in the U.S. economy and the debt troubles in the euro zone, which have threatened to spin out of control."^{lxxvi}

⁶⁴ Data Center for China Internet offers data on the Chinese Internet, advertising, search engine, e-commerce, digital entertainment, and web services market.

Alibaba's chief executive, Jonathan Lu, vouched for the fact that despite the troubles in the external environment, the company would continue with its focus on upgrading its business model and building trustworthy and quality e-commerce platforms.

As of November 2011, the company was also making efforts to increase the revenue per user by planning to offer value-added services such as extra ways to advertise on the site. Industry experts felt that with the acquisition of 40 percent of Yahoo!'s stake in Alibaba, Ma would take the company forward.

Suggested Questions for Discussion

1. Critically analyze the factors that led to Alibaba sustaining its leadership position in the Chinese e-commerce market.
2. Discuss the rationale behind Ma establishing Taobao.com. What are the factors that led to Taobao's success as compared to eBay in the Chinese online auctions market?
3. Though Alibaba was the market leader in the Chinese e-commerce market, it failed to make a mark in the lucrative Chinese web search market. Do you think Alibaba's strategy of launching eTao, an online shopping search engine, would help it combat competition with Baidu? Why (not)? Do you think Alibaba's decision to acquire its 40 percent stake in Yahoo! China would help it gain some momentum in the Chinese web search market? Why (not)?
4. Critically examine Alibaba's business model. Do you think it is sustainable? After having captured the Chinese e-commerce market, what steps should Alibaba take to expand globally?

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