IMD
REAL WORLD. REAL LEARNING

TOMORROW'S CHALLENGES

# A LEAP OF FAITH WITH ALIBABA

## THE STORY BEHIND THE MUCH-AWAITED IPO AND CHINA'S BOOMING E-COMMERCE MARKET

By IMD Professor Winter Nie – June 2014

**IMD**
Chemin de Bellerive 23
PO Box 915,
CH-1001 Lausanne
Switzerland

Tel: +41 21 618 01 11
Fax: +41 21 618 07 07
info@imd.org
www.imd.org

Copyright © 2006-2013 IMD - International Institute for Management Development. All rights, including copyright, pertaining to the content of this website/publication/document are owned or controlled for these purposes by IMD, except when expressly stated otherwise. None of the materials provided on/in this website/publication/document may be used, reproduced or transmitted, in whole or in part, in any form or by any means, electronic or mechanical, including photocopying, recording or the use of any information storage and retrieval system, without permission in writing from IMD. To request such permission and for further inquiries, please contact IMD at **pressroom@imd.ch**. Where it is stated that copyright to any part of the IMD website/publication/document is held by a third party, requests for permission to copy, modify, translate, publish or otherwise make available such part must be addressed directly to the third party concerned.

It is not hard to understand why Alibaba's fast-approaching IPO sparks excitement. While only a decade ago the internet giant felt threatened by eBay's vigorous entry into the China market, today Alibaba controls nearly 80% of all e-commerce in China. The company handles a volume of online transactions that is more than three times the size of eBay's gross merchandise volume. Alibaba is frequently compared to Amazon, except that Alibaba's earnings are greater.

Founded by Jack Ma and a small group of Associates in a Hongzhou apartment in 1999, Alibaba initially concentrated on linking Chinese manufacturers to global buyers. By 2003, Alibaba had 1.8 million registered users in 200 countries, and was handling $7.3 billion in trade. Yet the looming competitive threat on the horizon was eBay, which had just bought shares in a local Chinese online auction site, EachNet. A global expansion campaign launched by eBay in 1999 resulted in its domination of 16 out of 17 markets. The only market eBay had failed to conquer was Japan, where its main competitor, Yahoo Japan, offered its services for free. Although eBay focused on C2C, Ma was convinced that it would eventually begin competing in the B2B sector, encroaching on Alibaba's home territory.

In April 2003, Ma decided to challenge eBay's EachNet directly by creating a new C2C site, "Taobao," ("Treasure Hunt" in Chinese). The original seven-employee start-up team had an average age of 25, and it spent ten-hour days studying eBay for weaknesses. Taobao went online on May 9, 2003. To differentiate itself from eBay's EachNet, Taobao was free. Jack Ma had decided to go for market share and worry about profits later. Ma reasoned that if Taobao could produce a critical mass of buyers online, the sellers would soon follow.

Competing with eBay's EachNet forced Alibaba to become increasingly innovative. To simplify online payments, Ma launched Alipay, a system similar to Paypal, but adapted to China's lack of a credit infrastructure and concerns over security. By 2006, Alipay had 20 million users. Taobao placed a heavy emphasis on identifying itself as a "Chinese company with Chinese thinking." While eBay EachNet's web portal looked glossier and less cluttered, Taobao's site looked busier, more colorful and much more visual. It was clear that while eBay's American management valued utility, Chinese Internet users preferred an atmosphere that looked more like a Chinese market. Taobao promoted a "tea house" culture and it adopted easy-to-remember names and references to highly popular kung fu novels. Taobao's instant messaging system, "Wangwang," not only sped up transactions, but also became a popular social networking hangout. One user confessed to spending up to eight hours online, talking with potential customers.

eBay's strategy had been to go global and create a marketplace without borders. Taobao consciously remained local. Taobao's search engine was highly adapted to the way a Chinese customer was likely to begin looking for a product, and it used categories that were familiar to Chinese thinking.

By the end of 2006, Taobao had 30 million registered users and was handling $6.27 million in transactions a day. 70% of the transactions went through Alibaba's payment system, Alipay. Thanks to its Taobao subsidiary, Alibaba now controlled an estimated 70% of the C2C market in China, while eBay EachNet's market share was less than half that. Ma summed up the strategy, "eBay may be a shark in the ocean, but I am a crocodile in the Yangtse River. If we fight in the ocean, we lose, but if we fight in the river we win."

The next issue was how to make money. After a few unsuccessful attempts to charge fees for services, Alibaba settled on three business models: B2B, B2C and C2C. Taobao marketplace focused on charging fees for value-added service, and Taobao Mall, eventually renamed "TMall," provided a B2C platform for name brands to sell directly to customers. The latter proved very successful. It turned out that manufacturers had been looking for a low-cost distribution platform, and Taobao Mall fit the bill perfectly.

The resulting formula propelled Alibaba to near total dominance of China's e-commerce market, with transactions adding up to nearly $250 billion a year. A smaller part of the organization, Alibaba Express, even began marketing successfully in the US. It is China's e-commerce market, however, that interests investors. A McKinsey report estimates that by 2020, approximately 75% of China's urban population will be in the middle class, earning from $9,000 to $36,000 a year. Roughly 57% will be in the upper middle class. Meeting their consumer needs requires rapidly expanding China's already badly stretched warehouse space and improving logistics. Getting merchandise bought on

Alibaba to customers already accounts for a significant percentage of Chinese postal deliveries. Expanding warehouse space will cost an estimated $2.5 billion over the next 15 years, but all that is only likely to further fuel the economic boom.

Despite the potential for enormous profit, investing in Alibaba's IPO will still require a leap of faith in Jack Ma and the company's tightly held management. The decision to launch the IPO in New York was made in part because New York Stock Exchange rules allowed the company's current management to remain firmly in control. The IPO is currently projected to bring in up to $20 billion, making it the biggest in US history, outdistancing Facebook. In April, Alibaba valued itself at $109 billion. Bloomberg recently estimated Alibaba's true value at closer to $168 billion. "I always knew that we had a future," Ma told company staffers in a recent corporate internal video. "I just never thought that it would be this big."

*Winter Nie is a professor of operations and service management at IMD. She teaches in Orchestrating Winning Performance, IMD's flagship program for individuals and teams.*

# Related Programs

## ORCHESTRATING WINNING PERFORMANCE - http://www.imd.org/owp

**The global business program for individuals and teams**
Program Directors Michael Wade, Bettina Büchel, Dominique Turpin

- Get exposed to the latest management thinking and to practical and innovative solutions for your business
- Anticipate global business trends
- Boost your performance, broaden your perspectives and expand your global network
- Design the program that suits you and your team
- Become a complete executive through activities that develop your mental, physical, and emotional health