



FELIX OBERHOLZER-GEE

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Alibaba's Taobao (A)

In early 2008, the Hangzhou-based Alibaba Group operated China's leading online marketplaces: Alibaba.com, an international business-to-business (B2B) exchange that assisted small and medium-sized Chinese enterprises in finding overseas trading partners; Alibaba.com.cn, the company's B2B site for domestic trade; and Taobao, a B2C and C2C exchange for Chinese retailers and consumers. The group also ran a web portal (Yahoo! China), an online payment services provider (Alipay) and a marketplace for online advertising inventory (Alimama). By 2008, Alibaba Group had captured about one half of B2B e-commerce in China.

The group's quickly growing consumer site, Taobao (淘宝, "hunting for treasures"), had attracted particular attention after it managed to displace the once dominant eBay, the world's largest consumer marketplace. After spending hundreds of millions of dollars trying to defend its presence in China, at the end of 2006, eBay management cut its losses and shut its site, acknowledging Taobao's appeal among consumers and retailers.¹ With a market share among C2C players of 84% in 2007, Taobao had become China's leading consumer e-commerce marketplace, facilitating transactions valued at RMB43 billion.^a

By spring of 2006 it had become apparent that Taobao was pulling away from its closest rival eBay. However, the company had little revenue because it offered its services free of charge. In a first move to test a monetization model, Taobao launched a value-added service called Zhao Cai Jin Bao (招财进宝, "bringing wealth and riches"). The service let sellers bid for keywords, ranking paid listings ahead of free listings and collecting a fee when a transaction relating to the paid listing was completed through Taobao. As the company rolled out Zhao Cai Jin Bao, the executive team waited in suspense. Would the service be a success? Had Taobao chosen the right way to monetize its marketplace?

Alibaba's B2B Platform

Jack Ma founded Alibaba with the support of a group of friends in December 1998. Ma, a former teacher who had experience building websites for Chinese companies, created Alibaba to assist small and medium-sized companies (SMEs) in selling their products on the internet. Ma explained: "There

^a In mid 2008, 100RMB equaled US\$14.6.

are more than 40 million SMEs in China. Many of them operate in fragmented markets, with limited access to communication channels and information sources that would help market and promote their products. A critical difficulty is that many SMEs have no way to evaluate the trustworthiness of their trading partners."

At the outset, the website offered little more than a bulletin board on which a few businesses posted trade leads. But a decade later, more than 32 million registered users relied on Alibaba's B2B platform to find trading partners, and the group had built a sophisticated ecosystem around its core business. Posting a trade lead on Alibaba remained free, but about one percent of registered companies purchased premium subscriptions to display their products and storefronts on Alibaba's marketplaces. Premium subscribers operated their own storefront on Alibaba, and the company assisted them in building and maintaining their websites (Exhibit 1 shows the site of Zhejiang Sunkey Industrial Co., a manufacturer of aluminum profiles.) Scott Ni, director of site operations at Alibaba, explained: "We visit the factories of our members to shoot videos and take pictures of products. We also create their website and produce promotional materials to showcase our companies at tradeshows."

The storefronts of premium subscribers provided detailed product information, a virtual tour of the company, and TrustPass verification. Under the TrustPass program, Alibaba asked third parties to verify the corporate registration and banking information of its members. TrustPass members were also able to view and post feedback on other TrustPass companies.

Alibaba's B2B marketplaces thrived. In 2007, the company tripled its operating profit to RMB804.3 million on revenues of RMB2,163 million (Exhibit 2 provides financial information). Premium subscribers using the international marketplace (www.alibaba.com) paid an annual fee of RMB50,000. These fees generated about 70% of company revenue. With 23 million registered users, the company's site for domestic trade (www.alibaba.com.cn) was much larger but less important financially, with 266,000 premium subscribers each paying RMB2,800 for a standard China TrustPass package. As of 2007, the company had 700,000 storefronts on its international marketplace and 2.26 million storefronts on its China marketplace. Additional sources of income were promotional placements, banner advertising, and paid keyword searches. Companies paid up to RMB120,000 annually to have their name listed first when buyers searched for a popular item.

At the end of 2007, Alibaba listed its B2B business (marketplaces Alibaba.com and Alibaba.com.cn) in Hong Kong, selling 19.25% of the company's enlarged share capital and raising US\$ 1.7 billion. The market responded enthusiastically, driving the company's P/E ratio to 320 in post-IPO trading (Exhibit 3 provides share price information). Taobao and the group's other businesses remained privately held. Each group company had its own executive team (president, CFO, and vice presidents responsible for the operating units) and its own board of directors. The overriding objective was to encourage the businesses to be best in their industry. Ma explained: "Business unit presidents must have the freedom to do what is right for their business. I want business units to compete with each other."

With group companies given free reign to develop on their own and capture new opportunities, it was natural that company's activities would not always be aligned. Joe Tsai, CFO of Alibaba Group, described an example: "Alipay's primary objective is to be a leader in payment processing which requires it to develop its own client base of online merchants. However, these clients could be other e-commerce websites that compete directly with Taobao. For example, Joyo.com is a client of Alipay, yet is a subsidiary of Amazon, a company that competes with Taobao."

Taobao

Porter Erisman, Vice President of International Corporate Affairs, remembered the beginnings of Taobao well: "Jack told me in April 2003 that he wanted to pursue a new venture. The project was to be top secret. Seven employees started to work on Taobao that month. The team was hidden off-site in Jack's old apartment where Alibaba was born. They spent day and night there and were not even allowed to tell their families and friends what project they were working on."

Ma had carefully observed the rise of eBay in China. The U.S. company had entered China by investing US\$30 million in EachNet in 2002. EachNet, a Chinese online auction founded in 1999 by Tan Haiyin (HBS 1999) and Shao Yibo (HBS 1999), mostly catered to early internet users, many of whom were tech-savvy computer enthusiasts (see **Exhibit 4** for internet penetration rates). At the time of eBay's investment, EachNet commanded an 85% market share with revenues of RMB12 million. In June 2003, eBay CEO Meg Whitman (HBS 1979) acquired the remaining 67% stake in Eachnet, rebranding the site as eBay EachNet.² Whitman had high hopes for her company's venture, predicting that "China could be eBay's largest local market in a five-to-ten-year period."³

Ma explained his concern over eBay's entry:

eBay grew strongly. At that time, there were only two companies in China that understood online marketplaces, eBay and Alibaba. I was particularly concerned that eBay's power sellers would grow their business to compete in the B2B space. In China, the line between individuals and small businesses is blurry. There are many people with entrepreneurial ambitions. I needed to stop eBay to protect Alibaba.

Marketplace Design

Taobao sought to distinguish itself from eBay in numerous ways. Ma wanted to imbue Taobao with a strong local culture that reflected a deep understanding of Chinese consumers and an attitude of informality. Taobao's president, Sun Tongyu, explained: "We ask Taobao employees to select a nickname and refer to each other by it. The nicknames come from fictional characters in Jin Yong's famous kung fu novels."

Yu Yan, the Taobao nickname of Zhang Yu, vice president in charge of C2C marketplace operations at the company, explained the cultural differences between Taobao and eBay, pointing out differences in the design of the two websites (see **Exhibit 5** for sample homepages): "Chinese consumers like busy web designs with strong colors. Westerners prefer sparse sites like Google's, but Chinese customers want their sites to be noisy, with lots of links."

Added Erisman: "We got the navigation right. Our design was much more usable for Chinese eyes. It reflected how Chinese shoppers think. Even some small details, such as including a men's navigational tab and a women's navigational tab, made the navigation more suitable to China's online shoppers. It was like being in a Chinese department store."

Trust

To attract buyers and sellers, the company needed to find a way to engender trust between vendors and customers. This was particularly challenging in the Chinese context. Professor Paul Ingram of Columbia Business School, who studied social networks, explained:

In the West, we tend to reserve trust from the heart (affect-based trust) for family and friends and trust from the head (cognition-based trust) for business partners. We see emotional concerns in business as unprofessional. But in China, affect- and cognition-based trust are highly intertwined, even in business.⁴ It is important that business partners have an affective bond. Few Chinese business relationships develop without socio-emotional exchanges such as sharing meals, gifts, and socializing with each other's family.

Taobao developed a number of mechanisms to help create trust between sellers and buyers.

- Taobao sellers needed to register using their national identity card and bank account information.
- As eBay, Taobao allowed buyers and vendors to provide feedback for each other. Taobao distinguished between a person's reputation as a seller and a buyer. (eBay provided only one score for each user.) Sellers on eBay tended to have more positive reputation scores (almost 50% had no negative scores in a six-month window) compared to sellers on Taobao (14% had no negative scores).⁵ Taobao sellers who provided feedback on a buyer automatically received a positive rating if the buyer did not respond within 45 days.
- In 2004, the company introduced Alipay (支付宝, "payment treasure"), an escrow service designed to eliminate settlement risk among trading parties. Using Alipay, a buyer deposited payment for an outstanding order in an Alipay account; Alipay informed the seller when it received the funds, and the seller then shipped the goods. When the buyer informed Alipay that the merchandise had arrived, it instructed its bank to release the funds to the seller. Erisman explained the significance of Alipay:

Alipay was critical to Taobao's development. Even when buyers see a seller with high ratings, the lack of trust still creates a big challenge. Alipay eliminates the settlement risk. The payment mechanism itself is not important. Payment is easy in China. People are used to wiring money; they can even do it online. But banks cannot address the settlement risk. This is where Alipay comes in. Now more than 80 percent of Taobao transactions rely on Alipay.

Taobao members were able to use Alipay free of charge. On eBay, there were many buyers who complained that they did not receive an item. Thanks to Alipay, this problem barely existed on Taobao.⁶

- Taobao invested significant resources to facilitate communication between buyers and sellers and between users and the company. It embedded an instant-messaging service, Wangwang, in its website, allowing buyers to directly haggle with sellers, a process which both sides seemed to enjoy (see **Exhibit 6**). Yu Yan explained: "Buyers and sellers use our instant-messaging service to provide continuous feedback, ask for assistance, and make suggestions." As a result, "communication problems" comprised only 8% of Taobao's non-positive feedback. At eBay, this share stood at 20%.⁷

Fees

Unlike its U.S. competitor, Taobao did not charge listing or transactions fees. Erisman explained: "E-commerce was new in China. People were wary of scams. Chinese consumers were not familiar with online marketplaces, and merchants were reluctant to sell online without significant incentives. They wanted the marketplace to be free so they could dip their toes in the water."

Ma directly challenged Whitman: "We call on eBay to do what's right for this phase of China's e-commerce development and make its services free for buyers and sellers in China."

Whitman was not amused: "Free is not a business model. It speaks volumes about the strength of eBay's business in China that Taobao is unable to charge for its products."⁸

Locked into a head-to-head race, in 2004 it remained uncertain whether Taobao or eBay would prevail (**Exhibit 7** compares user satisfaction levels in this period).

Competition

eBay By the time Taobao entered the C2C segment, eBay's global revenues were US\$2,165.1 million and the company had about 5,700 employees. In addition to its dominant position in the U.S., eBay had established a local presence in 19 countries. Creating a global marketplace was critical to eBay's strategy: "A key element of our growth strategy is to continually expand the eBay marketplace to new communities around the world." In 2003, international markets accounted for 35% of the company's net revenues—more than a five-fold increase from 2000.

eBay had successfully expanded into international markets using the same basic business model. In 2001, eBay claimed to be the dominant platform in four of its overseas markets: Australia, Canada, Germany and the U.K. eBay's international expansion strategy was to enter countries with a large degree of internet penetration and computer usage, then on a case-by-case basis, determine whether to start from scratch, do an acquisition or enter into a partnership. In Germany, eBay entered via acquisition in 1999 by buying Alando.de, the premier auction site in that country. The company achieved similar success in the U.K. where eBay crushed its competition. In 2002, in response to eBay's achievements, Yahoo withdrew from the internet-auction business throughout most of Europe.

In contrast to Europe, eBay struggled and eventually lost the Japanese market to Yahoo. eBay's failure was due to a series of missteps. Yahoo managed to enter Japan first, a full five months before eBay. Masahiro Inoue, president and CEO of Yahoo Japan, explained: "It was critical to be first. We knew catching up with a front- runner is hard in auctions."⁹

Inoue was so concerned about achieving quick success that he asked his 120 employees to list items for sale to make the website look busy in the first few weeks. Once eBay entered, Japanese consumers perceived its site as insufficiently localized and expensive. eBay emphasized the used-collectibles business, thinking that the development of the market would mirror the US. However, Japanese auction users were more interested in new goods. And while Yahoo's auction site was free, eBay charged commissions of 1.25% to 5% and required sellers to provide credit card numbers, a hassle for young Japanese who preferred to pay cash on delivery. Two years after its launch, Yahoo dominated the Japanese auction market, achieving a 95% share. In 2002, eBay conceded defeat and pulled out.

Eager to learn from its experience in Japan, eBay entered the Chinese market early, acquiring the market leader EachNet. eBay gave broad autonomy to the 150-person EachNet team, including Shao who remained in place as CEO. The company relied on website usability, marketing sophistication and strategic execution to defend its leading position. eBay charged Chinese sellers listing fees (up to 3RMB) and transactions fees of up to 2% of the item's value.

In 2005, eBay introduced its PayPal service to China to help transactions close more quickly. PayPal was a free service for all users. The same year, the company formed a strategic alliance with

B2B facilitator Global Sources Ltd. The new partnership was aimed at eBay "PowerSellers" worldwide who gained an easy way to source their products directly from manufacturers in China.

PaiPai While Taobao and eBay dominated consumer marketplaces in China, there were several smaller sites, Paipai being the most significant. Paipai.com was the e-commerce platform owned by Tencent Technology (Shenzhen) Company Limited. Tencent, a company listed in Hong Kong with revenue of RMB3.8 billion and net profit RMB1.6 billion, operated China's most popular instant messaging service, QQ. At the time of Paipai's launch, QQ had 170 million active accounts. "Our advantage is our huge community base, which allows us to tap various potentials in mobile and Internet areas," Tencent CFO Patrick Tsang said.¹⁰ Paipai was seamlessly integrated with QQ. The site offered its services for free. "We don't expect Paipai to bring in profits in the short term," explained Tencent chairman Pony Ma.¹¹

Market Leadership

In 2005, two years after Taobao's launch, the battle between Ma and Whitman was decided: the mighty eBay had fallen. By the end of 2007, Taobao had achieved a leading position in C2C commerce in China, leaving an ever-smaller share of business to its competitors (see **Exhibit 8** for market share information and **Exhibit 9** for patterns of growth). At the end of 2006, eBay shut its site. The company entered into a joint venture with Hong Kong-based Tom Online, hoping a local partner would enable it to stage a come-back.

By 2007, Taobao had reached a gross merchandise volume (GMV) of RMB43 billion, making it the second-largest retailer in China. Analysts estimated online shopping would grow at a rate exceeding 50% in the next 5 years. Taobao transactions data showed the company continued to deepen its reach. Online shopping, traditionally popular in the more affluent cities along China's coast, grew quickly in 2nd and 3rd tier cities. In addition, the mix of products shifted from higher-end technical gadgets to day-to-day merchandise (see **Exhibit 10**). Ma's vision of the company had evolved as well: "The retail infrastructure in China is terrible, extremely inefficient. Taobao will replace these traditional channels. We are now building the new Wal-Mart—online!"

Monetizing Taobao

For all its success, Taobao still had little revenue. Monetizing transactions had not been a priority for the company. Erisman remembered: "Jack was notorious for saying that we have no revenue model. The most important thing is to have critical mass. It gives you time to figure out what customers want. Let people make money. Let them use Taobao before we make money."

In a first attempt at monetization in May 2006, Taobao developed a new service, Zhao Cai Jin Bao. Similar to Google's auctions for keywords, sellers on Taobao were offered the opportunity to bid on keywords to influence the order in which the search results for listed items would appear. Taobao typically displayed 20 search results on its first page. Zhao Cai Jin Bao would determine the order for the top one half of these listings. Zhao Cai Jin Bao offered pay-for-performance contracts. Sellers would only have to pay their bid if a customer actually bought the advertised product.

Alibaba's executive team wondered whether they had taken the right approach to monetizing Taobao. Was Zhao Cai Jin Bao, a hybrid between the approaches pioneered by eBay and Google, the future of online marketplaces?

Exhibit 1 Zhejiang Sunkey's Website on Alibaba

Zhejiang Sunkey Industrial Co., Ltd.

Home Products Selling Leads TrustPass Profile About Us Contacts

search our products 

Products

- Aluminum Profiles [57]
- Aluminum Windows [194]
- Aluminum Curtain Wall [14]
- Aluminum Industrial Profile [38]
- Aluminum Thermal-Break Window Profile [31]
- Others [65]

Company Profile

Trade Show

Contact Us

Zhejiang Sunkey Industrial Co., Ltd.



Established in 2005, Zhejiang Sunkey Industrial Co., Ltd. is a specialized manufacturer of construction aluminum and industrial aluminum profiles. Our company is located in Ningbo City of the eastern Zhejiang Province and next to Shanghai City. ... [Read more](#)

Offline

Selected Products

See more

Aluminum Industrial Profile Aluminum Construction Profiles 80GT Thermal Break Sliding Window Aluminum Industrial Profile Aluminum Profile

Source: Company documents.

Exhibit 2 Alibaba.com Ltd.—Financial Information

Consolidated Income Statement (RMB '000)	2007	2006
Revenue		
International marketplace	1,547,695	991,869
China marketplace	615,062	371,993
Total revenue	2,162,757	1,363,862
Cost of revenue	(280,113)	(237,625)
Gross profit	1,882,644	1,126,237
Sales and marketing expenses	(736,813)	(610,198)
Product development expenses	(131,495)	(105,486)
General and administrative expenses	(229,868)	(159,969)
Other operating income	19,877	17,912
Profit from operations	804,345	268,496
Finance income, net	345,099	22,892
Profit before income taxes	1,149,444	291,388
Income tax charges	(181,649)	(71,450)
Profit attributable to equity owners of the Company	967,795	219,938

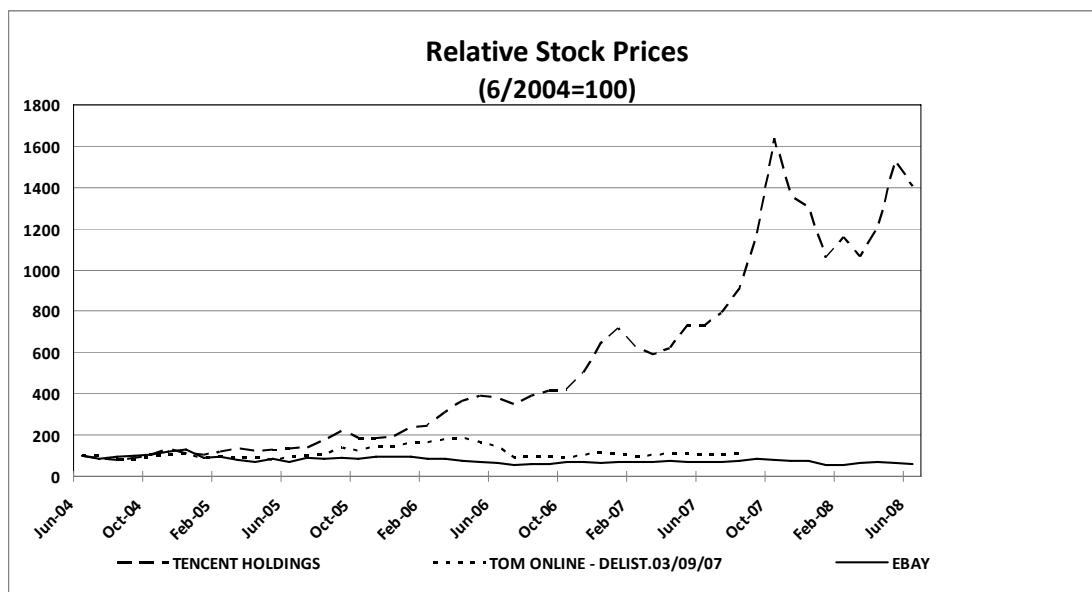
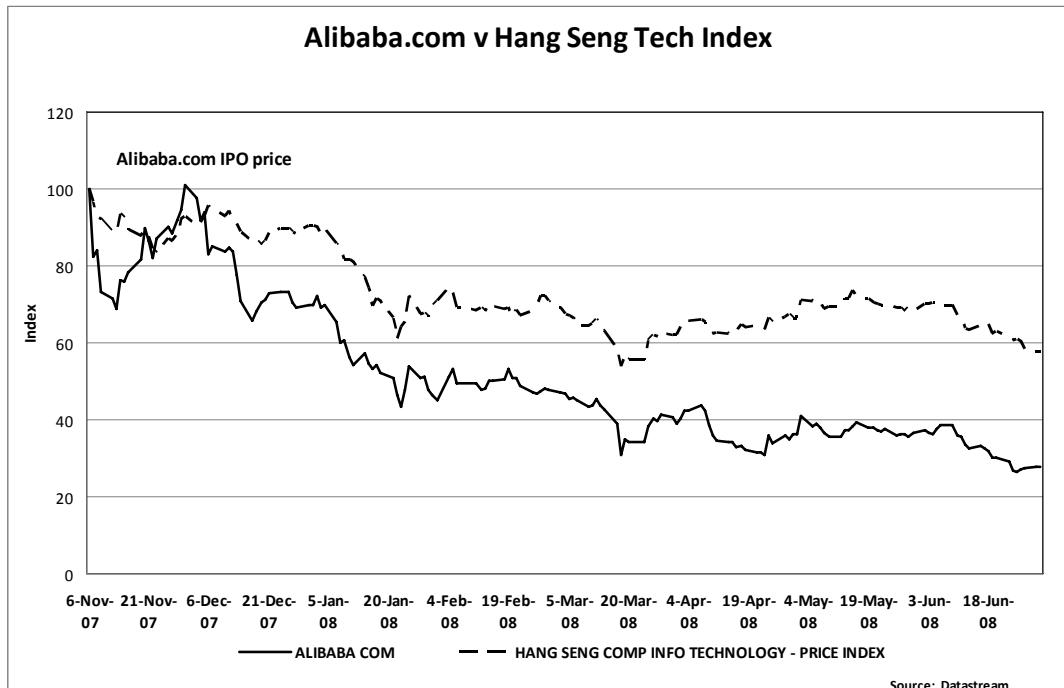
Source: Company documents.

Exhibit 2 (continued) Alibaba.com Ltd. – Financial Information

Consolidated Balance Sheet (RMB '000)	2007	2006
Assets		
Non-current assets		
Lease prepayment	29,088	-
Property and equipment	158,992	113,304
Deferred tax assets	260,311	211,875
Prepayments, deposits and other receivables	27,067	
Deferred costs	10,767	4,988
Total non-current assets	486,225	330,167
Current assets		
Amounts due from related companies	26,320	25,148
Prepayments, deposits and other receivables	48,143	36,389
Deferred costs	219,229	163,392
Restricted cash		781
Term deposits with original maturities of over three months	952,382	1,051,000
Cash and cash equivalents	4,321,170	437,804
Total current assets	5,567,244	1,714,514
Total assets	6,053,469	2,044,681
Equity		
Capital and reserves		
Share capital	486	
Share premium	2,893,132	
Capital reserve	(55,787)	354,533
Exchange reserve	20,357	3,937
Statutory reserves	119,615	58,223
Retained earnings/(Accumulated deficit)	635,278	(271,125)
Total equity	3,613,081	145,568
Liabilities		
Non-current liabilities		
Deferred revenue	70,194	37,146
Current liabilities		
Deferred revenue and customer advances	1,849,655	1,216,818
Trade payables	12,883	8,698
Amounts due to related companies	17,039	161,538
Other payables and accruals	337,085	172,281
Dividend payable	-	195,909
Current income tax liabilities	153,532	106,723
Total current liabilities	2,370,194	1,861,967
Total liabilities	2,440,388	1,899,113
Total equity and liabilities	6,053,469	2,044,681
Net current assets/(liabilities)	3,197,050	(147,453)
Total assets less current liabilities	3,683,275	182,714

Source: Company documents.

Exhibit 3 Alibaba and Main Competitors - Share Price Information



Source: Company documents.

Exhibit 4 Internet Penetration

	2002	2003	2004	2005	2006	2007
Internet users (millions)	59	76	94	111	137	210
Internet penetration	4.6%	6.2%	7.3%	8.5%	10.5%	16.0%
Broadband users (millions)	6.6	17.4	42.8	64.3	90.7	163.4
Broadband penetration	11.2%	21.9%	45.5%	57.9%	66.2%	77.8%

Source: Company documents.

Exhibit 5a Taobao Homepage May 2003



Source: Company documents accessed via Internet Wayback Machine.

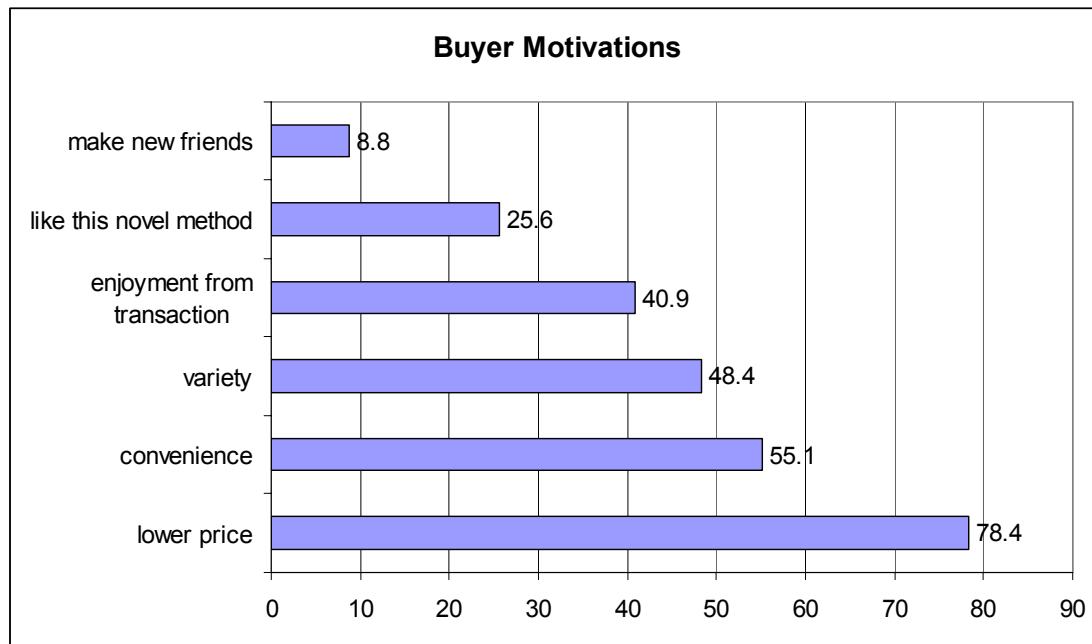
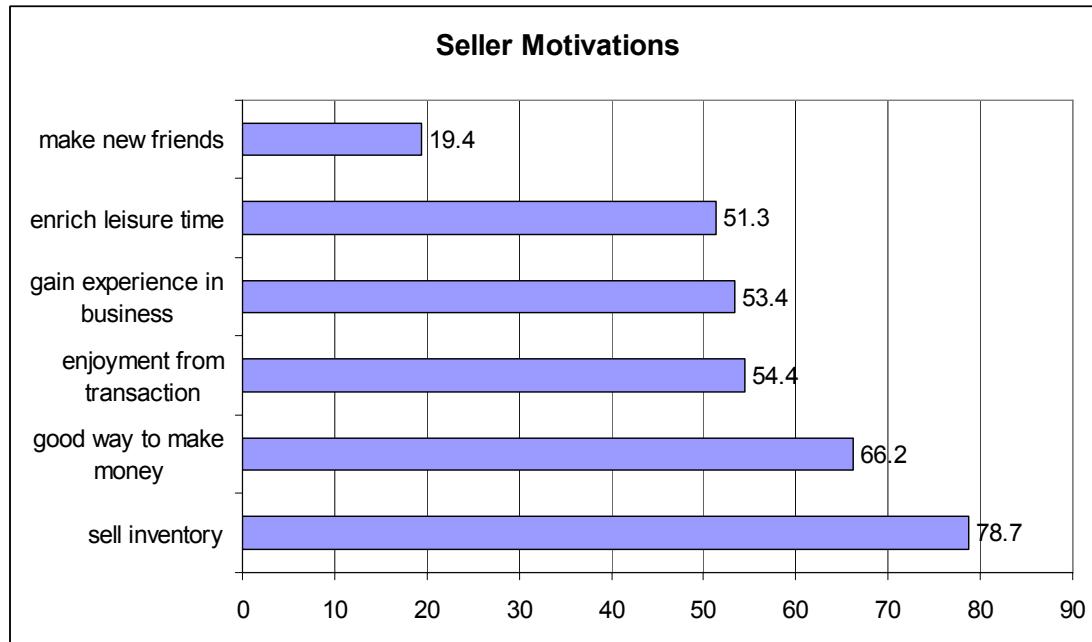
Exhibit 5b Taobao Homepage July 2008

Source: Company documents accessed via Internet Wayback Machine.

Exhibit 5c eBay Homepage January 2003

Source: Accessed via Internet Wayback Machine.

Exhibit 6 Why Do Buyers and Sellers Use C2C Websites?



Source: iResearch, Shanghai: China C2C Ecommerce Research Report 2005.

Exhibit 7 User Satisfaction Taobao and eBay (2004)

(in percent)	Taobao	eBay
Very satisfied	24.3	10.9
Satisfied	52.2	51.5
So so	21.4	31.3
Not satisfied	2.1	6.3

Source: Company documents.

Exhibit 8 Market Shares of C2C Marketplaces—by Gross Merchandise Volume (GMV)

(in percentage)	2002	2003	2004	2005	2006	2007
Taobao		7.8	29	59	65	84
eBay (TOM Eachnet) ^a	85	72.4	65	36	26	7
PaiPai					4	9
Others	15	19.8	6	5	5	0

Source: Company documents.

^aTOM Eachnet was a joint venture between eBay and TOM Online, established in December 2006.

Exhibit 9 Growth of Online Shopping Sites

	2002	2003	2004	2005	2006	2007
All Online Shopping Sites						
Registered users (millions)	8.4	15.2	22.4	32.5	43.1	55.0
GMV (RMB billion)	1.3	1.9	5.1	15.7	25.8	56.1

Source: Company documents.

Exhibit 10 Popular Products on Taobao

	2006	2007
Most popular products		
Rank #1	Mobile handsets	Clothes
Rank #2	Notebooks	Mobile handsets
Rank #3	Clothes	Cosmetics
Rank #4	Cosmetics	Home products
Rank #5	Cameras	Home appliances
New products (%)	91	
Buy it now (%) ^a	99	
Transactions using Alipay (%)	86	

Source: iResearch China Online Shopping Research Report (2007–2008).

^a“Buy it now” refers to transactions in which sellers and buyers negotiate a price. The remaining transactions used auctions to determine prices

Endnotes

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⁸ Eric Auchard, "Rivals Taobao, eBay clash on whether free is best." CRN, 21 October 2005, at <http://www.crn.com.au/News/20610,rivals-taobao-ebay-clash-on-whether-free-is-best.aspx>.

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¹¹ Sherman So, "Tencent profit jumps on one-off gain," *The Standard*, 25 August 2005.