



Open Sesame? Or Could the Doors Slam Shut for Alibaba.com?

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In the tale "Ali Baba and the Forty Thieves," Ali Baba, a poor woodcutter, uses the magical phrase "Open, sesame" to gain access to the cave where the thieves have hidden their treasure. In a modern-day version of the story, Jack Ma, an entrepreneur who grew up in modest circumstances, also has a key to unlock riches. The difference, though, is that Ma is a real person and his portal to wealth isn't a cave but the Internet. Ma is founder, chairman and CEO of Alibaba.com, a China-based e-commerce company that has established a global reputation as a major player in bringing buyers and sellers together in cyberspace.

Ma, a former schoolteacher, and 17 colleagues launched the company in 1999 from an apartment in Hangzhou, which is south of Shanghai in eastern China. Since that time, Alibaba has grown into three online marketplaces serving the business-to-business, business-to-consumer and consumer-to-consumer segments. Alibaba has a solid reputation in China, where it is a household name and Ma is something of a business hero.



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Faculty members at Wharton and other researchers and analysts around the world who follow Alibaba say the company has done an exemplary job at using its knowledge of China to grow its businesses there. The question is whether Ma, in the months and years to come, can expand his business in other countries while at the same time increasing his share of the intra-China B2B market being fueled by exploding domestic economic growth. Ma and his management team also are engaged in a showdown with global online auction leader eBay for preeminence in the large and growing C2C space in China, where there are an estimated 100 million Internet users.

Right now, Alibaba's sites display information about businesses and products that bring buyers and sellers together. In business jargon, Alibaba acts as an "aggregator" that serves as a go-between, according to Alberto Luiz Albertin, professor at the Getulio Vargas Foundation's Business school in São Paulo, Brazil. But the sites are largely free of charge, and once users of the sites find each other, Alibaba does not finish the transaction; the users contact one another to do the deal. A central challenge for Ma is to become an online transaction service that takes a fee for each transaction it makes possible. Ma must adjust his business model to ensure that the company provides more value to customers than it does now and develops new sources of revenue, these experts say. This is especially critical if Alibaba decides to do an initial public offering. Many expected the company to offer shares to the public in 2004, but it did not do so.

"One of Alibaba's biggest strengths is that it's located in the middle of one of the world's largest collections of factories, near hundreds of thousands of suppliers," says Wharton operations professor [Ravi Aron](#). "And being able to speak the language and understand the culture is very, very valuable. It's by no means an insignificant strategic asset. That said, other companies can come in and beat Alibaba at its game."

"It's too early to claim success," says Francesco D. Sandulli, head of the Internet business management

department of the Complutense University of Madrid. "On numerous occasions, Ma has had to defend himself against charges that his business model is fragile."

According to Wharton management professor [Marshall Meyer](#), "the question is whether the business model is sustainable. No doubt Jack Ma has accomplished a lot, but what Alibaba does going forward, who can tell?"

A Focus on Small Firms

Alibaba has three businesses, each of which has a distinct target market and portal. Alibaba International (www.alibaba.com) is an English-language website that facilitates business transactions between small- and medium-size enterprises (SMEs) in China with businesses worldwide. It has one million registered users in more than 200 countries. Alibaba China (www.china.alibaba.com) is a Chinese-language site that focuses on buying and selling among small- and mid-size businesses in China. It has more than five million registered users. Alibaba China's subscription fee includes authentication and verification, by a third-party credit agency, of the member's identity. The third business, TaoBao (www.taobao.com), is China's most popular C2C site and is the business that is in direct competition with eBay within China. TaoBao means "treasure hunt."

Alibaba has been successful because it recognized it could fill a gaping market need: China has virtually no printed directories or electronic databases that allow companies to describe their products and help buyers and sellers find one another while providing a certain level of comfort that the firms are on the up and up. Moreover, Alibaba focuses on mom-and-pop businesses in China, of which there are untold numbers, rather than trying to facilitate transactions between multinationals, which often have their own web-based systems for dealing with suppliers, and other big companies.

Alibaba "offered a platform where China manufacturers can reach world exporters and vice versa," says Safa Rashtchy, an e-commerce analyst with the investment firm Piper Jaffray. "It's a pretty inefficient system [in China] right now. The company figured if it signed up all the manufacturers in China and carefully listed their products and made them available to the U.S., Europe or wherever, it could extract good revenue. That's what they're doing." Rashtchy credits Ma with achieving success in an underdeveloped economic environment. "He's a highly determined man."

Yuxin Chen, a marketing professor at New York University's Stern School of Business, says Alibaba's major advantage is that it is located in a country that has emerged as the "manufacturing base for the world. Most companies in China doing exporting are not big companies. So for them, Alibaba provides a good platform." In addition, Chen likes the synergy provided by Alibaba's three portals. "Those [small-business] sellers who use Alibaba will also use Taobao," in much the same way that small-business owners who use eBay to sell goods may also buy and sell items as consumers on eBay.

Generally, access to Alibaba's portals comes free of charge. But users also can sign up for "premium" content. For companies using Alibaba International, there is an annual subscription charge of \$5,000 to \$8,000. For companies using Alibaba China, the cost is \$300 a year. Generally, companies that sign up for "premium" content can provide more details about the products they offer, obtain personalized web pages, authorize payments, and get preferential positioning on the portal. Alibaba offers a secure-payment service called AliPay, which is similar to eBay's PayPal and Moddo's ModdoCash.

Buyers and sellers using Alibaba's websites engaged in about \$5 billion in trade in 2004, according to the company. Alibaba, which employs 2,000 people in China, the United States and Europe, is the only import-export marketplace named "Best of the Web" five years in a row by *Forbes* magazine. The company had \$68 million in cash revenues in 2004.

In Search of Revenue

But the company knows it must continue to innovate. "Currently, Alibaba's management is considering new sources of revenue," says Sandulli. "They may begin to charge commissions for their AliPay service. They may also launch a new service that allows Chinese customers to search for offers using keywords. They are also starting to consider ways to increase their advertising revenues."

Wharton's Aron says obtaining new sources of revenue will be pivotal for Alibaba going forward because of some inherent shortcomings in its B2B business model. Typically, firms like Alibaba have primary revenue streams (derived from charging customers for value-added services); secondary streams (subscription fees and listing fees); and tertiary revenue streams (advertising and fees for providing links to other sites).

"Most of the B2B companies that went under in the U.S. [when the Internet bubble burst in 2000] did so because the revenue stream was tertiary, which is easily lost," Aron explains. "The problem with SMEs is that, by their nature, you're restricted to making money off commissions and advertising." Another shortcoming is that Alibaba at the moment offers none of the value-added services that major corporate buyers and sellers look for, such as the ability to track shipments from start to finish in real time -- known as "pick, pack and track" -- or manage invoicing or escrow accounts.

Major corporations -- in industries like chemicals, plastics or steel -- already have their own sophisticated procurement systems in place, which Alibaba cannot match. As things stand today, successful B2B models are not third-party B2B companies but private B2B markets owned and operated by companies like GE, IBM and Boeing, according to Aron.

"The Chinese B2B market is immature," notes Aron. "It is indeed the world's low-cost manufacturing destination of choice, but that does not mean it is very sophisticated in its ability to handle information. Chinese suppliers of most goods have fairly primitive information systems. So I don't worry about third-party B2B companies going to China and knocking Alibaba off the table. A shallow portal [like Alibaba] does not support value-added services. But if Alibaba can get significant traction in vertical companies, then it may be able to stand up to the behemoths of the West."

Sandulli in Madrid echoes Aron's view. "One of the problems Alibaba faces is its horizontal quality. It is involved in too many sectors, and it loses the ability to adapt to them the way a vertical portal such as Moddo in Spain adapts in the footwear sector. Moddo offers services that are very close to the companies in its sector, and delivers much greater added value than Alibaba does. As a result, it has a more complete revenue model. For that reason, I think it will be easier for vertical global markets to achieve success than for markets that are more horizontal."

According to Sandulli, Alibaba's chief B2B competitors at present are Global Sources in China, IndiaMart in India, and ECEurope, which is focused on Asian business, despite its name. In addition, there are portals that offer classifications and directories, including Yahoo, as well as eBay's consumer business.

Sandulli also points out that although Alibaba has worldwide customers, the company cannot truly be considered a global portal. "Although suppliers from other countries such as India and Russia have joined this portal, most of the companies tend to be Chinese. For each European company in Alibaba, there are about three U.S. companies and eight Chinese companies. In other portals, such as ECEurope, the ratio of Chinese companies is not that high."

Jack Ma's View

In an interview with *Knowledge@Wharton*, Ma, a slightly built man who speaks fluent English, alternates between self-confidence and self-effacement. He is aware of both what Alibaba has accomplished so far and the potential pitfalls and opportunities ahead.

"Our B2B commerce site reflects our understanding of e-commerce in both China and the world," says Ma. "We created our own style. Just a couple of years ago, few people even recognized us as e-commerce, and now there are so many B2B sites in China that all identify with us. We seem to be viewed as the B2B standard, which I don't think is necessary. B2B has various formats, and there are many ways to establish a big marketplace to help mid- and small-sized companies succeed and make money. So B2B would exist even without us, but it would likely be a B2B different from Alibaba."

Ma adds that "it's impossible for Alibaba to be unchallengeable" and that "a lot of people are imitating us." He goes on to say that Alibaba is still a small company -- "a kindergarten kid at most." He says Alibaba's success "is due to our determination, but it's also accidental to some extent. We believe in ourselves and don't care how other people view us, but care how we view the world."

Alibaba's main domestic competitor in consumer e-commerce is EachNet, a Chinese-language site that predates Taobao and was acquired in 2003 by eBay, which is based in San Jose, Calif. eBay has said it will spend \$100 million to strengthen its presence in China in 2005. According to *Forbes*, eBay CEO Meg Whitman told analysts earlier this year that China is a "must win" and "is likely to be the defining measure of business success" on the Internet. Alibaba says that in the first quarter of 2005 it passed EachNet as China's largest consumer e-commerce site with \$120 million in gross merchandise volume, compared with EachNet's \$85 million to \$90 million. This advantage may not last long if eBay throws its considerable financial resources behind EachNet to further strengthen its position vis-à-vis Alibaba. eBay reported revenues of \$3.27 billion and net income of \$778.2 million for 2004. For the first quarter ended March 31, 2005, revenues were \$1.032 billion and net income was \$256.3 million.

EachNet may be an older company than Taobao but Ma says he does not believe that "the first-mover advantage is insurmountable. The followers can succeed if they are determined and have strong execution capabilities. In fact, EachNet was established five years before Taobao. So EachNet was the first mover. But in the end, it's the execution that counts the most."

Ma appears more concerned about competing against eBay globally than against EachNet domestically. "In terms of competitors worldwide, I think that only eBay has the understanding and the capability, while EachNet doesn't. By way of illustration, some people say dogs and wolves look alike, but they are different animals. A wolf would know a wolf. We know that eBay is a lot like us.... eBay also has realized that Alibaba is the only animal in the world that is just like itself. It's because we share the same understanding about the Internet, about interaction, about community, and about the establishment of an e-marketplace. But EachNet doesn't share such an understanding; it established only a website. So our beating EachNet doesn't mean we can beat eBay."

Going Public

Asked about an IPO, Ma responds: "We don't know when we will go public, but of course we embrace change. If we really are to go public, it could happen quickly, because we're ready for an IPO. But we don't have a detailed IPO plan; we're still very focused on our business. Secondly, our financial conditions are expanding very well, and very comfortably. We have a big cash reserve, which probably is at least equal to that of any other Internet company in China. And our cash profits are among the best, compared to any other Internet companies in China -- even including those that are already publicly traded. We have a lot of cash, and we have a lot of things to do. So we don't think that an IPO is the most important thing for us. We can still expand if we want to expand. But at present, there is not a single company we want to buy."

Rashtchy of Piper Jaffray agrees that there is no immediate need for Alibaba to go public and says he feels that Ma is being wise in biding his time. A company and its investors should wait until they achieve "good critical mass" before going public, Rashtchy says, adding that Google could have gone public several years before it finally did so in 2004. Doing an IPO also "creates expectations" that a company may or may not be ready to meet.

But Wharton's Meyer says Alibaba's decision not to do an IPO last year may be a sign that the company has much more work to do in convincing investors it can grow. The decision also is an indication that China, even with its burgeoning economy, is still a place where transparency is rare and accurate information about companies wishing to buy and sell on the Internet is hard to come by.

"It was clear they wanted to do an IPO last year but didn't," Meyer explains. "What does this tell you about Alibaba and China? This is a business that thrives in the vacant spaces, the interstices. It reminds you that China is still a developing economy, not a mature economy. Western society is full of information and the job is sorting it out. In China, it's exactly the opposite. Ma has come in and filled only part of the vacuum."

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