ALIBABA GROUP: FROM ONLINE TO O2O

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ABSTRACT

"One day I was in San Francisco in a coffee shop, and I was thinking Alibaba is a good name. And then a waitress came, and I said do you know about Alibaba? And she said yes. I said what do you know about Alibaba, and she said ‘Alibaba and 40 thieves’. And I said yes, this is the name! Then I went onto the street and found 30 people and asked them, ‘Do you know Alibaba?’ People from India, people from Germany, people from Tokyo and China… They all knew about Alibaba. Alibaba — open sesame. Alibaba is a kind, smart businessperson, and he helped the village. So…easy to spell, and globally known. Alibaba opens sesame for small-to medium-sized companies. We also registered the name Alimama, in case someone wants to marry us”

Jack Ma has built Alibaba over a decade from a simple B2B Web site for manufacturers to a global online empire. These days, Alibaba Group is an extremely powerful force of e-commerce in China; it is similar to the combination of Amazon and e-Bay in China today. Since its inception, it has developed leading businesses in consumer e-commerce, online payment, B2B marketplaces and cloud computing, reaching Internet users in more than 240 countries and regions. Alibaba Group consists of 25 business units and is focused on fostering the development of an open, collaborative and prosperous e-commerce ecosystem.

Chinese e-commerce giant Alibaba Group is now dipping its toes into O2O business. With the involvement of online payment, O2O (Online To Offline) is a new business mode combining the online shopping and the front line transactions. O2O Commerce is the use of online and mobile to drive offline local sales or redemption. More simply put, it is offline purchasing propelled by the web. Unlike B2C and C2C where purchase of goods is packed and delivered to the hands of consumers, the O2O consumers can still go to enjoy the service offline. In the case of Alibaba, customers are then able to browse retail stores and purchase goods by paying using Alipay Wallet, a third-party online payment platform, and receive the discounts associated with buying goods online.

Not only for Alibaba, but also for other e-commerce companies, O2O commerce is a trillion dollar opportunity to capture the market. In this new paradigm, Alibaba is now attempting to seize the opportunity of O2O business to sustain the leadership by leveraging its core-competence, Alipay.

The purpose of this report is to focus on how Alibaba can succeed in O2O environment with its competitive advantage, specifically in Chinese market. This report will also provide solutions to the strategic issue by identifying
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competitive advantages, and analyzing internal and external environment of Alibaba’s current O2O business followed by analyzing those of competitors’.

KEYWORDS: Powerful Force of E-Commerce, O2O Commerce, Leadership by Leveraging, Strategic Issue

INTRODUCTION

ALIBABA: FROM ONLINE TO O2O (ONLINE-TO-OFFLINE)

Alibaba Group

Company Overview

Alibaba is a Hangzhou-based e-commerce company, specializing in global trading and consumer online shopping. 18 people led by Jack Ma, a former English teacher from Hangzhou, China, established Alibaba Group in 1999. Alibaba Group has grown into a market leader of online commerce in Chinese market. Today the company has leading presence in e-commerce (B2B, B2C & C2C), third-party online payment system, and logistics. Alibaba Group consists of 25 business units and is focused on fostering the development of an open, collaborative and prosperous e-commerce ecosystem.

Major Businesses and Affiliated Entities

Alibaba Group and its affiliated entities now have more than 22,000 employees across some 70 cities and regions. Alibaba Group has diversified its efforts from e-commerce sites to mobile payment system, logistics, online traveling services, cloud services, digital platforms and etc (Exhibit 1). Accroding to Alibaba’s IPO filing (Exhibit 2), 86% of its revenue comes from China commerce (Tmall and TaoBao), and 8.8% from international commerce (Alibaba.com).

Alibaba.com is the primary company of Alibaba Group, Launched in 1999. Alibaba.com is a B2B site, which links foreign companies to Chinese manufacturers(Quartz, 2014).

Taobao founded in 2003, is a marketplace that connects small businesses and individual sellers to buyers. Taobao does not charge registration and comission fees to sellers, which attributed gaining marketshare against Amazon.com in the early stage of business. TaoBao’s revenue model relies on advertisement fee and support services for sellers. TaoBao currently holds a staggering 80% marketshare of China’s C2C market (Alibaba IPO filing, 2014).

Tmall.com Introduced in 2008 as an online retail platform to complement the Taobao C2C portal and became an independent business in 2011. As an open B2C platform, Tmall.com is marketplace for foreign brands, such as Nike, P&G and Apple. It’s revenue model is based on charging annual membership fee, commision fee on every transactions, advertisement, and support services to sellers. Tmall accounted for 51% of Chinas B2C online sales in 2013 (Alibaba IPO filing, 2014).

Alipay launched in 2004, Alipay is a third-party online payment platform. It was launched as a solution for trust issue between sellers and buyers of TaoBao. With the shift to mobile environment, Alipay expanded its business from third-party online payment platform to mobile payment systems. Alipay accounts for 41% marketshare in mobile payment systems (China Internet Watch, 2014). Due to its significance of being a ‘bank’ in China, Alibaba Group seperatedAlipay from Alibaba Group (Exhibit 1). Therefore, Alipay’s financial statements are not disclosed with Alibaba’s IPO filing. However, considering mobile payment market size in China and Alipay’s market share, its profits are presumably substantial.
Competitive Advantages

Expertise in Connecting Buyers and Sellers in e-commerce

Having experience in Chinese e-commerce market for over a decade, Alibaba built expertise in connecting buyers and sellers in e-commerce market. As a third-party intermediary, Alibaba has strong partnership with sellers and related businesses such as logistics companies. Also, Alibaba has been offering support services to sellers for enhancing their business. As a result, Alibaba not only has expertise in connecting buyers and sellers but has built up immense data on consumers - big data.

Economies of Scope & Scale

Alibaba’s business model is providing a platform, infrastructure, for online transactions. Therefore, it does not have any inventories, and with huge market share, Alibaba could reach economies of scale more substantially than its peers such as Amazon.com or JD.com. Also, Alibaba could reach economies of scope by sharing activities and its expertise in diversification. Their business specializes in online and mobile commerce. Alibaba shares activities and services such as Aliexpress (logistics), Alimama advertising division (advertising services for sellers), Alipay (payment system), and Information platform division (providing consumer data to sellers). Moreover, Alibaba leveraged its market share and core competencies to diversify into numerous businesses such as local deals division and group buying website (Juhuasuan.com).

2.3.3 Good Relationship with Chinese Government

Since Alibaba has built up infrastructure for online shopping, small business owners gained opportunities to sell their goods and services all over China, which boosted Chinese economy even more. As a result, Chinese government became favorable to Alibaba group. The company could also get some benefit from Chinese government - being able to launch Alipay which is similar to banking is an example of it. The government regulated overseas companies such as Amazon.com or Ebay, which might be one of the reason why Alibaba group could get successful nowadays. Considering economic politics in China, having good relationship with Chinese government is crucial factor to succeed in the market.

40% Profit Margin and the Biggest IPO Value

As a result, Alibaba has profit margin of 40%, which is higher than any of its peers (Exhibit 3). Recently, Alibaba decided to go public in U.S. stock market. Considering potential of Chinese market, consumer spending power and Alibaba’s success, it is estimated that the value of the company will be bigger than Facebook, which was the biggest IPO in history. Capital raise from the IPO, Alibaba can gain more market power by enhancing its existing business and further diversification.

When we investigated these competitive advantages in the view of Resource-based view, all has VRIN features. As following:

Chinese Market and Online-to-Offline (O2O)

In the past, the transaction in China was difficult and not effective, due to massive land size and expensive credit transfer fee within different districts. But thanks to the Internet, people were able to easily sell and buy products country-wide with less cost - online shopping was disruptive innovation even more for Chinese.
Particularly, mobile as a tool for business transaction has more market ripple effect in China. Most of accessible IT channel to Chinese consumer is mobile more than PC which costs more and has less portability. A research proves it; 81% of chinesenetizens access the internet via a mobile device. The fastest growing online activity amongst chinesenetizens is online shopping and the market size of mobile shopping and the number of mobile shoppers are increased by 169% and 160% respectively. Another reason why mobile has more ripple effect than wired internet is that wireless internet coverage is cheaper to install than wired internet coverage (LG 경제연구소, 2013). This led PC-based businesses going towards mobile and targeting smartphone users.

O2O stands for online to offline. In narrow sense, it means attracting consumers through mobile channels to offline shopping places. For offline businesses in the past, it was difficult to marketing their business because of huge population and large-sized land. Also, the rise of online shopping was a threat to offline businesses because of lower pricing of online shopping offerings. However, mobile is a complementary for offline businesses because it is a marketing channel for attracting customers due to smartphone’s mobility - location based services, offering incentives to customers. The real gold mine of O2O business is mobile payment through QR code. By attracting customers to offline stores, customers make payment with mobile wallet. As for offline business owners, mobile payment systems are cheaper alternative to credit card payment since it only requires printed QR code. Considering mobile payment system’s market growth and smartphone market penetration rate against credit card penetration (Exhibit 4), gaining momentum in O2O market will be a huge cash cow, and this is why O2O is important paradigm in China.

In a boarder sense, O2O represents enhancing offline shopping experiences with mobile devices. This is use of social media together to create more engaging shopping experiences (PWC, 2014), and use of mobile application for more convenient shopping experience. Examples of the latter are Walmart’s scan & go service which enables customers to check out faster, and TESCO’s Oculus which uses virtualreality(VR) technology.

An example of facilitating O2O into marketplace successfully in China is Taxi booking app, which connects passengers between drivers, is among the Top 10 downloading app in China. It is hard to get a cab especially in China, because few people own their car and the distance from point to point is long. But this app reduces passenger’s time wasting on the street while waiting taxi, and for driver, finding passengers. It makes both convenient also. Recently, some taxi booking app introduced new payment system cooperating with internet companies. So there is no need to pay in cash, just scan QR code with mobile which is linked to customer’s banking account and it allows the payment. Not only taxi booking app, there are numerous stores on online and offline introducing this system. Then, which company is providing this payment system? Alibaba and Tencent – top major internet companies in China. Now, let’s look at both companies’ business in O2O wave.

Internal Analysis; Alibaba’s O2O

So, why O2O is essential to Alibaba? O2O can be a great opportunity to Alibaba with rapidly changing business environment and customer’s buying pattern. Even better, Alibaba has an ‘Alipay’, the mobile wallet which has gained a trust from many users for a long time, which plays critical role in O2O.

To build a O2O platform, Alibaba have aggressively diversified into several businesses. Shared activities among them make a synergy. To categorize a few, Taobao, Tmall and Juhuasuan(Group buying site) are in e-commerce sector, Alipay(Online payment service), UCWeb, Weibo, Aliyun(Cloud service), Laiwang(Instant messaging app), AutoNavi and
Kuaide (Taxi hailing app) are in m-commerce sector and InTime (Department store operator) is in Offline sector. Among them, Taobao, InTime, AutoNavi and Alipay are main businesses which generate significant synergy. Alibaba also diversified into social media business to gain ‘marketing outlet’ for O2O (Exhibit 5).

Alibaba acquired InTime - department store chain - in 2014. InTime’s 35 stores started partnered with Alibaba on Nov 13, 2013. It encouraged the use of Alibaba’s mobile Taobao app to buy and send virtual gift card. Alipay is essential in that it allows Alipay app users to pay with their digital wallets in InTime department stores. It allows Tmall access to InTime’s offline inventory product database and InTime to access to Alibaba’s m-commerce experience. By this, Alibaba can use InTime’s physical department stores as order fulfillment hub for online orders. Also, InTime can connect to offline store shoppers through their smartphones and send them targeted promotions and membership benefits. This can be achieved through Alibaba’s strong customer base. Alibaba has accumulated a strong customer database for a long time through Taobao. They know about customer’s preference and geographic locations. By connecting these data to InTime’s member system, it will help improve the business intelligence of offline business and achieve accurate marketing by providing customized experience to users through location-based technology.

Also, AutoNavi offers location-based service and it is closely connected to Alibaba’s businesses. Map data is vital in that it can be a solid foundation in shared data system. For instance, suppliers on Alibaba’s e-commerce sites can advertise their offline locations to the app’s users. Also, by integrating with Alipay, it allows users to pay taxi fares through Alipay with a discount from Kuaide app which is their famous taxi hailing app.

**Competitor Analysis; Tencent’s O2O**

In the meantime, Alibaba is not the only one stepping towards the O2O strategy. Tencent, another huge Chinese IT company, also has been watching for a chance to succeed through O2O and now it has become not only a competitor but also a major threat to Alibaba.

Tencent, founded in 1998, first started with the instant messenger ‘QQ’. Starting from QQ, it kept on developing various free services in the fields of social networks, online games, contents, and e-commerce. For example, some of the representative services include WeChat (instant messaging application), QQ Game (online game portals), Qzone (social networking site similar to blog), and Paipai (online C2C auction site). (Tencent Holdings Limited, 2014) Tencent’s purpose was first to attract new users and generate interaction within the community. In fact, so far, Tencent’s corporate strategy was heavily focused on the ‘value-added services’ from the social networks and online games. Most of Tencent’s revenue (78% as of 1Q2014) was also generated from those two sectors (Exhibit 6).

However, recently, with the shift of e-commerce market to m-commerce and again to O2O, Tencent started to boost the development of their commerce business (Exhibit 7 & 8) It is aiming for the extention of business out to the level where Tencent can become a major part of consumer's overall lifestyle. That is, Tencent’s long term plan for sustainable growth is to be placed in the center of Chinese O2O ecosystem using its core competency in social networking service (Exhibit 9).

First, in order to enhance its commerce sector, Tencent formed a strategic alliance with JD.com. (Tencent Holdings Limited, 2014) Tencent was already well aware of that their pre-existing e-commerce website, Paipai, lacks its competitiveness in the current commerce market. So, it decided to hold hands of JD.com.
Following Tmall which has 59% of market share in Chinese online B2C market, JD.com is the second biggest player in e-commerce market with 27% of the market share. Most of all, it is well-known for its quality-delivery service. (Zhang, 2013) Unlike Alibaba which relies on third-party delivery services, JD.com operates its own system with 82 warehouses in 34 cities, 1,453 delivery stations in 460 cities and 18,005 professionally trained trade staffs. (Tracey Xiang, 2014)

Now, with JD.com as a great stepping stone, Tencent is aggressively moving to transfer its competitive advantage in mobile platform into the O2O ecosystem. Tencent’s plan for O2O is a major threat to Alibaba mainly because of its ‘great bargaining power over the consumers’, which comes from the considerable size of the WeChat user base.

In order for a company to implement O2O strategy successfully, it needs to fulfill two necessary components; 1) Payment system which can be shared throughout offline and online. 2) Marketing channel or platform which can be a connecting hub for online sellers, offline stores and consumers. Just like Alipay from Alibaba, Tencent is also equipped with payment system called ‘Tenpay’. However, where Tencent really excels at is the second component, marketing channel. WeChat has well above 355 million monthly active users, around 80% penetration rate of monthly visitors, and 50% market share by monthly effective browsing duration. (Steven Millward, 2014) This provides a sound basis for a marketing platform. Also, considering the characteristic of social networking services, its network effect yields a high switching cost to the customers and naturally it enhances Tencent’s bargaining power over the consumers.

To illustrate, Tencent has already been considering WeChat as a main platform where the O2O transaction first starts. It is providing services such as paying for the purchases from vending machines, taxi booking and movie tickets using Tenpay and all these are possible through its WeChat application. (Tencent Holding Limited, 2014)

STRATEGIC ISSUE AND SOLUTION

**Strategic Issue:** How can Alibaba Win in O2O Environment with Consistency Leveraging its Core Competency?

Alibaba and Tencent will not give up a significant battlefield, which is O2O, or online-to-offline commerce, a buzzword in e-commerce of China. These two companies are based on online and mobile, respectively, but O2O makes them to exclusively earn new money mine from directly connected offline with their partners. Even though they target a same field, their core competencies are little bit different. And they do their businesses with logical layouts based on their own competitive advantage, respectively. They are summarized as follows.

Tencent’s core competency, the best forte of Tencent, is a Social Media channel of user based foundation. WeChat is a platform which already has significant number of users, and it creates network effects among them, as well as switching cost not to move on to another platform. With such a consumer bargaining power, Tencent broadened its business layout leveraging its core competency, which is a highly influential marketing channel for O2O, creating bargaining power over suppliers as well. Currently, Tencent gained more momentum in O2O market due to it’s bargaining power over consumers and market power in mobile social networks. On the other hand, Alibaba is leverages its core competency in commerce which is consumer database - Alibaba’s acquisition of Intime. Limitation of this strategy is that it has less ripple effect that Tencent’s O2O strategy using WeChat as a platform. Intime is not a major department store chain, only having 36 stores in China (Young China Biz, 2014). Also, owning a department store chain might undermine Alibaba’s successful business model of being intermediary, and having no inventory & low overhead costs. Alibaba’s AutoNavi is also not exceptional because Tencent offers similar service using WeChat as a platform.
Here’s Alibaba turn out to be spotted. Alibaba does not have an absolute short board like a WeChat of Tencent which will combine all the businesses in one ground, creating huge bargaining power. That is, Alibaba has a lot of diversified businesses, which are individually connected to the payment method Alipay, but it does not have any clear something to bind them with a consistent logic. That’s a strategic issue: How can Alibaba win in O2O environment with consistency leveraging its core competency?

Solution

Creating a Social Media Platform Like WeChat of Tencent - Alibaba’s IM app Laiwang

Alibaba has been investing heavily to increase market share in IM (instant massaging) app. This could provide Alibaba with a constant platform, as well as O2O marketing channel like WeChat of Tencent. However, there has been no precedent where non-first mover in IM market gained leading market share because network effect and first mover advantage is substantial in IM market. Therefore, possibility of Alibaba gaining leading market share in IM app is very low, and economic benefit is also questionable. Moreover, IM is a social media field which is not Alibaba’s area of expertise - Alibaba could not leverage its core competency. Although increasing IM app’s market share could be complementary for Alibaba’s O2O business, this cannot be a core strategic path.

Developing Mobile Operating System

In order to create market power and switching costs for O2O and mobile platform, Alibaba has developed OS, Aliyun, Android based operating system. Alibaba attempted to launch the OS with Taiwanese manufacturer Acer in 2011 but Google blocked the device, accusing Alibaba of infringing on the Android OS and threatening to stop working with Acer (James Vincent, 2013). Instead, Alibaba has been developing Linux based mobile operating system and planning to release it this July. Precedent of e-commerce firm launching OS is Amazon.com, which was released in June 2014. Amazon already has a built certain expertise in OS from Kindle over the years. On the other hand, Alibaba has not. We will have to see how Alibaba’s OS release would be, but possibility of Aliyun gaining momentum in mobile market is low, and economic benefit is questionable. Moreover, it doesn’t seem like leveraging Alibaba’s core competency.

Leveraging Consumer Database - O2O Business Model for Intime

Alibaba connected Intime’s offline inventory product database with Alibaba’s customer database from Taobao for attracting targeted consumers. As for now, this business model is applied for Intime and partially for Alibaba’s incentive - promotion - offering apps that attracts consumers to offline stores. This is leveraging Alibaba’s core competency of it’s expertise in online shopping. Although it is very valuable resource, Alibaba has yet gained bargaining power, increasing switching costs, through this resource. Alibaba has been successful by offering a service package (advertisement, support services, consumer database and so on) to sellers from Tmall and Taobao. For O2O market, Alibaba also could develop a service package specializing in consumer data - which is like a portal system that enables offline business owners to manage inventories, online presence (online selling), effective promotion that targets right consumers and etc. By offering these valuable services, Alibaba can gain market power over suppliers, and should create another ‘closed-loop system’ as how Alibaba created ‘closed-system’ in e-commerce market. Limiting suppliers only to use Alipay as mobile payment system could do this. A difference of this strategy to Tencent’s O2O strategy is that Alibaba’s O2O strategy targets creating switching costs of suppliers’ whereas Tencent’s O2O strategy targets creating switching costs of buyers. Alibaba’s customer base is smaller than Tencent’s social media customer base. Therefore, Alibaba’s O2O strategy should target suppliers instead.
To emphasize, Alibaba’s O2O strategy goal should be building ‘data platform’, rather than ‘user platform’ like Tencent. Alibaba should develop a more engaging, omni-channel data platform that digitally connects sellers and buyers, enhancing shopping experience of customers. This, in turn, enables Alibaba offering significantly valuable services to offline business owners - creating switching cost of suppliers as a result. This strategy is possible, has economic benefits, and clearly leverages Alibaba’s core competency.

CONCLUSIONS

It is obvious that Alibaba Group has been the most successful and profitable company in China. As Alibaba Group announced its IPO recently, their total value became even much larger and grabbed the tremendous attention from the world. Nonetheless to say, the changes in China market was not a big problem for them; e-commerce market which could get growing through PC based transaction looks like giving away its position to m-commerce market which boosts its power recently with the development of smart phones. Alibaba Group focused on this change and so did competitors like Tencent. The rivalry became very fierce in mobile commerce market. Then the new challenge has arisen. As mobile commerce users increase, moves for O2O paradigm become more noticeable. Alibaba Group also faced these new changes in Chinese market and performed appropriate countermeasures. However, competitors including Tencent look like they also want to be successful with O2O system. Under this circumstance, Alibaba has to consider and decide how to outperform others. What we suggested as the best solution was that Alibaba can provide advantages for offline sellers such as providing customer information or marketing sellers’ business to the targeted customer segment. In that way, Alibaba would be able to sustain considerable numbers of sellers in the offline market and consumers would be ended up going to where the sellers are if they want to buy something. It will make synergy effect with Alibaba’s already-built online sellers’ community and help Alibaba dominate O2O paradigm.

This solution, however, could be the only short-term solution even though it is very important and unavoidable step to be successful in O2O strategy. Therefore, we would like to suggest here the long-term solution; this solution would be only able in case that short-term solution applied to the real business world appropriately. What we suggest is ‘Every Payment with Alipay’ system. Now Alibaba put considerable amount of effort to Aliyun mobile OS business to be completely dominance in m-commerce market. Then, when Aliyun make smart phones in the future, they can install Alipay system as the already built-in application. Next step is Alibaba cooperates with government or any organization and make them accept Alipay payment when people pay for their tax, rent, taxi ride, food, clothes and etc. If it becomes wide-spread and people use Alipay without any resistance and as a matter of course, it will become their habit and Chinese people will pay every daily life payment with Alipay. Now think about how this change in purchasing behaviors will make huge synergy effect when it combines with O2O stream. If Alibaba becomes successful and get enough numbers of consumers in O2O system, this ‘Every Payment with Alipay’ strategy will get rid of every other competitor and Alibaba would become the company that cannot be beat.

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