

Alibaba: Credibility Crisis

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ABSTRACT

For the past eight years, Alibaba has supported business growth throughout China and Has begun to expand beyond China's border aiming to become a leader in international markets. However, this path has not been easy. This case summarizes the challenges Alibaba Group has faced over the recent past, including global expansion, up-and-coming rivals, going public, and an emphasis on the accusations of counterfeiting. Alibaba's reactions to these challenges are discussed along with the company's outlook for the future.

Keywords: -----

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THEMES

E-commerce, product strategy, competition, global expansion, positioning, ethics, intellectual property, governmental regulation, and corporate reputation. The case is suitable for both undergraduate and graduate-level courses in marketing, specifically strategic marketing analysis, and in areas in which students are studying marketing strategy and marketing planning.

HISTORY OF ALIBABA

Jack Ma founded Alibaba Group in 1999. At the time, the company consisted of eighteen people. From its inception, Alibaba Group believed “the internet would level the playing field by enabling small enterprises to leverage innovation and technology to grow and compete more effectively in the domestic and global economies (Alibaba Group, 2010).” With this conviction underlying everything the company does, Alibaba Group has become a global leader in mobile and online commerce.

It began with what is currently known as 1688.com. This initial website helped small Chinese manufacturers, exporters, and entrepreneurs market goods internationally. Now, Alibaba Group and its subsidiaries operate prominent wholesale and retail online marketplaces as well as a variety of internet-based services including advertising and marketing services, electronic payment, cloud-based computing, and mobile solutions to name a few.

Ecommerce Websites

- *Taobao*. Launched in May, 2003, Taobao Marketplace has grown to be China’s largest shopping destination in terms of gross merchandise volume. The site offers shoppers hundreds of millions of products and service listings. This vast assortment, value, and convenience are why Chinese consumers view Taobao as their online shopping destination of choice. Additionally, from August, 2012 through July, 2014, the mobile Taobao App was the most popular mobile commerce app in China.

- *Alibaba*. Alibaba.com was the first business launched by Alibaba Group. The site has become the leading platform for global wholesale trade. Small businesses, typically manufacturers and distributors use the site to market their products to companies in other countries. The majority of the sellers are found in China and other manufacturing countries such as Thailand, India, Pakistan, and the United States.

- *TMall*. Alibaba Group wanted to create a platform dedicated to delivering a premium shopping experience and began TMall in April, 2008. The site aims to satisfy the needs of the growing market of sophisticated Chinese consumers who want to purchase top-quality brands. As of 2013, TMall was the largest brand and retail platform in China in terms of gross merchandise volume. A sizable number of international and Chinese brands and retailers have launched storefronts on the site.

- *AliExpress*. In 2010, Alibaba Group started AliExpress. The site is a global retail marketplace targeting consumers throughout the world. The site facilitates the purchase of goods direct from wholesalers and manufacturers located in China. Consumers are located in countries such as Russia, the United States, and Brazil and are attracted to AliExpress because of the wide variety of product offerings at very competitive prices.

MAIN COMPETITOR

Estimated to be worth one trillion dollars by 2016, the cross-border ecommerce market has become flooded with companies vying for a share. In 2014, the Chinese government began to promote ecommerce through tax relief programs and other policies. Many firms used this opportunity to create platforms that cater to shopper fears about the quality and safety of local goods.

According to iResearch, with a 53 percent market share, JD.com is the largest online direct sales company in China when measured by transaction volume during the second quarter of 2014 (Cecilia, 2015). With a theme of providing an enjoyable online retail experience, JD.com offers an extensive selection of authentic products at competitive prices delivered in a speedy and reliable manner. This competitive advantage is due to the company developing its own nationwide fulfillment infrastructure. JD.com possesses a network of 97 warehouses, 1,808 delivery stations, and 715 pickup stations. These stations, staffed by JD.com employees provide a last-mile delivery network supporting both the online marketplace and online direct sales. Due to their strong relationships with suppliers, JD.com's direct sales business has been very successful (JD.com, 2014).

JD.com's business has grown at a rapid rate with the number of products offered growing from 1.5 million stock keeping units (SKUs) in 2011 to 25.7 million at the end of 2013. As a technology driven company, JD.com has heavily invested in developing a highly scalable proprietary platform that will support its growth and enables the company to provide customers with value-added technology services.

EXPANSION

E-commerce in China accounts for 85 percent of Alibaba's revenue, while international business represents only seven percent (Cecilia, 2015). Alibaba plans to improve its e-commerce reach in rural areas of China to expand its domestic market share. With an estimated internet population of 800 million people by the end of 2015, Alibaba cannot ignore its home country in order to expand internationally. They plan to develop the domestic market by using established operating centers in rural areas to bring and promote agricultural products that will be commercialized online. However, even with the majority of its business located within China, Alibaba can see the potential growth associated with international expansion. Alibaba's current products and services were designed specifically to meet the needs of Chinese consumers. Additionally, China still presents a large untapped market. Alibaba has deliberately increased its global presence at a gradual pace understanding international markets have different sets of needs compared to the Chinese market.

In 2007, Alibaba opened a European office in Geneva to spearhead its expansion within Europe. The European continent represents an important international market for Alibaba in terms of active members. The company is using the establishment of offices overseas to build relationships and develop knowledge of the new potential markets (Alibaba Group, 2007).

Alibaba, in 2013, opened offices in the United States to strategically invest in U.S. companies. This was precipitated by Alibaba's strongest international competitors Amazon and eBay, both located in the United States. Several of the businesses Alibaba has invested in include e-commerce companies such as Shop Runner, but also include Kabam, Peel, Lyft, and Tango.

GOING PUBLIC

Rumors of an Alibaba public offering had circulated for several years, but became more serious in 2014. This was due to Alibaba, supported by Taobao, China's largest online shopping portal and largest business to consumer platform, posting over \$2.5 billion in revenue in the second quarter of 2014 (The Economist, 2015). This revenue was up 46 percent from the previous year (Luckerson, 2014). With this financial performance a norm for Alibaba, people questioned why the company wanted to go public and expose the business group to regulations that could restrict growth. Several advantages included (Kent, 2014):

- *Investor payback.* Alibaba needed to buy back a \$1 billion equity stake it had previously sold to Yahoo. Alibaba had committed to repay the funding as soon as possible and a public offering would provide the necessary funding for repayment.
- *Acquire Yahoo.* One of Alibaba's goals was to expand to the U.S. and North American market. The acquisition of Yahoo would leverage their brand in a market with little knowledge of the company.
- *Fill portfolio gap.* While Alibaba has been profitable in their current markets and industries, the company's growth potential is limited if their presence cannot be expanded in foreign and diverse markets.
- *Build brand awareness.* Alibaba's IPO and the months of media frenzy prior to the public offering, resulted in a significant amount of international publicity for the company.

With the possibility of the advantages above, Alibaba stock (BABA) was listed on the New York Stock Exchange. Closing at \$93.89 the first day, the IPO resulted in a market capitalization of almost \$220 billion; larger than Facebook, eBay, and Amazon (Ho and Kim, 2014). The IPO lived up to all of the hype. However, with such a strong beginning, it seemed almost impossible for the company's stock to maintain its initial position.

In 2015, almost six months after the IPO, BABA stock hit its lowest price, trading just above \$80 per share. Although Alibaba continued to report growing levels of sales and earnings, the stock continued to fluctuate and decrease. Several explanations include:

- *Unreasonable expectations.* In January, 2015, Alibaba's financial performance was, again, successful. However, while profits exceeded expectations, sales missed estimates at a time BABA was trading around \$100. This misstep resulted in more reasonable expectations and forecasts.
- *Growing competition.* As noted above, several competitors were "nipping at (Alibaba's) heels." JD.com went public last year and has consistently performed better in comparison to BABA stock.
- *More shareholders selling.* As Alibaba's stock price continues to fluctuate and the future share value seems uncertain, many investors are choosing to divest of their shares at a price that would still yield a significant capital gain.
- *Overextension.* Alibaba is expanding too rapidly. For example, the company currently owns major shares in a soccer team, a movie studio, and a mobile video game unit, among its traditional ventures, and is planning on entering the U.S. cloud market. While ambitious, this aggressive strategy could result in the company's resources being stretched too thinly.

- Pirating. Since its introduction, Alibaba has been criticized that most of its sites are harbors for counterfeit goods and services. This doubt in the minds of consumers and investors alike has a negative influence of stock performance. This case concentrates on this pirating concern and its implications.

While the IPO was successful in creating a large amount of wealth for a large number of people, the potential success of Alibaba and the wealth for investors remains uncertain.

THE PIRATING PROBLEM

The International Anti-Counterfeiting Coalition defines counterfeiting (also known as intellectual property theft) as a “crime that involves the manufacturing or distribution of goods under someone else’s name without their permission. They are generally made from lower quality components in an attempt to sell a cheap imitation of similar goods produced by brands consumers know and trust (Wong, 2015).” Counterfeit goods span multiple industries including goods such as apparel, music, software, medications, cigarettes, automobile and airplane parts, consumer goods, toys, and electronics.

Counterfeit goods are a problem for several reasons. First, the practice is illegal and the purchase of such goods supports a criminal activity. Secondly, counterfeit goods can pose a health and safety risk to consumers. Counterfeit goods are made with cheap, substandard, and sometimes dangerous components. Additionally, consumers are providing counterfeit merchants with personal information and are at a greater risk for identity theft and credit card fraud.

Most importantly, counterfeiting hurts legitimate companies which have invested significant time and financial resources in researching and developing products, as well as building a positive and trusted reputation for quality. Counterfeiters attempt to profit from using other companies’ trusted names. Such unfair competition results in lower wages, lost jobs, and as well as higher prices for consumers.

Unfortunately, it does not seem that the trafficking of counterfeit goods will slow in the near future. In 2013, the Department of Homeland Security seized counterfeit goods with a value of over \$1.7 billion (Young, 2015).

RECENT ACCUSATIONS

Two months after Alibaba’s IPO, a Chinese government agency accused the company of providing an online medium for manufacturers selling counterfeit goods. China’s State Administration for Industry and Commerce (SAIC) indicated that “Alibaba Group has long paid insufficient attention to the illegal business activities on Alibaba’s platforms (Young, 2015).” More recently, a U.S. clothing trade group accused Alibaba of tolerating fake goods on its Taobao e-commerce platform. This has led to a major credibility crisis. These accusations have tarnished Alibaba’s reputation and relationships with investors and the Chinese government. The accusations stipulated the following issues:

- Alibaba ignored the sale of fake cigarettes, alcohol, and branded handbags by vendors on its marketplace sites, as well as the sale of restricted weapons and other forbidden items.
- Staffers took bribes from merchants seeking to obtain advertising space and boost their search rankings.

- Alibaba ignored vendors that faked transactions to make sales volumes appear higher.
- The company demonstrated anticompetitive behavior by forbidding merchants to participate in rival sites' promotions.
- Company officials did nothing to stop merchants from employing unethical tactics such as false and misleading advertising.

Peter Luo, a portfolio manager at the U.S. asset management firm RS Investments, purchased Alibaba shares in the IPO last year and indicated he believed the accusations are a concern. He stated, "I think this dispute could pose a serious risk for Alibaba. It could change not only Alibaba's relationship with the government and regulators, but also the perception among consumers. If consumers lose confidence in Alibaba, its business will be affected (Wong, 2015)."

COUNTERFEIT GOODS IN PRACTICE

Alibaba has become a medium for manufacturers to sell counterfeit goods. With more than 1,000 brands represented on the company's website Taobao, U.S. sellers use Taobao to locate suppliers of counterfeit products and then use Amazon or EBay to reach domestic customers. Finding such a supplier on Taobao is easy and considered worth the risk due to the high profit margins on the goods. For example, a counterfeit Michael Kors mobile case costs \$4.38 each (including shipping) on Taobao and can be sold in the U.S. on Amazon for \$35. This represents an 87.5 percent profit margin so it is no wonder why counterfeit goods are so abundant in our world markets today.

ALIBABA'S RESPONSE

Alibaba has been willing to participate in the battle against counterfeit products. The company has spent over \$160 million in 2013 and 2014 to address the counterfeiting problem. However, the regulation of digital trade has become a game of "spinning plates." As soon as one vendor of counterfeit goods is blocked another forms to take its place. Alibaba conducts random checks using data-mining technology and offers an online complaint forum to regulate counterfeit practices (Alibaba Group, 2010).

REALISTIC EXPECTATIONS?

Two days after a Chinese government regulator accused Alibaba Group of enabling counterfeiters, the regulatory agency (SAIC) and Alibaba came together to cooperate in developing ways to guard against counterfeiting (Merced, 2015). Both entities believe that regulators of online platforms share a common interest in creating a safe shopping experience for consumers. Alibaba planned to hire 300 additional employees to form a counterfeiting task force to improve the policing of suspected counterfeiting sites. There is doubt Alibaba will be able to address the counterfeiting swiftly. The slow pace of improvements suggests Alibaba is either not capable of or interested in addressing the problem.

Another view would be that citizens in poorer countries do not have the financial capability to purchase top name-brand products anyway and that strict policing of counterfeit sites will yield little results.

ALIBABA'S FUTURE

In 2014, Alibaba recorded a strong financial year with a successful \$25 billion IPO accompanied by a 50 percent increase in the company's stock price. Alibaba sold \$8 billion of bonds and increased sales by 48 percent. In 2015, the company's revenue is expected to rise about 43 percent to around \$103.5 billion. Sales will continue to grow as Alibaba's online commerce sites such as Taobao and Tmall continue to develop.

Alibaba has recognized international expansion as a key area for the future. In 2013, the worldwide business-to-consumer e-commerce market was \$1.25 trillion. By 2017, the online market is projected to be around \$2.35 trillion. To take advantage of this projected growth, Alibaba has set up a global version of their successful marketplace Taobao. Additionally, the company has invested in several other technology companies such as Kabam, Peel, Lyft, ShopRunner, and Tango. With such success in 2014, one thing is certain; there are high expectations of Alibaba in the future.

QUESTIONS FOR DISCUSSION

1. What type of marketing strategy should Alibaba employ to succeed in the U.S. market?
2. What are some of the challenges Alibaba will face due to international growth?
3. How can Alibaba position its products in the market to effectively compete with international competitors?
4. What has been the major benefit to Alibaba as a result of their IPO in the U.S.?
5. How can Alibaba recuperate from its credibility crisis?
6. What would be an effective strategy that could be used in competing against counterfeit goods?
7. Are there methods that could be used to end counterfeiting of products?
8. What do you believe the future holds for Alibaba and why?

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