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ALIBABA: CREDIBILITY CRISIS

SYNOPSIS: 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 its challenges are discussed along with the company's outlook for the future.

THEMES: Ecommerce, product strategy, competition, global expansion, positioning, ethics, intellectual property, governmental regulation, corporate reputation

THE HISTORY OF ALIBABA

In 1999, Jack Ma founded Alibaba Group. 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." With this conviction behind everything they do, Alibaba Group has become a global leader in mobile and online ecommerce.

It all started with what is currently known as 1688.com. This website helped small Chinese manufacturers, exporters and entrepreneurs sell 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. This site offers shoppers with hundreds of millions of products and service listings. This assortment, the value and convenience are the reasons why Chinese consumers see Taobao as their online shopping destination of choice. Additionally, from August 2012-July 2014the Mobile Taobao App was the most popular mobile commerce app in China.

- *Alibaba*. The first business launched by Alibaba group was Alibaba.com. It has become the leading platform for global wholesale trade. Small businesses, typically manufacturers and distributors, use it to sell 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 so it launched Tmall.com in April 2008. This 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 this site.

- *AliExpress.* In 2010, Alibaba Group launched AliExpress. It is a global retail marketplace that targets consumers across the world. The site facilitates the purchase of goods direct from wholesalers and manufacturers located in China. The consumers are located in countries like Russia, the United States and Brazil and flock to AliExpress because the sellers can offer a wide variety of products at very competitive prices.

EXPANSION

China's e-commerce counts for 85% of Alibaba's revenue, while their current international revenue only counts for 7%. Alibaba is aiming to improve the e-commerce reach in rural areas of China to expand its domestic market share. With an estimated internet population of 800 million in 2015, Alibaba cannot ignore its home country to expand internationally. They plan to achieve this by using established operating centers in those areas to bring and promote products such as agricultural to be commercialized online. But even with the majority of its business being located within China, Alibaba sees the potential growth that could happen due to international expansion. Alibaba has deliberately increased its global market presence at a gradual pace, because it understand that international markets have a different set of needs from the Chinese market and its current services and products were designed specifically to meet the needs of the Chinese people and its own country still has a large untapped market.

In 2007, Alibaba opened a European office in Geneva to spearhead its expansion within Europe. The European continent is the most 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 markets. This information will be used to create services that will assist the market's SMEs become more competitive on a global scale.

In 2013, Alibaba opened offices in the U.S. to strategically invest in U.S. companies. Its strongest international competitors, Amazon and eBay, are both located in the United States which was one of the motives behind this action. Some of the companies they have invested in include e-commerce companies such as ShopRunner, but also include companies such as Kabam, Peel, Lyft, and Tango.

RIVALS

Estimated to be worth $1 trillion 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, at 53% market share JD.com Inc. is the largest online direct sales company in China when measured by transaction volume during the second quarter of 2014. With a belief in 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 speedy, reliable delivery is possible 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 which provide a last-mile delivery network that is staffed by JD.com employees who support both the online marketplace and online direct sales. Their direct sales business is successful due to their strong relationships with suppliers.

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 technology platform that will support its growth and enables them to provide customers with value-added technology services.

GOING PUBLIC

Rumors of Alibaba going public in the US had circulated for years, but picked up steam in early 2014. This steam was due to Alibaba, supported by having China's largest online shopping portal, Taobao, and China's biggest business to consumer platform, posting over $2.5 billion in revenue in the second quarter of 2014, up 46% from the previous year. With this amazing financial performance a norm for Alibaba and its business, people questioned why they wanted to go public and expose themselves to regulations that could restrict growth. While there are many speculated answers, some of the key theories included:

- *Investor Payback.* Alibaba needed to buy back a $1 billion equity stake it had previously sold to Yahoo. They had committed to repay the funding ASAP and a public offering would provide the funds needed for repayment.
- *Acquire Yahoo*. In general, Alibaba strongly desires to expand to the US and North American market. Acquiring Yahoo would leverage their brand in a market that knows nothing about them.
- *Fill Portfolio Gap*. While Alibaba has been effectively profitable in many of the markets and industries they currently occupy, their growth potential is limited if they cannot increase their presence in foreign and diverse markets.
- *Gain Some Currency*. With their audacious future plans for expansion, the IPO will in a sense give Alibaba their own currency and enabling them to attain those goals more efficiently.
- *Build Brand Awareness*. Alibaba's IPO, and the months of media frenzy circling it in the months prior, gained Alibaba a significant amount of international publicity.

With all these advantageous opportunities on the horizon via an IPO, Alibaba made a decision that would affect millions of people, and, most importantly, the size of their wallets.

On Friday, September 19, 2014 at 9:30 am, a new set of initials hit the New York Stock exchange: BABA. These four letters represented a new world record for the biggest IPO in history. The IPO raised $25 billion, eclipsing the previous record of $22.1 billion established by the Agricultural bank of China. Alibaba began trading at $68 a share (35% above IPO price) and closed for the day at $93.89, 38% higher than at the opening bell. By the end of the day, Alibaba's IPO gave them a market capitalization of roughly $219.8 billion, larger than Facebook, eBay, and Amazon. The IPO lived up to all of the hype it had created in the months beforehand, but with such a strong start, it seemed nearly impossible to maintain this level of stock growth.

On Tuesday, March 3, 2015, nearly six months after the IPO of Alibaba, BABA stock hit its lowest price, trading at just above $80. Although, Alibaba as a company continued to report stellar levels of sales and earnings growth, the stock price continued to fluctuate and decrease. Some core explanations include:

- *Unreasonable Expectations*. In January 2015, Alibaba's performance as a business was successful yet again. Even though profits beat expectations, sales missed estimates at a time when BABA was trading around $100. This misstep resulted in more reasonable expectations and forecasts.

- *Growing Competition.* As mentioned above, many companies are "nipping at (Alibaba's) heels." JD.com, one of those companies, also went public last year and has consistently performed better in comparison to BABA stock.
- *More Shareholders Selling.* As the stock continues to fluctuate and the future price seems uncertain, some investors are choosing to get out now, as the current price would still yield a profit.
- *Overextending Itself.* In other words, Alibaba may be expanding too quickly. For example, the group is currently involved in a soccer team, a movie studio, and a mobile video game unit among its traditional ventures and is looking to enter into the U.S. Cloud market. While ambitious, this aggressive mindset could stretch the company too thin.
- *"Pirate Problem."* Since its introduction, Alibaba has been dogged by claims 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 on stock performance. This case will concentrate on this concern and its implications.

While the IPO was successful in creating a great deal of wealth for a large amount of people, the potential wealth for investors and Alibaba as a company remains uncertain.

The Pirate Problem

According to the International Anti-Counterfeiting Coalition, counterfeiting, also known as Intellectual Property (IP) Theft, is 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". Counterfeit goods span across multiple industries. It includes everything from apparel, accessories, music, software, medications and cigarettes, to automobile and airplane parts, consumer goods, toys and electronics.

Counterfeit goods are a problem for a variety of reasons. First of all, it is illegal and its purchase supports an illegal activity. Secondly, these items are dangerous to consumers' health and safety, because consumers are not aware of where the goods originated from or how they were made. Counterfeit goods are usually made using cheap, standard, and sometimes dangerous components. Additionally, consumers who make purchases are providing counterfeit merchants with their information and are at great risk for identify theft and credit card fraud.

Most importantly, it hurts legitimate companies who have use substantial resources to become the well-known brands they are today. These companies have devoted significant time researching and developing products, as well as building a positive and trusted reputation for quality. According to the Angelo Young, "Counterfeiters in turn seek to profit unfairly off of another company's good name. The lost sales and profits that result from this unfair competition translates directly into lower wages and lost jobs, as well as higher prices for consumers".

The trafficking of counterfeit goods does not look as if it will slow down any time soon. In 2013, the Department of Homeland Security seized counterfeit goods valued over $1.7 billion at U.S borders. Globally, the trafficking of counterfeit goods is much larger and growing.

RECENT ACCUSATIONS

Two months after Alibaba became an IPO, a Chinese government agency accused Alibaba of becoming the medium by which manufacturers are selling counterfeit goods. China's State Administration for

Industry and Commerce (SAIC) stated, “Alibaba Group has long paid insufficient attention to the illegal business activities on Alibaba platforms”. More recently, the 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 hurt Alibaba’s reputation and relationship with investors, brands, and the government.

The accusations stipulated the following:

- 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 get advertising space and boost their search rankings
- Alibaba ignored vendors who faked transactions to make their sales volumes appear higher
- They showed anticompetitive behavior by forbidding merchants to participate in rival sites' promotions
- Worst of all, company officials did nothing to stop merchants from using unethical tactics such as false and misleading advertising

Peter Luo, a portfolio manager at U.S. asset-management firm RS Investments, bought Alibaba shares in the IPO last year and said he believed the accusations are a concern. He stated, “I think this dispute could pose a serious risk for Alibaba. It could damage 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.”

COUNTERFEIT GOODS IN PRACTICE

Alibaba has become a medium by which manufacturers sell counterfeit goods. More than 1,000 brands are represented on Alibaba’s website “Taobao.” U.S sellers of counterfeit goods use Alibaba to find suppliers of these goods and then, use Amazon or EBay to reach customers. Finding a counterfeit supplier on Alibaba is relatively simple and considered worth the risk by small vendors because counterfeit goods have a high profit margin. For example, a counterfeit Michael Kors mobile case costs $4.38 a piece (including shipping) on Alibaba and can be sold in the U.S. on amazon for $35. That is an 87.5% profit margin. It is no wonder why counterfeit goods are so abundant in our world today.

ALIBABA’S RESPONSE

Alibaba's stated that they are "willing to assume the responsibility of fighting fakes and [their] efforts are far from complete. [They] welcome additional supervision and greater efforts by law enforcement to crack down on fakes, because [they] are a victim and not a beneficiary of counterfeit items". The company further explained that they have spent more than $160 million during 2013 and 2014 battling counterfeits on its marketplaces, but regulating digital trade has become a game of whack-a-mole. As soon as one vendor is blocked another forms. Alibaba’s spokeswoman explained that currently the company conducts random checks using data-mining technology and offers an online complaint forum to regulate counterfeit practices. However, are those efforts proposed enough to regulate such a massive company?

REALISTIC EXPECTATIONS?

Two days after the Chinese government regulator accused Alibaba Group of enabling counterfeiters, SAIC and Alibaba made peace and discussed ways to cooperate in fighting against counterfeiting. Both the SAIC and Alibaba believe that regulators and online platforms share a common interest in creating an online shopping environment where consumers feel safe and satisfied and to promote the healthy development of online commerce industry. Alibaba plans to hire 300 employees to form an anti-counterfeiting task force to improve its policing of its sites. Although they achieved peace, Alibaba filed a formal complaint against the director of the SAIC for accusing them and using improper research methods.

Many doubt that Alibaba will be able to address this huge problem swiftly. The American Apparel and Footwear Association, in its letter to the U.S. trade representative stated, “The slow pace has convinced us that Alibaba is either not capable of or interested in addressing this problem.” They urged the regulator to increase scrutiny of Alibaba’s efforts to police Taobao for counterfeits, especially given the commitments made by the company during the lead up to its IPO.

However, some believe that the SAIC accusing Alibaba shows that we do not have to worry about the people who market fake and counterfeit goods. They reason that citizens of poor countries do not have the money to purchase top brand goods, therefore protection of said brands will not increase the IP holder’s wealth. As a country’s wealth rises, IP protection will follow. Although, the Chinese government is recognizing that IP is an increasingly important part of domestic Chinese production, the change will occur slowly as the country becomes rich enough for IP to be considered a necessity.

Alibaba's Future

In 2014, Alibaba recorded a strong year with a successful $25 billion IPO accompanied by a 50% increase in stock price from initial listed value. In addition, Alibaba sold $8 billion worth of bonds and increased sales by 48%. In 2015, their revenue is expected to rise 43% to around $103.5 billion.

Currently, Alibaba holds a dominant position in the Chinese e-commerce market with 80% market share. Sales will continue to grow as Alibaba's market places, such as Taobao and Tmall continue to develop. Plus, China plans to increase its internet penetration and number of internet users shopping online. In 2015, internet penetration is expected to increase from 50% to 54% leading to a rise in internet shoppers of 5% to 65%.

Alibaba has recognized international expansion as a key area of investment for the future. In 2013, the worldwide Business to Consumer e-commerce market was $1.251 trillion. In 2017, it is expected to climb to $2.357 trillion. In line with that forecast, Alibaba's international commerce revenues are projected to rise by 20% in 2015. However, results could be higher as effects of Alibaba’s new acquisitions and perfected strategies are felt.

Alibaba plans to set up a global version of their successful marketplace Taobao. In addition, they have invested in many other technology businesses such as Kabam, Peel, Lyft, ShopRunner, and Tango. Consequently, profitability may see a short term decrease due to the acquisition of these new businesses, an increase in marketing and promotional efforts, and investments in cloud computing, a mobile platform, and product development activities.

With all this success in 2014, one thing is certain: there are high expectations for Alibaba. The need to match performance to market expectations and manage their current counterfeit crisis or investors may lose interest. This is a pivotal point in Alibaba’s history. Only time will tell of their success with endure.

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