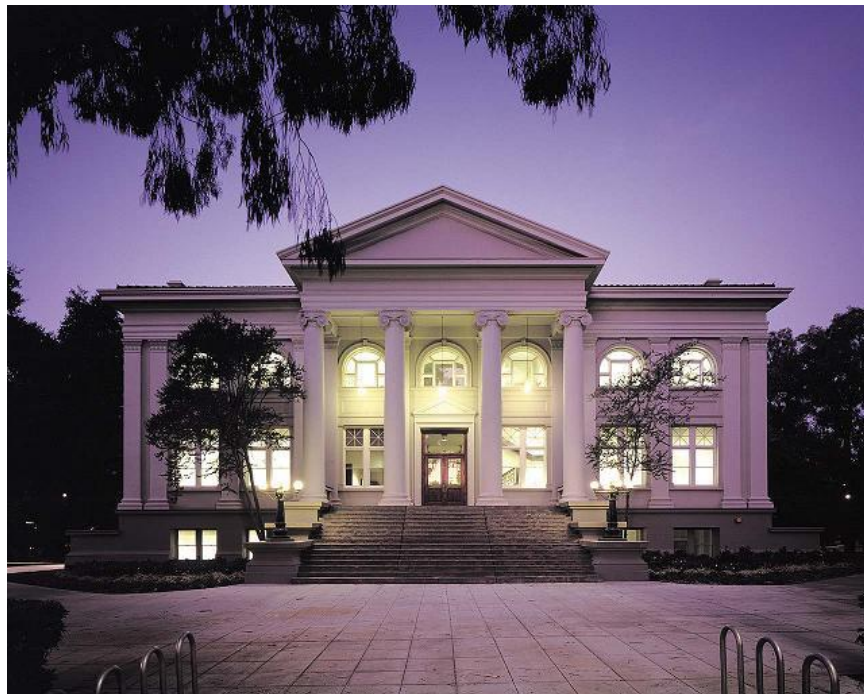


Alibaba

CLIENT REPORT

SONTAG SOLUTIONS



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Executive Summary

Alibaba Group is the dominant player in the Chinese ecommerce industry. Operating several sites across the ecommerce spectrum, the company has established itself as *the* Chinese online retailer. With the largest market share, high growth rates, and easy access to capital, Alibaba's primary goal is to decide how it should expand. Opportunities exist in both China and in Western markets. In China, the company should look to securing the necessary logistics and infrastructure to meet the demands of the emerging rural and middle classes. In the West, Alibaba should find partnerships in the B2B market and gradually establish itself as a major player in the US. Alibaba should leverage its size and financials to make aggressive acquisitions, but needs to limit its purchases to those which will most directly help grow its user base and expand revenue per user. The company is also faced with a movement to mobile ecommerce in China, and needs to generate a higher monetization rate for mobile sales to maintain its revenue growth.

Company Overview

Alibaba Group is a Chinese ecommerce company which provides a wide array of online and mobile services. The company was founded by Jack Ma in Hangzhou in 1999 as an online marketplace for business to buy from Chinese producers. Riding a wave growth in production and consumption, the company has since expanded to over 26,000 employees

worldwide and has vastly expanded its services. Alibaba is China's largest ecommerce company, with several sites having over one hundred million users. As of 2014, Alibaba handles more online business than other company in the world.¹ Alibaba released an initial public offering on the New York Stock Exchange on September 19, 2014. The offering was the largest in US history, with \$21.8 billion USD of capital raised.



Alibaba Group operates many sites, many of which are market leaders. These sites include:

Taobao.com (Launched in 2003): Taobao includes both C2C and B2C offerings in China. In 2013, the site was the number one online destination for C2C purchases².

¹ <http://projects.wsj.com/alibaba/>

² iResearch



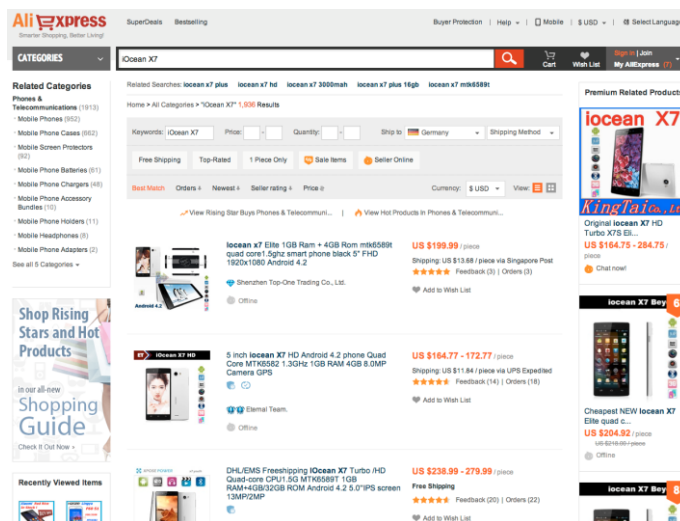
Tmall.com (2008): Tmall is a B2C marketplace which highlights branded products in their own uniquely customized storefronts. The site is currently Asia’s largest B2C website.



Jehusuan.com (2010): Jehusuan offers discounts on products by aggregating demand from many users. Purchases usually take place during ‘flash sales’. Products include apparel, accessories, electronics, and beauty/health products.



AliExpress.com (2010): AliExpress allows buyers from around the world to buy directly from wholesalers and manufacturers in China. The site operates in English, Russian, and Portuguese. Products range from apparel and accessories to electronics and sporting goods.



Alibaba is also a large shareholder in many other Chinese technology and media companies, including 17% of Youku Tudou, a publically Chinese Youtube-television service hybrid. Additionally, in March 2014, Alibaba took a controlling stake of ChinaVision Media Group (since renamed Alibaba Pictures), a television and film production company.³

Financial Highlights

Alibaba has experienced strong financial growth over the past decade. Additionally, the company does not have any immediate risk of not meeting short or long term obligations. The company's strengths come from large cash reserves, high profit margins, and low debt levels. This can be leveraged for aggressive expansion strategies.

Alibaba Group Holding Ltd.⁴	
Market Cap	¥1.3 Trillion RMB (\$209.6B USD)
P/E	46.9
EPS	¥11.90 RMB (\$1.92 USD)
ROA	8.67%
ROE	29.5%

Income Statement

³ http://dealbook.nytimes.com/2014/04/28/alibaba-buying-stake-in-youku-tudou-a-chinese-web-tv-company-for-1-2-billion/?_php=true&_type=blogs&r=0

⁴ Note that Alibaba Group Holding Ltd. (NYSE:BABA) is a different entity from Alibaba Group. BABA is a Variable Interest Entity which holds profit sharing contracts with Alibaba Group. This is set up to allow for foreign 'ownership' of Chinese internet firms

Alibaba Income⁵						
	2010	2011	2012	2013	2014	TTM
Revenue	5,558	6,417	20,025	34,517	52,504	70,810
Cost of revenue	931	1,260	6,554	9,719	13,369	21,171
Gross profit	4,627	5,157	13,471	24,798	39,135	49,639
Total operating expenses	3,199	3,340	8,456	14,047	14,215	23,652
Operating income	1,428	1,817	5,015	10,751	24,920	25,987
EBITDA	1,763	2,070	6,470	12,619	30,651	38,969
Net income	1,470	1,713	4,228	8,532	23,315	26,970
<i>Profit Margin</i>	<i>26%</i>	<i>27%</i>	<i>21%</i>	<i>25%</i>	<i>44%</i>	<i>38%</i>

Fiscal year ends in March. Amounts in millions CNY

In general, Alibaba's income statement displays the company's dramatic growth and profitability. Annual revenue expanded 56% between 2013 and 2014. Overall, the company grew at an annualized rate of 75% between 2010 and 2014. However, data from 2014 would suggest that revenue might be slowing. Quarterly earnings released in December 2014 report a 40% increase in revenue and a 25% increase in net income when compared to the previous year's quarter. With low variable costs, Alibaba has been able to scale quite well and grow its margins considerably. Operating costs as a percentage of income fell from 58% in 2010 to 27% in 2014. Additionally, net income grew 172% in 2014 giving the company a net margin of 44%.

Alibaba Revenue Breakdown				
	2013	2014	Growth	% of Rev
China				
Online Marketing				
Services	19,697	29,729	51%	59%
Commission	6,161	12,023	95%	24%
Wholesale Commerce	2,197	2,300	5%	5%
Other	1,112	1,080	-3%	2%

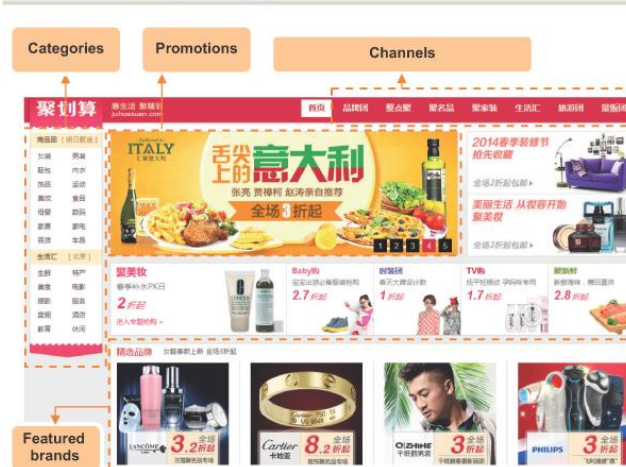
⁵ All Alibaba Financial Data Taken From Alibaba's IPO filing - SEC Form 424BC September 2014 and Alibaba December Quarter 2014 Earning Press Release

Total China	29,167	45,132	55%	90%
International				
Retail Commerce	392	938	139%	2%
Wholesale Commerce	3,768	3,913	4%	8%
Total International	4,160	4,851	17%	10%
Cloud Computing and Other	1,190	2,521	112%	5%
Total	34,517	52,504	52%	105%

Amounts in millions CNY

The company's revenue mostly comes from online marketing and services and commission in its Chinese businesses (83% of revenue). The largest growth from 2013 to 2014 occurred in international retail commerce, but the overall contribution to revenue was only 2%. The company's revenue stream largely comes from China and the largest absolute increases in revenue came from Chinese marketing services and commissions, which increased 10 billion and 6 billion RMB respectively in 2014. Marketing services consist of sellers paying Alibaba's sites to place ads in favorable search result placement, promotional spaces, or as featured brands.

Juhuasuan - Desktop homepage



Balance Sheet

Alibaba's has a very healthy balance sheet with over ¥133 billion RMB (\$21.5 billion USD) in cash and short term investments. The company's large income has been able to increase available cash despite high amounts of investment spending – usually in the form of acquisitions. Total debt has increased by almost ¥70 billion RMB since 2012, but the company still has a high current ratio and is not in any risk of missing any obligations. This means that the company will have the flexibility to both deploy capital and to make strategic purchases. The recent IPO in September 2014 helped increase the company's already growing capital reserves, raising over ¥150 billion RMB (about \$25 billion USD) in exchange for 15% of the company⁶.

Alibaba Ratios	
Current Ratio	2.7
Interest Coverage Ratio	13.8
Total Debt to Equity	0.5

Cash Flow

Alibaba's cash flow reflects the company's large returns and aggressive acquisition strategy. In 2014, the company bought or took minority stakes in many large companies across a range of online industries, with investment sizes ranging from \$15 million USD for a position in 1stdibs – a luxury ecommerce site – to \$1.22 billion USD for a 17%

⁶ Forbes

stake in Youku Tudou. Despite ¥48 billion RMB (\$7.7 billion USD) in investment spending for the nine months ending in Dec 2014, the company still was able to generate a ¥75 billion RMB net change in cash, largely thanks to its net income and the company's public offering. Alibaba's recent injection of capital should allow the company to pursue a variety of growth strategies.

Cash Flows - Nine Months Ending Dec. 31 2014	
Starting Cash	33,045
Cash From Operating Activities	35,450
Cash From Investing Activities	(47,782)
Cash from Financing Activities	86,462
Net Change in Cash	74,005
Ending Cash	107,050

Amounts in million CNY

Gross Merchandising Volume

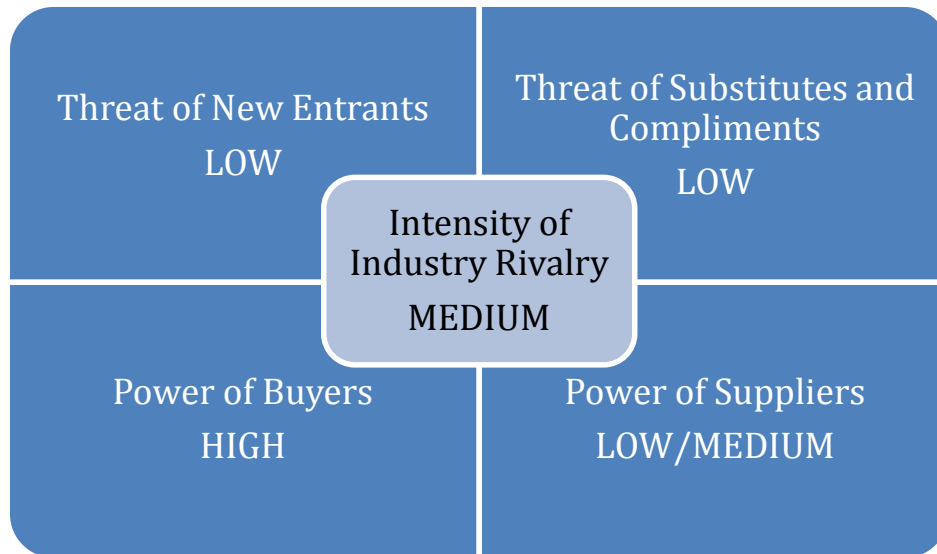
Another important metric for Alibaba is Gross Merchandising Volume (GMV). This indicates the size of total transactions that are facilitated through the company's marketplaces. GMV has grown significantly over the past several quarters. This increase indicates the growing usage of Alibaba to facilitate commerce.

GMV Growth⁷		
	GMV (billions RMB)	QoQ Growth
Dec-13	529	-

⁷ Alibaba December Quarter 2014 Results Investor Relations Presentation

Mar-14	430	-19%
Jun-14	501	17%
Sep-14	556	11%
Dec-14	787	42%
Average Quarterly Growth		10%
Annualized Growth Rate		48%

Competitive Analysis (5 Forces)



Threat of New Entrants - LOW:

The ecommerce marketplace industry does not generally have high barriers to entry. Capital requirements of maintaining a website and conducting commerce online are not particularly high. However, there are many factors restricting the ability of new firms to compete. Large-scale ecommerce requires a critical mass of buyers and sellers to draw in new customers and firms. Economies of scale mean that newer firms struggle to match

the pricing of larger marketplaces. Access to distribution channels can also be difficult for emerging firms, particularly in China, where infrastructure in many areas is still inadequate.

As the first mover in the Chinese market, Alibaba has enjoyed many benefits, such as quickly capturing a large share of online GMV, name recognition for new buyers/sellers, and trust within the Chinese market. The staying power of firms such as Amazon and eBay are good indicators of the difficulty of deposing ecommerce giants. Another factor in the Chinese market which might create obstacles for new firms is regulation. A new law announced in February of 2015 aims to enforce quality-assurance practices in the ecommerce industry, including registration of sellers and mandatory return policies⁸. These laws generally hurt smaller firms disproportionately, as they do not have access to the same resources (or at least not at the same price) to meet these requirements.

China does not allow foreign ownership of e-commerce firms. Instead, foreign firms must take part in a joint-venture with local firms to operate in China. This restricts profitability and control for outside competitors looking to enter the market. However, China has recently removed the restrictions on foreign ownership of e-commerce firms in the country's special economic zones⁹. If this trend continues, this barrier will diminish heavily or be removed all together. Yet, even if foreign firms find their way into the Chinese market, history would suggest that many natural barriers, such as the

⁸ <http://blogs.wsj.com/chinarealtime/2014/02/19/china-shines-regulatory-spotlight-on-e-commerce/>

⁹ <http://www.reuters.com/article/2015/01/14/china-ecommerce-idUSL3N0UT1PU20150114>

understanding of cultural norms or market practices, still exist. eBay's difficulty in the Chinese market, for example, eventually led to its exit in 2006. Amazon, another likely foreign entrant, has recently listed itself as a virtual store front on Tmall.com. This move might signify a way in which both firms could access Chinese consumers in a mutually profitable way.

Power of Buyers - HIGH:

Ecommerce buyers face few costs in switching platforms, and therefore are able to demand competitive pricing and a high quality of service. Many retailers maintain their own sites, and also sell in physical locations, which can act as a substitute for buyers who might otherwise purchase products through Tmall or Taobao. Additionally, competitors such as JD.com and Dangdang offer alternatives to many of the same goods. Pricing and convenience play a large role in consumer preference for e-commerce shopping. This keeps the market fairly competitive and keeps firms from being able to make large demands of their users.

Buyers do not make significant financial or social commitments when using an ecommerce platform, and switching between several platforms to fulfill different consumption habits is a viable practice. Since ecommerce marketplaces do not produce the goods themselves and do not possess exclusive selling rights, they have little to no power in negotiating with buyers as a whole. However, on the individual level, buyers have reduced bargaining power because of low individual impact on the total market.

Power of Suppliers – LOW/MEDIUM:

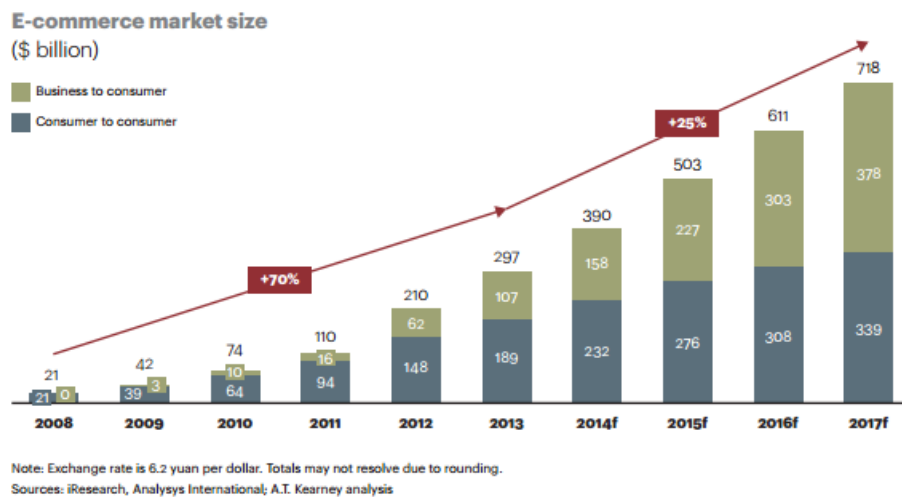
The bargaining power of sellers can vary with the size of the seller. Small suppliers often heavily rely on an ecommerce site's user base to generate traffic and can make up a significant percentage of revenue. In this way, sellers rely on firms like Alibaba to stay in business or grow. This allows ecommerce platforms to take large cuts from these companies.

As the demand for a particular product grows, however, the bargaining power of the supplier increases. Companies with particular brands that are in high demand (Apple or Louis Vuitton, for example), can offer their products for sale elsewhere online or in-store with little fear of losing out on sales. Since the marketplace for selling branded goods is competitive and sellers face low costs when looking for alternative outlets, larger sellers have higher leverage when negotiating with carriers of their products. However, after an ecommerce firm reaches a significant size, it can make up a significant portion of a brands exposure to the market. It can also begin to determine which goods consumers buy. With a large enough store that sells a wide array of products, buyers will begin to buy certain brands just because they are offered at the location (or site) they are already shopping at, and convenience trumps product differentiation. Walmart's access to buyers and its ability to make high demands of its suppliers demonstrates this effect.

Threat of Substitute Products/Services - LOW:

Alibaba’s offerings are heavily diversified across both product types and brands. Because of this, most substitute goods are also sold through one of the company’s sites. A common alternative to purchasing goods online is to purchase them in person at brick-and-mortar stores. However, the trends in China suggest that, as access to internet and infrastructure improve, more and more Chinese consumers are making the choice to shop online.

Online shopping will continue to grow in China, though more modestly



Intensity of Competitive Rivalry – MEDIUM:

Alibaba’s main competitor in the Chinese B2C market is JD.com, the largest direct online sales company in terms of transaction volume in the country¹⁰. JD.com is more similar to Amazon in its operations, which include the managing of warehouse inventories and shipping logistics. Traditionally, Alibaba’s business model has stayed away from inventories and logistics. This has created some differentiation between the revenues and

¹⁰ <http://www.cnbc.com/id/101688577>

expenses generated by each firm. However, recent developments seem to be pushing the two firms into more similar practices.¹¹ Alibaba and JD.com have been expanding the number of retailers who can sell their products on the site. Even if these two companies are largely vying for the same customer base, there should be adequate room in the market for two players.

SWOT Analysis



Strengths

¹¹ <http://qz.com/211959/alibaba-and-jd-com-are-battling-for-a-huge-emerging-market-poorer-inland-china/>

Growing Industry: A 2014 report by Forrester predicts that online retail spending in China will reach \$1 trillion USD by 2019. This would represent a \$560 billion increase compared to 2014 estimates (and a compounded average growth rate of 20%)¹². This means that Alibaba can continue to expect strong GMV growth over the next 5 years. This top line growth will also likely lead to increased margins, since the firm's cost of revenue is only about 25%. Currently, operating margin and net margin are 47% and 44% respectively.

The Chinese ecommerce industry can also expect to see a sizeable increase in users over the next few years, especially from rural areas. In 2015, based on a MiKinsey research report China Internet Watch estimated internet penetration in rural areas was only about 19% compared to 76% in top-tier cities. However, it also found that 60% of rural digital consumers used e-commerce. This has led to a growth rate in transaction volume almost 14% higher than in large cities¹³. With almost half of China's population still living in rural areas, growing infrastructure for internet and delivery will be needed to provide access to an immense new user base. Rural Chinese families are also experiencing faster income growth than that of their urban counterparts. A paper published in the Economics of Transition journal in 2012 found that market reform policies and development programs were leading to significant convergence between rural and urban areas of China¹⁴.

¹² <https://www.forrester.com/China+Online+Retail+Forecast+2014+To+2019/fulltext/-/E-res118544>

¹³ <http://www.chinainternetwatch.com/12535/rural-online-shoppers-60pct/>

¹⁴ Su and Chang 2012 <http://onlinelibrary.wiley.com/doi/10.1111/ecot.12012/pdf>

Size/Market Share: Alibaba has massive market share in Chinese C2C and B2C markets. Taobao currently holds about 95% of the C2C market while Tmall hold 57% of B2C¹⁵. The company also has about 86% of the country's mobile shopping market. This has given the company massive scalability. A large user base is also a vital component of ecommerce marketplaces. More users attract more sellers and more sellers attract more buyers, leading to a virtuous cycle. Alibaba's size advantage also opens up the ability to partner with large Chinese and international companies to obtain selling rights, new technology, and new products. The company's size also gives it brand recognition and trust with online shoppers. Because of its size and profitability, Alibaba has the resources necessary to maintain high quality standards and support for buyers and sellers.

Weaknesses

Over Exposure to Chinese Economy: Alibaba currently derives a vast majority of its revenues through Chinese commerce (retail and wholesale). Although the company has been making acquisitions in foreign countries, the percentage of revenue coming from China has increased from 78% in 2012 to 86% in 2014. Although that number dropped to 84% in December 2014, the company still maintains high exposure to Chinese markets.

China's GDP growth has been decelerating since 2010 and the IMF's latest projections show the economy growing at only 6.8% in 2015¹⁶. Additionally, debt has been building

¹⁵ <http://www.forbes.com/sites/greatspeculations/2014/12/02/heres-why-changing-market-dynamics-should-worry-alibabas-investors/>

¹⁶ <http://www.theguardian.com/business/2015/jan/20/imf-cuts-global-economic-growth-forecast>

up in the Chinese private sector. Investments flowing into the country over the past few decades have helped China drive its tremendous export growth. However, as the Chinese economy slows and exports fail to meet expectations, rising interest rates could provide liquidity problems that could further hinder Chinese buyers and sellers. A fall in Chinese consumer spending would be disastrous for Alibaba, whose growth is dependent on an increasing GMV. With so much of the market already secured, it is very unlikely that the company could make up any shortcomings by expanding its market share.

Opportunities

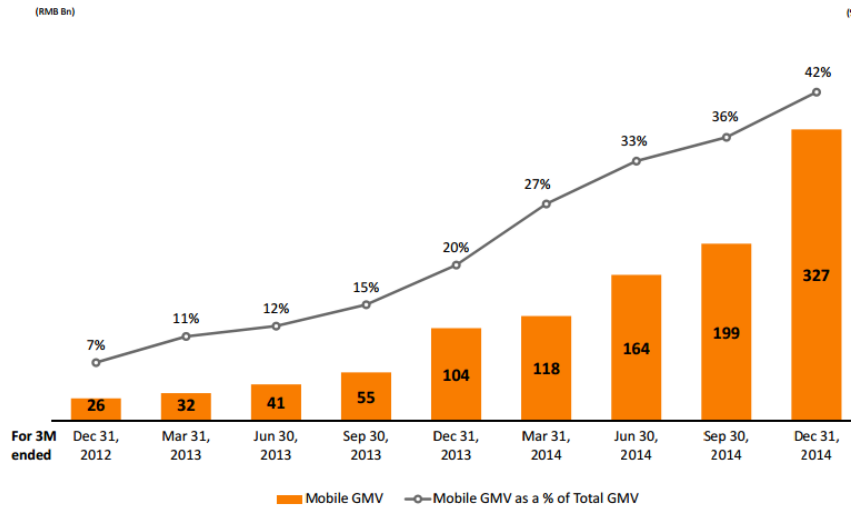
Mobilization of Mobile: Alibaba is currently a distant leader in Chinese mobile retail transactions. In 2014, approximately 86.1% of China's mobile retail GMV went through Alibaba's marketplaces, which have around 188 million monthly active users.¹⁷ However, growth in the mobile market is also steadily replacing Alibaba's non-mobile sales.

¹⁷ Alibaba's IPO filing - SEC Form 424BC September 2014

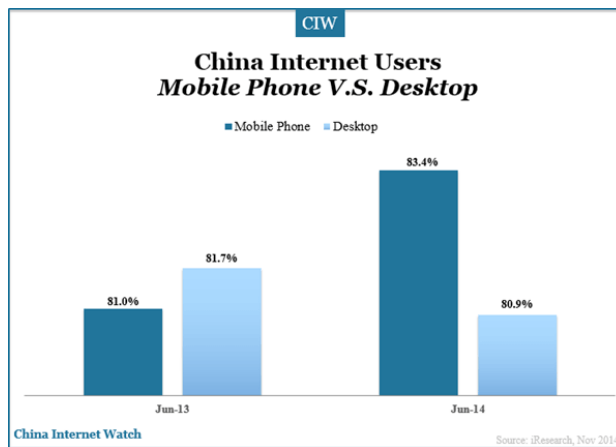
Mobile GMV Contribution



Quarterly Mobile GMV and Mobile Penetration (China Commerce Retail)



Mobile’s share of online GMV is increasing around the world including the United States, but it has grown particularly fast in China, where mobile’s share expanded 250% from 2013 – 2014¹⁸. The movement to mobile is not only in ecommerce, but is rather a product of the changing preferences of Chinese internet users.



¹⁸ <http://www.statista.com/statistics/298802/alibaba-gross-merchandise-volume-gmv-mobile-share/>

As mobile takes off, Alibaba will continue to see decreasing margins. This is because the mobile monetization rate for advertisements is much lower compared to ads on non-mobile devices. In 2014, the company reported \$27.8 billion RMB (\$4.5 billion USD) of revenue from online advertisements. This represents approximately 53% of total revenues. Additionally, in 2014, the mobile monetization rate was only about 1.5% compared to a non-mobile rate of 3%. As the company continues to move towards mobile transactions, they will likely see margins fall significantly. For example, if mobile's share of GMV increases to 60% by 2017, the company could see revenue growth drop by as much as 15%. However, a simple model can show that an increase of the mobile monetization rate from 1.5% to 2.5% by 2017 could lead to revenue growth about 10% higher than the current rate (Appendix I).

Capitalizing on Big Data: In addition to generating revenue through purchases, buyers can also provide huge value to Alibaba through their data. With a large consumer base, Alibaba has the opportunity to keep track of consumer spending habits and preferences. With 334 million annual active buyers, the company has a unique chance to have its fingers on the pulse of Chinese markets.

Expansion Outside of China: Although growth in the Chinese market might slow, Alibaba has the opportunity to capture large markets in other regions. With growing recognition outside of China and relationships with major brands, the company can take advantage of its size to push its way into other countries.

It may be difficult to go up against major established players in the B2C market such as Amazon in the US or Rakuten in Japan. However, Alibaba’s B2B sites face a more fractured market, where its economies of scale and economies of scope can provide it with a huge advantage. Ecommerce is projected to make up almost 9% of all global retail by 2018¹⁹. Despite Alibaba already capturing the largest market (China), the GMV of the other top nine are predicted to reach over \$1 trillion USD. About half of non-Chinese ecommerce GMV will be in the US.

Ecommerce in the United States is projected to make up 10% of all US retail sales by 2017, which represents a 10% compounded annual growth rate²⁰. Us digital advertisement spending is also set to increase from 28% of total advertisement spending to 35% by 2017. By then, online advertising will be about 75% larger in the United States than in China.



¹⁹ <http://www.emarketer.com/Article/Total-US-Ad-Spending-See-Largest-Increase-Since-2004/1010982>

²⁰

http://www.digitalstrategyconsulting.com/intelligence/2012/11/global_online_ad_revenue_to_re.php

If Alibaba is able to leverage its size and acquisition strategy to gain market share to take advantage of the inevitable move to online commerce in the US and other Western countries, it will be able to drastically expand its GMV and Revenue.

Threats

Regulation: There has recently been a new wave of regulatory enforcement aimed at the authentication of goods sold on Chinese ecommerce marketplaces. In early 2015, the Chinese government accused Alibaba of failing to curb the sale of fake goods, bribes, and other illegal goods and services traded through its sites.²¹ This highlights that the government, which had previously been very supportive of Alibaba's business, might become increasingly focused on regulating and overseeing ecommerce markets. An increase in regulatory oversight could not only decrease transactions on Alibaba's sites – and the revenues that go along with them – but also force the company to use their cash to make sure compliance is met. Alibaba stated that during 2013 and 2014, it spent ¥1 billion RMB (1.15% of revenue for those two years) removing as many as 90 million listings in an attempt to improve consumer protection.²²

Almost all access to the internet in China is through state-owned telecommunication operators under strict regulatory supervision from the Ministry of Industry and Information Technology of China. Connections to international gateway access are

²¹ WSJ <http://www.wsj.com/articles/chinas-saic-criticizes-alibaba-over-fake-goods-1422425378>

²² <http://www.usatoday.com/story/money/markets/2015/01/28/china-criticizes-alibaba/22452417/>

always under the control of the Chinese governments. Alibaba must be able to quickly and effectively respond to any new regulatory standards released by the government or else it will not be able to effectively maintain its sites – both domestic and foreign.

Infrastructure and Logistics Restrains: Alibaba's business relies heavily not only on China's internet infrastructure, but also its highway networks. Chinese highway systems aren't nearly as extensive as they are in the US, and it is particularly difficult to reach many rural areas in a timely and inexpensive manner. Many areas do have railway access, but it is usually used to support passengers rather than freight.²³

Warehouse space outside of large cities is also severely restrained. According to Reuters, some consultants estimate that Boston has more modern warehousing capabilities than all of China combined. Less than 20% of the country's warehouses are fully equipped with computerized tracking systems and are often lack the raised loading bays necessary for easy pickup and delivery. In fact, even with low wages in China, it can be more than double the cost to transport goods compared to the US in some cases.²⁴ The physical and financial strains brought about by poor logistical infrastructure not only increases costs for delivery, but can also serve as a bottleneck to impede growth.

An additional threat to Alibaba comes from competitors who are seeking to get in on the ground floor of new logistics and infrastructure projects in the country. Unlike Alibaba, competitors like JD.com run their own delivery services. During the third quarter of

²³ <http://www.bloomberg.com/bw/articles/2014-05-29/alibaba-and-chinas-shipping-problem>

²⁴ <http://www.reuters.com/article/2014/05/11/us-china-warehouse-idUSBREA4A0AT20140511>

2014, JD.com spend ¥2.2 billion RMB on expanding and improving its delivery service.²⁵ Controlling the pipeline that connects buyers with their purchased products can be a huge advantage. For example, during Chinese New Year, many delivery companies experience massive delays or even shut down entirely. This is because many of the couriers go home for the holiday, which leaves companies vastly understaffed. During Singles Day in 2014, buyers also noticed sizable issues with receiving their orders.²⁶ By directly controlling these delivery services, firms can better prepare for high-traffic delivery days and directly put their capital to work in improving delivery and storage efficiency. Alibaba currently contracts with third parties to ship products.²⁷ Without control over delivery, Alibaba might continue to suffer. Worse yet, competitors like JD.com might be able to establish market dominance in logistics and slowly choke out rivals like Alibaba.

Strategy Recommendations

Key Acquisitions

With large amounts of available capital, Alibaba should continue its aggressive acquisition strategy. The company should continue to focus on generating high levels of growth that will increase income in the short run while tending to investments that will

²⁵ <http://www.cctv-america.com/2015/02/16/chinese-e-commerce-companies-pushing-delivery-services-during-spring-festival>

²⁶ <http://www.nytimes.com/2014/11/12/technology/on-singles-day-in-china-a-push-to-improve-online-shoppings-slow-delivery.html>

²⁷

ensure that Alibaba's business will be sustainable in the long run. Acquisitions should be focused to two main areas:

1. Logistics and Infrastructure – As ecommerce grows in China, so too will the need to move large amounts of freight around the country in a highly precise way. The current infrastructure is inadequate to meet the growing needs of the industry. Controlling logistics is also important because it can prevent bottlenecks. Blockage in the delivery pipeline could slow delivery, driving consumers to buy goods at physical locations, and also increase costs for Alibaba. Acquiring almost 50% of China Smart Logistics Network was a good start²⁸, but the projected ¥15 Trillion RMB in necessary investments over the next 15 to 20 years²⁹ means that there is still plenty of moves to be made.

A good start would be picking up delivery services in areas that experience particularly high traffic during peak holiday times. This would enable Alibaba to have an advantage in delivering services on time and could also rent out time to other suppliers when demand is high. Additionally, investing in large warehouse projects in rural areas will provide for strong long term investments. As more development takes place in rural areas, demand will continue to grow to ship goods to less accessible areas. Controlling large distribution hubs located in between high-growth areas will allow Alibaba to capitalize on the expanding rural middle class. By renting out storage space to sellers, Alibaba can help reduce the negative effect that warehouse expansion can have on its margins.

2. Overseas Partnerships – having access to ecommerce in Europe and the US can help drive Alibaba's revenue growth. With large advertising budgets and established consumer spending,

²⁸ <http://techcrunch.com/2013/05/28/alibaba-csn/>

²⁹ <http://www.scmp.com/business/economy/article/1701443/provinces-plan-spend-us24t-boost-economy>

the United States can yield high returns for the company. However, the market is also highly saturated and firms such as Amazon and eBay provide large obstacles. Alibaba's competitive advantage is in international trade. In particular, Alibaba's B2B business is a good starting point for US entry. The B2B ecommerce market in the US is now twice as large as the B2C, and the market still has a ways to go in maturing.³⁰ While the industry is still going through growing pains in the US, Alibaba has the opportunity to put its experience, expertise, and user base to work in establishing itself as a major player. By picking up smaller regional firms and establishing partnerships in the US, Alibaba can ease its way into the market without too much direct confrontation with established ecommerce players.

Although India might also be seen as a lucrative market for future ecommerce expansion, the market is still far too small (\$10-20 billion USD by 2017)³¹ to provide Alibaba with meaningful growth in the short run. Political, infrastructural, and economic factors will likely keep India on the backburner for years to come, although it should still be considered in the long run.

Alibaba must also focus on avoiding the *wrong* kind of investments. With so much cash on hand, it's easy to get carried away writing checks, but spreading the company out among many (often non-core) business can derail Alibaba's focus and also restrict capital. Alibaba's investments in Youku Tudou and ChinaVision Media (\$1.2 billion and \$804 million USD respectively) are good examples of this. These businesses do not directly contribute to expanding Alibaba's business in a meaningful way. According to the chairman of Youku, Alibaba's investment is meant to "build an

³⁰ <http://www.forbes.com/sites/brianwalker/2014/05/06/why-e-commerce-still-isnt-clicking-with-b2b-executives/>

³¹ <http://www.pwc.in/assets/pdfs/publications/2014/evolution-of-e-commerce-in-india.pdf>

immersive cultural entertainment platform that integrates online and offline entertainment.”³² Yet, there is still a noticeable lack of a coherent tangible plan to leverage these investments. If Alibaba hopes to maintain high levels of growth, it should stick to leveraging its resources to grow its ecommerce revenues. Not only will it be able to maintain higher growth rates this way, it will also free up focus of the management to pursue other strategic objectives.

Mobile Monetization

Alibaba should not fight the trend towards mobile ecommerce. Mobile ecommerce services are in high demand, especially among Chinese consumers, and neglecting to meet this demand could drive users to use the services of Alibaba’s competitors. Since the commission rate for sales through mobile is the same as it is for non-mobile, mobile monetization will need to rise through increasing the charges for advertisements and pay-for-placement campaigns.

As mobile sales expand in China and internationally, Alibaba’s sellers will continue to gain an understanding of the importance of mobile to reach their target markets. Since advertisements serve extremely similar purposes on mobile and on desktops, the prices should eventually converge. The only barrier to obtaining the same revenue might come from an inability to show the same number (or size) of ads on a mobile screen. However, with fewer advertisements shown to the consumer at once, the value of each advertisement should be higher. Because of this Alibaba should be able to gradually

³² http://dealbook.nytimes.com/2014/04/28/alibaba-buying-stake-in-youku-tudou-a-chinese-web-tv-company-for-1-2-billion/?_php=true&_type=blogs&r=0

increase the price of advertisements on mobile over time. In addition, Alibaba should work to research the optimal style, positioning, and wording of advertisements to ensure that they will draw the user's attention. With a large percentage of Chinese consumers using their mobile devices to shop, top placement of a seller's products will be vital for brands to get through to their target market. Alibaba could also fund psychological studies to both uncover more information about mobile user habits and also use results to justify higher prices to sellers.

Develop Data Solutions

There are two ways in which Alibaba should use this information to expand its revenue:

1. Partner with sellers to provide user data to firms - In 2013 Mercedes-Benz utilized data provided by Alibaba's data management platform for an outside campaign for a new compact smart car. Mercedes was able to use this data to target particular buyers and reported a noticeable increase in traffic at launch³³. Alibaba should continue to seek out high-profile brands who could benefit from user consumer data and form partnerships to sell selected data.
2. Use data to promote Alibaba to potential new users – consumer preference data is extremely valuable. With its large consumer base, Alibaba has access to more data than its competitors. By targeting the preferences of consumers in certain demographics or geographic regions, Alibaba can deploy targeted advertising to individuals or groups that are not currently using Alibaba through search engines and

³³ Alibaba's IPO filing - SEC Form 424BC September 2014 p.199

social media. This data can also be helpful for understanding rural markets as they develop. With higher logistics costs to reach rural areas, it can be very valuable to know what consumers are most likely to want and when they are most likely to want it. This can help Alibaba prepare the necessary steps to store and ship certain types of goods to strategic locations. For example, if a particular region is known to purchase an unusually high volume of Nike basketball shoes during March, then Alibaba can maneuver resources to targeted hubs and warehouses for efficient and speedy deployment.

User data can also help Alibaba partner with US and other foreign firms. Many B2B transactions involve foreign (especially Chinese and southeast Asian) manufacturers. If Alibaba has exclusive data on the buyers or sellers in these markets, US firms are far more likely to take up partnerships to access this information (when prices are likely to change, which materials are selling best, which products are often sold as complements, etc.). This can help Alibaba penetrate US markets more quickly and with more support from businesses in the US.

Appendix

I. Income Model Showing Effects of Growing Mobile Monetization Rate

Assumes:

*gradually declining GMV growth rate

**diminishing growth in mobile as % of total GMV

***growth in non-mobile monetization³⁴

	2014	2015	2016	2017
*Growth Rate of GMV	47%	49%	45%	40%
Total GMV	2274.00	3388.26	4912.98	6878.17
Non-Mobile GMV	1956.00	1829.66	2210.84	2751.27
Mobile GMV	318.00	1558.60	2702.14	4126.90
**Mobile as % GMV	0.14	0.46	0.55	0.60
Total Commerce Revenue	50.49	78.27	127.00	178.83
Non-Mobile Revenue	48.90	54.89	72.96	96.29
Mobile Revenue	1.59	23.38	54.04	82.54
***Non-Mobile Monetization Rate	0.025	0.03	0.033	0.035
Mobile Monetization Rate	0.005	0.015	0.02	0.02
Revenue Growth	52.17%	55.02%	62.26%	40.81%
-With Growing Mobile Monetization-				
Mobile Monetization Rate	0.005	0.015	0.02	0.025
Total Commerce Revenue	50.49	78.27	127.00	199.47
Revenue Growth	52.17%	55.02%	62.26%	57.06%

-Excludes Cloud Computing and Other Non-Commerce Revenues-

³⁴ Alibaba December Quarter 2014 Results Presentation p.8