

## **The biggest shop in China**

### **Facebook's big, but Taobao could be the world's biggest unlisted dotcom**

For most unmarried folk in China, last year's Singles Day wasn't the most romantic of days. Since the emergence of shopping site Taobao, Singles Day (held annually on November 11 in observation of its four solitary digits: 11.11) has taken on a different meaning. On the day in question last year, 21 million people turned up at the Taobao Mall website to participate in its first '50% All-Out Sale', spending almost Rmb1 billion in 24 hours.

Traffic was so heavy that Taobao's online payment system temporarily froze.

If you haven't heard of Taobao, you should have. It is hands-down China's hottest internet property and is revolutionising the way Chinese shop.

Owned by the e-commerce firm Alibaba Group (the parent company of Alibaba.com, China's leading business-to-business e-commerce site) and Alipay (China's version of PayPal) Taobao now dominates online merchandise sales. Transactions on the site reached Rmb400 billion (\$60 billion) last year, almost doubling on 2009. To help put that in perspective, in 2010 total sales on Amazon.com were \$34.2 billion.

### **So how did Taobao get so big?**

When Taobao was founded in 2003, it looked puny. At the time, eBay and its Chinese partner EachNet controlled 90% of China's online shopping market. More importantly, eBay had much more experience, and a supportive global team. Alibaba, on the other hand, was a Chinese company that had done well in helping small companies find customers and suppliers. Outside China, few people had heard of it.

But Jack Ma, founder and chairman of Alibaba Group, feared eBay would make a play for Alibaba's customers. "Someday, eBay will come in our direction," he told InternetNews.com in 2004. So he decided to launch a competing consumer-to-consumer (C2C) auction site Taobao, which means "digging for treasures." Initially, it was less about making money and more to distract eBay from Alibaba's lucrative Chinese small business market.

What started out as a diversionary tactic soon became popular with the online audience. Unlike eBay, which made money from listing and transaction fees, Taobao did not charge customers directly. Instead, it made money from advertising. Executives at eBay openly ridiculed Ma's strategy, saying "free is not a business model". Others nicknamed him "Crazy Ma".

But Ma's understanding of the local market also came to pay dividends. Aware that most Chinese did not have credit cards, he introduced AliPay, an electronic payment system that keeps a purchaser's cash in escrow until the goods arrive. Since most Chinese users were unfamiliar with online auctions, the majority of Taobao's listings were also arranged as straightforward sales (only 10% of items were auctioned, compared to a much higher percentage at eBay). Taobao also built a huge forum for

consumer discussions, so that buyers and sellers could discuss questions in online in real-time.

Taobao quickly struck a chord with customers. Its market share of online consumer-to-consumer sales (for example, you could use it to sell your bike to another) jumped from 8% to 59% between 2003 and 2005. eBay China's slid from 79% to 36%, and the next year eBay pulled out of China altogether, citing dwindling market share and losses. Taobao now claims a 75% share in China's e-commerce market.

Home field advantage seems to have played an important part in Taobao's victory. Asked about the rivalry with eBay, Ma had this to say: "eBay may be a shark in the ocean, but I am a crocodile in the Yangtze River. If we fight in the ocean, we lose. But if we fight in the river, we win."

Taobao now claims that it has 700 million product listings online at any point in time. Apparel, cosmetics and handsets are the most popular categories, mostly because cutting out the cost of a physical retailer lowers the price of online goods substantially (often as much as a fifth cheaper, according to analysts). Unlike eBay, the site sells a much greater share of brand new goods, although secondhand items are available too.

Counterfeits, however, are still a big problem and Taobao has been criticised for contributing to a flourishing trade in pirated goods. It denies the accusation, saying it has a programme that is designed to crackdown on counterfeit sellers.

### **Now with 370 million registered users, how much bigger can Taobao get?**

The potential of the online retail market is vast. Even though Chinese internet users are embracing online shopping more than ever – last year market grew by more than 370% year-on-year, reaching Rmb520 billion – the internet accounts for a small portion of total retail sales (just 2% in 2009, according to a recent McKinsey report. The consulting firm predicts that online transactions will grow to roughly 7% of the overall market by 2013, closer to the US average).

"About two-thirds of Chinese [internet users] have been online for three years or less, and half for less than two. In the past, it has taken about three years for an internet user to become an online shopper," says McKinsey. "Assuming that this conversion continues, tens of millions of new e-commerce consumers could be just around the corner."

Taobao certainly believes so. In January, Ma told reporters that he expects daily order numbers on the Taobao site to rise to 20 million next year, compared with 8 million today. In less than 10 years, says Ma, Alibaba could even overtake the world's largest retailer Wal-Mart in sales if it grows at an annual rate of 10%.

Wishful thinking? Maybe. But a decade ago no one would have believed that Taobao would kick eBay out of the market in three years.

### **Changing more than shopping habits...**

Taobao's influence goes beyond shopping. Alipay, the online payments system, has also made it easier for millions of Chinese to make payments over the internet. It boasts 500 million users worldwide, and has replaced PayPal as the world's largest online payment company by registered users. In some Chinese cities people can use Alipay to pay their credit card and utility bills, says 21CN Business Herald.

Taobao is also one of China's largest job creators. As of the end of last year, Taobao helped generate 1.82 million direct employment opportunities, mostly among young people opening up new online stores. And for every direct job opportunity created on Taobao, 2.85 indirect jobs in related industries such as storage and logistics were also created, according to research by IDC.

That probably shouldn't come as a surprise, given that purchases on Taobao now make up more than 70% of domestic couriers' daily deliveries. The trend has led United Parcel Service, the US package delivery company, to move ahead with plans to establish a domestic service in China to tap the country's booming e-commerce market, says Beijing Business Today.

Fed up with the country's logistics system, Ma also announced last month that Alibaba Group is investing as much as \$4.6 billion to build its own network of warehouses across the country so that "in 10 years, we hope that anywhere in China you can buy a product online, and, at the slowest, it will get to your home in eight hours".

Alibaba plans to develop around 20 distribution centres close to major population centres like Beijing and Tianjin, the Yangtze River Delta in east China and the Pearl River Delta in the south. It plans to start out with floor space the size of 560 football fields, servicing everyone from logistics partners to Taobao sellers and other business-to-consumer websites, says Century Weekly.

Industry observers are supportive of the investment as local logistics companies are generally underdeveloped and lack the capacity to cope with the fast growth in e-commerce sales. Customers complain frequently about delays and patchy quality in delivery.

"Creating a network of warehouse facilities is a key tactic in our strategy to resolve the bottleneck facing the logistics industry in China," says Zhang Wei, a senior vice-president at the Alibaba Group.

### **What's next?**

Though it's hard to imagine many challengers seriously encroaching on Taobao's market in the near term, analysts do expect competition to intensify in future.

Tencent, China's largest internet company by registered users, is working to expand Paipai, its e-commerce arm, and Taobao will also have to fend off group-purchasing sites like Groupon, because they are competing for many of the same advertisers ([see WiC83](#)).

There's also the problem of Taobao Mall, the company's business-to-consumer platform. While Taobao enjoys a virtual monopoly in the consumer-to-consumer market, its business-to-consumer arm hasn't had quite the same success. A third of the B2C category counts as a weak performance by Taobao dominant standards.

That could spell trouble. Baidu, the country's leading search engine, launched a business-to-consumer website in October together with Rakuten, Japan's largest online shopping mall operator. In response Ma recently spent \$30 million on an advertising campaign to attract more users, and created a new domain for Taobao Mall (TMall.com) to better differentiate the brand.

But currently, the biggest question about Taobao is how much profit it is making. The company is not publicly traded and therefore does not disclose financial information. As mentioned, almost all of Taobao's Rmb40 billion in revenue comes from advertising (and not in commissions on the massive Rmb600 billion sales turnover on the site). Taobao says the advertising revenue is covering virtually all its operational costs.

Still, shareholders will be optimistic of stronger performance ahead and speculation is growing that the company may be thinking about an initial public offering. Taobao's chief financial officer Daniel Zhang shot down rumours on the topic recently but industry observers anticipate a 2011 IPO would value Taobao at \$20 billion. Yahoo will be rubbing its hands at the prospect (it owns 40% of Alibaba Group, see WiC79). Other potential investors will be hoping Taobao's phenomenal growth can continue.

Source: Week In China