

Question Paper
Integrated Case Studies - I (MB3J1): January 2009
Case Study* (100 Marks)

- This section consists of questions with serial number 1 - 5.
- Answer all questions.
- Marks are indicated against each question.

Read the case carefully and answer the following questions:

1. Till 2005, eBay EachNet was the leader in the Chinese e-commerce market, controlling more than half of it. But eBay EachNet soon lost its market leadership position to Taobao.com (Taobao). In this context, analyze the reasons that can be attributed to Taobao's edge over eBay. [<Answer>](#)
(20marks)
- 2.a. To enable people to trade with each other, Pierre Omidyar created a marketplace in September 1995 which was later called eBay. By mid 1997, eBay received one million page hits per week with 15,000 listings on a day making it one of the most visited sites on the Internet in the US. Discuss the growth strategies adopted by eBay in US. [<Answer>](#)
(15marks)
- b. eBay initially had some success in China but failed to live upto the expectations. In this light, discuss how eBay entered China and the strategies it adopted to revive itself and its slowing growth rate. (10marks)
3. A significant mistake made by the eBay team in China was its notion of applying its US business model in China. Discuss the business model of eBay in the US, its strengths and weaknesses. Also analyze how eBay tried to adapt its business model to increase its market share in China. [<Answer>](#)
(20marks)
4. The entry of large Multi National Companies (MNCs) into emerging economies was considered to be the end of local players in markets. With the evolution of new markets and the change in the mindset of the customer, local companies are more successful than before in keeping the MNCs at bay. Critically analyze this statement giving reasons for success/failure using relevant examples from the world of business. [<Answer>](#)
(15marks)
5. The concept of e-commerce was introduced in China only in 1993 and it took some time for it to catch on. But once it did, e-commerce in China grew at a frantic pace. In this regard, discuss the opportunities and road blocks of Chinese e-commerce market. [<Answer>](#)
(20marks)

eBay's Problems in China

*"We do not anticipate fading from China, we are very committed to the China market and we think the China market is going to be a very big market for m-commerce (mobile commerce) as well as e-commerce."*¹

– **Meg Whitman, President and CEO, eBay Inc, in 2006.**

"I think it's a question of recognizing that they were not achieving what they were hoping to, and finding a solution that offers them a better opportunity for the long term.... I think

* The case is prepared only for the purpose of examination and not to illustrate effective or ineffective performance of the company. The case contains factual information adapted to and combined with other information to enable analysis of the given topics.

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- ¹ “eBay CEO Whitman Says Company ‘Not Fading’ from China,” December 20, 2006.
 - ² Will Swarts, “eBay Partners with Tom Online in China,” www.smartmoney.com, December 19, 2006.
 - ³ JupiterResearch is a leading provider of information services to the IT and technology companies.
 - ⁴ eBay EachNet is a subsidiary of eBay Inc. in China. eBay Inc. (eBay) is the world’s largest online auction company and has around 233 million online auction users. The company had revenues of US\$ 6 billion in 2006. In addition to providing online auction markets, eBay also has an online payment service called PayPal and a communications business under Skype, which offers voice-over-Internet protocol (VoIP) services.
 - ⁵ TOM Online Inc. is a Chinese online portal and wireless Internet company. It was the media flagship of Hong Kong-based conglomerate Hutchison Whampoa, which had interests in Operating of ports, Retail, Property development, and Communications.
 - ⁶ Founded in August 1999 by Chinese entrepreneurs, Bo Shao and Haiyin Tan, EachNet had 3.5 million registered Internet users in 2002.
 - ⁷ Alipay is a division of one of the leading e-commerce companies, Alibaba.com, that allows individuals and businesses to send and receive payments online conveniently and securely. Alipay’s core service is an escrow service which solves the concerns related to settlement risk between buyer and seller. In this system, after a buyer commits himself/herself to an online transaction, his/her payment is held in an Alipay account until he receives the product ordered. After the product is received the buyer notifies Alipay and the payment is then forwarded on to the seller. As of December 2006, Alipay had 33 million registered users. (Source: “Alipay - 33 Million Registered Users,” www.imnewswatch.com, February 5, 2007)
 - ⁸ PayPal was a leading online payment company purchased by eBay in mid-2002. In June 2007, PayPal had 143 million user accounts across the world. Through PayPal, individuals and businesses could send or receive money over the Internet. PayPal supported payments in US Dollars, Canadian Dollars, Australian Dollars, Euros, Pounds Sterling, and Japanese Yen. Buyers could also pay for their online purchases on various e-commerce websites and auction sites like eBay using the balance in their PayPal account. Though this mode of transaction was quick, there were also a number of complaints from disgruntled PayPal users. Most of the complaints were related to the dispute resolution procedures of PayPal.
 - ⁹ In eBay China, transaction fees used to be charged as a percentage of the value of completed sales. This ranged from RMB 10 for a sale worth RMB 500 to RMB 115 for one worth RMB 20,000 (Source: “eBay China to Waive Transaction Fees amid Stiff Competition – Report,” www.forbes.com, January 19, 2006.)
 - ¹⁰ Yahoo! Inc. was founded by Jerry Yang and David Filo in January 1994 and was later incorporated in March 1995. It ranks second in the online advertising market, after Google Inc. The company’s revenues for 2007 were US\$ 6.7 billion.
 - ¹¹ Google, Inc. was co-founded by Sergey Brin and Larry Page in 1998. Google is the world’s most popular Internet search engine and has a diversified range of products such as E-mail, blogs, etc.
 - ¹² Founded in 2000, Baidu.com is the leading online search engine in China. The company’s revenues for 2006 were US\$ 107.3 million.
 - ¹³ Citigroup Inc., headquartered in New York City, New York, USA, is a leading financial services company.
 - ¹⁴ Ina Steiner, “Bad News for eBay in China,” www.auctionbytes.com, September 25, 2006.
 - ¹⁵ Plastic dessert holders bearing pictures of cartoon characters such as Spiderman and Snoopy.
 - ¹⁶ “Meg Muscles eBay Uptown,” www.pathfinder.com, June 5, 1999.
 - ¹⁷ “Celebrity Shopping Network: The Best Online Shopping Networks,” www.travel.syl.com, February 15, 2006.
 - ¹⁸ Griff, “The Way We Were,” www.pages.ebay.com, June 27, 2003.
 - ¹⁹ “Benchmark Capital,” www.fundinguniverse.com, 2000.
 - ²⁰ Earlier, Whitman had been General Manager, Pre School division of Hasbro Inc., a toy company (1997-98) and President and CEO at Florist’s Transworld Delivery, a floral products company (1995-96). She had also worked in various capacities at The Strite Rite Corporation (1992-95) and had been Senior VP for the Walt Disney Consumer Products division (1989-92).
 - ²¹ www.iship.com, provided shipping rates for Airborne Express, Federal Express, United Parcel Service, and the United States Postal Service.
 - ²² The B2B market size was expected to be between US\$ 2.7 trillion and US\$ 7.3 trillion by 2004, whereas B2C spending was pegged at around US\$ 184.5 billion by 2004. (Source: “eBay Taps Business to Business Boom,” CNET News.com, March 15, 2000.)
 - ²³ “eBay Launches Business Exchange,” www.investor.ebay.com, March 15, 2000.
 - ²⁴ Autotrader.com was launched in May 1998. The company had 1.5 million listings of used cars on its site in early 2000.
 - ²⁵ According to internetworldstats.com, as on September 30, 2005, the US was the largest market with 203 million Internet users followed by China with 103 million Internet users.
 - ²⁶ Shopping.com is a website that provides price comparison services for goods sold on the web. It was founded in 1998.
 - ²⁷ The China Internet Network Information Center (CNNIC) is the state network information center of China, founded as a non-profit organization in June 1997. The Computer Network Information Center of the Chinese Academy of Sciences runs CNNIC. CNNIC looks after everything related to the Internet in China like domain names registration, IP addresses, relevant researches, surveys and information services, and international liaison and policy research.
 - ²⁸ “CNNIC: 137 Million Internet Users in China,” www.imnewswatch.com, February 5, 2007.
 - ²⁹ “China Surpasses US in Internet Use,” www.forbes.com, March 31, 2006.
 - ³⁰ “China to Have More Internet Users Than US,” www.timesofindia.indiatimes.com, January 25, 2007.
 - ³¹ Giovanni Navarra, “The Future of Dissent: Hacking Chinese Censorship,” www.opendemocracy.net, December 20, 2005.
 - ³² “China E-commerce Profit Model Report, 2006-2007,” www.researchinChina.com, January 2007.
 - ³³ iResearch Consulting Group is a market research company based in China. It offers companies market research services related to e-commerce, Internet, online games, etc.
 - ³⁴ “China’s Baidu Says to Enter e-commerce Market,” www.reuters.com, October 18, 2007.
 - ³⁵ MII has the authority to regulate the software and communications industry and is accountable for the manufacture of electronic and information products. It is also responsible for information dissemination related to the Chinese economy.
 - ³⁶ C.E. Unterberg Towbin is an investment bank.
 - ³⁷ Will Swarts, “eBay Partners with Tom Online in China,” www.smartmoney.com, December 19, 2006.
 - ³⁸ A pictogram is a character that represents an object, a concept, or an activity through a picture.

*it's an indication of how complex and difficult China is. In most of the other countries where eBay has expanded, those have been pretty mature and stable economies. China is neither."*²

– **Patti Freeman Evans, Analyst, JupiterResearch³, in 2006.**

Ebay Changes its Strategy in China

- ³⁹ An ideogram is a character that represents an idea.
- ⁴⁰ Bill Powell and Jeffrey Ressler, "Why eBay Must Win In China," www.time.com, August 22, 2005.
- ⁴¹ Ling Liu, "Bidding Fierce for Chinese Online Buyers," www.sfgate.com, May 30, 2005.
- ⁴² Martyn Williams, "eBay Sees E-commerce Potential in China," www.thestandard.com, February 11, 2005
- ⁴³ Gross Merchandise Volume refers to the total value derived from closed listings in the online trading market.
- ⁴⁴ Ina Steiner, "Competitor Comments on eBay China Rumors," www.auctionbytes.com, November 08, 2006.
- ⁴⁵ Victoria Shannon, "eBay Returning to China," www.iht.com, June 21, 2007.
- ⁴⁶ Shaun Rein, "eBay's Tom Online Deal: Timely Lessons for Global Online Company Managers," www.seekingalpha.com, February 14, 2007.
- ⁴⁷ "eBay's Exit from China Opens the Door for News Corp.," www.seekingalpha.com, December 21, 2006.
- ⁴⁸ Bill Powell and Jeffrey Resner, "Why eBay Must Win in China," www.time.com, August 22, 2005.
- ⁴⁹ "Alibaba CEO Says Taobao Will Dominate China Online Auctions," www.forbes.com, May 20 2005.
- ⁵⁰ "Alipay - 33 Million Registered Users," www.imnewswatch.com, February 5, 2007.
- ⁵¹ Shuan Rein, "eBay's Tom Online Deal: Timely Lessons for Global Online Company Managers," www.seekingalpha.com, February 14, 2007.
- ⁵² The investment in Koubei.com was expected to give Alibaba a considerable exposure in the fastest growing e-commerce segments in China. With this deal, Alibaba would become a leading company in business-to-business, e-commerce, online payments, and community-based online listings.
- ⁵³ Ina Steiner, "Alibaba to Compete with eBay in Classifieds Market," www.auctionbytes.com, October 30, 2006.
- ⁵⁴ Amber Maitland, "eBay China Starts Joint Venture with Chinese e-commerce Firm," www.pocket-lint.co.uk, December 20, 2006.
- ⁵⁵ "eBay and TOM Online Form JV in China - Stocks to Watch," www.tradingmarkets.com, December 20, 2006.
- ⁵⁶ "eBay, TOM Online Reveal Joint Venture Agreement in China," www.tradingmarkets.com, December 19, 2006.
- ⁵⁷ Headquartered in California, Caris and Company is an investment bank offering services in industries like Consumer, Technology, HealthCare, and Energy.
- ⁵⁸ Katie Hafner and Brad Stone, "eBay is Expected to Close its Auction Site in China," www.nytimes.com, December 19, 2006.
- ⁵⁹ BDA China is an advisory firm offering advisory services to companies to invest in telecommunications, media, and technology (TMT) sector.
- ⁶⁰ Keith Bradsher, "For eBay, it's about Political Connections in China," www.nytimes.com, December 21, 2006.
- ⁶¹ Formerly known as Prudential Securities Inc., Prudential Equity Group is a subsidiary of Prudential Financial Incorporation offering services to retail investments and securities.
- ⁶² Melly Alazraki, "eBay & Tom.com -- Good or Bad Move?" www.blogingstocks.com, December 19 2006.
- ⁶³ Wolf Group Asia Ltd, based in Beijing, China, is a technology company.
- ⁶⁴ Steven Schwankert, "eBay to Replace Chinese Auction Site with JV," www.itworld.com, December 20, 2006.
- ⁶⁵ Will Swarts, "eBay Partners with Tom Online in China," www.smartmoney.com, December 19, 2006.
- ⁶⁶ Keith Bradsher, "For eBay, it's about Political Connections in China," www.nytimes.com, December 21, 2006.
- ⁶⁷ Troy Wolverson, "eBay to Shutter Site in China," www.mercurynews.com, 2006.
- ⁶⁸ Jeremy Goldkorn, "eBay's China Joint Venture to Waste Money," www.danwei.org, June 21, 2007.
- ⁶⁹ Victoria Shannon, "eBay is Preparing to Re-enter the China Auction Business," www.nytimes.com, June 22, 2007.
- ⁷⁰ "eBay's Market Share Plummets in China," www.texyt.com, August 14, 2007.
- ⁷¹ Analysys International is a leading provider of information related to technology.
- ⁷² Simon Burns, "Going Local No Help for eBay in China," www.vrurnet.com, August 23, 2007.
- ⁷³ "eBay Watch: StubHub Opportunity, Decreasing China Market Share, Analyst Updates," www.seekingalpha.com, August 24, 2007.
- ⁷⁴ "eBay's Market Share Plummets in China," www.texyt.com, August 14, 2007.
- ⁷⁵ The Economist, "China Soon to Lead Internet Use," www.startribune.com, February 4, 2008.
- ⁷⁶ Edahn Golan, "E-Commerce in India, China Grows By More Than 50% in 2007," www.idexonline.com, February 6, 2008. http://www.idexonline.com/portal_FullNews.asp?id=29528
- ⁷⁷ "Taobao.com Transactions Surge 156%," *Shanghai Daily*, www.China.org.cn, January 23, 2008.
- ⁷⁸ "eBay CEO Whitman Says Company 'Not Fading' from China," www.money.cnn.com, December 20, 2006.
- ⁷⁹ Shuan Rein, "eBay's Tom Online Deal: Timely Lessons for Global Online Company Managers," www.seekingalpha.com, February 14, 2007.
- ⁸⁰ "eBay Inc. and TOM Online Announce Joint Venture Agreement to Enable Next Phase of E-Commerce Growth in China," www.finanzen.net, December 20, 2006.
- ⁸¹ "eBay Partners with Tom Online in China Shift," www.informationweek.com, December 20, 2006.
- ⁸² "eBay Faces a Tough Road in China," www.seekingalpha.com, October 26, 2006.
- ⁸³ Shaun Rein, "eBay's Tom Online Deal: Timely Lessons for Global Online Company Managers," www.seekingalpha.com, February 14, 2007.
- ⁸⁴ "For New CEO John Donahoe, 'It's eBay's Game to Lose'," www.knowledge.wharton.upenn.edu, February 6, 2008.
- ⁸⁵ "eBay's Market Share of Chinese C2C Transactions Reaches 29% in Q4 2006," www.imnewswatch.com, March 30, 2007.
- ⁸⁶ "Tencent Releases Paipai Figures," www.marbridgeconsulting.com, December 19, 2005.

On December 20, 2006, eBay EachNet⁴ entered into a Joint Venture (JV) with TOM Online Inc.⁵ (TOM Online) to form TOM eBay. The JV was set up to explore opportunities for the growth of e-commerce and m-commerce in the highly competitive Chinese market. This marked a change in eBay's strategy in China as its Chinese site had failed to live up to expectations. However, Meg Whitman (Whitman), President and CEO, eBay, refused to admit defeat and said that the JV was an evolution of their strategy in China and that it would help them foster growth in the Chinese e-commerce market.

In 2002, eBay entered China by acquiring EachNet⁶, a leading auction site in China, to form eBay EachNet. Till 2005, eBay EachNet was the market leader in the Chinese e-commerce market, controlling more than half of the market (Refer to Exhibit I for online trading companies in China). But eBay EachNet soon lost its market leadership position to Taobao.com (Taobao). Some analysts opined that this was because of eBay's failure to localize its globally successful business model to China. Also, Chinese customers preferred Alipay⁷ as it was perceived to be safer than other payment systems such as PayPal⁸. Another factor for Taobao's success was that it did not charge any transaction fee from sellers on the website while eBay had listing fees for its sellers.

In 2006, eBay EachNet too decided that it would stop charging fees from its sellers.⁹ However, it continued to lose market share to Taobao. Consequently, eBay changed its strategy and entered into a JV with TOM Online. Analysts expected the JV to bring together eBay's global knowledge of e-commerce with TOM Online's local knowledge of the Chinese market. However, some were skeptical about whether this JV could compete effectively against Taobao.

eBay was not the only global Internet company to have faced problems in the Chinese market. Yahoo! Inc¹⁰ (Yahoo!) was also struggling to establish itself in the country. In 2005, Yahoo! handed over the management of its Chinese operations to Alibaba.com (Alibaba). Google Inc¹¹ (Google) too had failed to make its mark in the intensely competitive Internet market and lagged behind Baidu.com Inc¹² (Baidu), which had emerged as the leading search engine in China.

In 2006, Citigroup Inc.¹³ analyst, Mark Mahaney (Mahaney), said most of the foreign Internet companies that had failed to make a mark in China, had chosen to collaborate with local companies, which had a good understanding of the local business and culture. Mahaney said, "The Asia challenge to U.S. Internet companies is a material long-term issue, especially for eBay and Google.... eBay may well need to develop a strategic relationship in China along the lines of the Yahoo!-Alibaba partnership."¹⁴

Background Note

eBay was founded by Pierre Omidyar (Omidyar), a software programmer at San Francisco, California, USA, in 1995. Omidyar got the idea of creating an Internet auction site when his fiancée faced a difficulty while trying to collect Pez dispensers¹⁵ from the San Francisco Bay Area. Omidyar launched an online auction site called Auction Web (www.ebay.com being the domain name) in September 1995, creating a marketplace that would enable people to trade with each other.

Under eBay's business model, a seller would place an item on eBay's site with a minimum bid set for the buyer and the duration specified for auctioning that item. eBay started as a free website and soon attracted a lot of traffic. With the growth in the business volume, the company started charging a nominal fee for each listing on its site and a final fee after the listed item was sold through its website.

Omidyar encouraged buyers and sellers to establish a trading community to interact among themselves. But with the increase in interaction, complaints from buyers and sellers too began to mount. Omidyar urged them to resolve their issues amicably. He also encouraged users to communicate directly with him by mail in case they faced any problems.

In February 1996, Omidyar introduced a "Feedback Forum", a place where users could get to know about their trading partners, view their reputations, and express their opinions about them. Under this system, the credibility of the buyer and seller would be known when the trading partner rated a transaction as positive, negative, or neutral. These ratings helped users determine whether a buyer or seller was trustworthy. This was a bid to prevent scams and frauds occurring on the site. Commenting on this, Peter Kollock, Sociology Professor, University of California, Los Angeles (UCLA) said, "As high tech as

eBay is, the closest analogue to what they have created is the original small-town market. It is a market that relies on identity and reputation for risk management.”¹⁶

In 1996, Omidyar added another feature to its site, an online Bulletin board. The bulletin board was designed to limit his role and place more of a responsibility on the community. The bulletin boards were introduced to serve the needs of new customers, who did not know how to create a listing on the site or to get advice on the bidding strategy. With this initiative, Omidyar aimed to reduce the costs that were being incurred on customer support.

In 1996, Jeff Skoll (Skoll) was appointed as the President of eBay. Skoll noticed that Jim Griffith (Griffith), a customer who had won a US\$ 10 bid for a computer part on eBay, was often present on the Bulletin board and voluntarily provided technical support to new users visiting the site. In the same year, Skoll appointed Griffith as the first customer support representative at eBay. In September 1997, Auction Web officially changed its name to eBay Inc and was incorporated under the new name.¹⁷

Omidyar believed in increasing the user base and spent time with Skoll in strengthening the site technically. By 1997, the community of users had increased to such an extent that it was difficult for them to handle them efficiently. In mid-1997, eBay received one million page hits per week with 15,000 listings on a day making it one of the most visited sites on the Internet.¹⁸

With the increase in the number of users, further investment was needed to support the company’s rapid growth. In 1997, Omidyar and Skoll approached Benchmark Capital (Benchmark), a US-based venture capital firm, seeking investment in their company. Subsequently, Benchmark invested US\$ 5 million in eBay with a 22 percent stake in the company.¹⁹

With the company growing rapidly, Omidyar and Skoll felt the need to bring in an efficient manager who would use his/her expertise in consumer technology and brand building to build a management team and help eBay sustain its meteoric growth in user base. Benchmark started searching for someone to supervise the operations of the company and direct the company’s growth. Benchmark delegated this responsibility to David Beirne (Beirne), a well-known headhunter in California, along with Robert Kagle (Kagle), one of Benchmark’s partners and largest investors. In February 1998, Beirne and Kagle persuaded Meg Whitman (Whitman), with an MBA from Harvard, to join eBay as President and CEO of the company.²⁰

One of the first tasks that Whitman took up was to make eBay public. But before issuing the stock, Whitman wanted structural changes to be made to the site in order to make it more professional and profitable. She realized that in doing that, they had to tread a fine line between making the site attractive for businesses without alienating the trading partners referred to as “eBayers” responsible for making the site successful.

On September 24, 1998, Whitman initiated an Initial Public Offering (IPO) by offering 4.025 million shares to the public at US\$ 18 per share. The issue received a tremendous response from the market and the stock closed at US\$ 47.

In 1999, Whitman acquired Butterfield & Butterfield (Butterfield), an auctioneer famous for fine arts & collectibles. After the acquisition, eBay launched ‘eBay Great Collections’, which offered a collection of high quality and high price items from auction houses and dealers from around the world. The company also acquired Kruse International, one of the world’s largest brick and mortar companies in the collectibles cars auction business.

In the same year, eBay launched 53 regional sites, addressing around 50 largest metropolitan areas in the US, starting with eBay LA. These sites helped the company to encourage trade in items that were too bulky or expensive to ship, items of local interest, and items that people preferred to view before purchasing.

In April 1999, Whitman signed a US\$ 75 million deal to strengthen eBay’s relationship with America Online (AOL). The company announced it would pay US\$ 75 million over four years to AOL in exchange for AOL traffic being driven to eBay’s website.

Around the same time, eBay entered into an alliance with Mail Boxes Etc. (MBE), a famous franchiser of packing and shipping services and iShip.com²¹, a leading provider of multi-carrier Web-based shipping services. MBE provided convenient drop-off and pick-

up locations and informed buyers and sellers of the actual locations of goods in transit. iShip provided information to eBay users regarding shipping costs and options.

In June 1999, eBay suffered a major setback when its website went down for 22 hours (June 10-11, 1999). The files in the database became corrupted and had to be recreated prior to bringing the system online. Experts were of the opinion that this had happened because of eBay's inability to build scalable and redundant web architecture. The company took various steps to deal with the crisis. It decided to forgo the listing revenues (around US\$ 4.6 million) and apologized for the outage. eBay also announced new technological initiatives to minimize the possibility of such outages in future. During the two-day outage, eBay's stock crashed by US\$ 47 to US\$ 135, reducing its market capitalization by US\$ 5.7 billion.

In early 2000, eBay announced its entry into business-to-business (B2B) trading²². The 'eBay Business Exchange' service offered 34 business-related categories, including computer hardware, software, professional tools, industrial equipment, office equipment, and electronics. eBay expected to drive traffic to its B2B site with the help of targeted banner advertising on business sites and through existing marketing tie-ups. Commenting on eBay's foray into the B2B market, Brian Swette, Chief Operating Officer, eBay said, "Business Exchange is a natural evolution of the eBay business model, enabling businesses to obtain new, used and refurbished business merchandise, and providing businesses of varying sizes a targeted way to reach buyers of business items."²³

In March 2000, eBay formed a partnership with AutoTrader.com²⁴ to sell used cars through a common site www.ebay-autotrader.com. AutoTrader users could sell either by listing their cars on AutoTraders' classified site or by paying US\$ 25 and auctioning off their vehicle. Also in March 2000, eBay entered into a marketing alliance with Visa. eBay was to promote Visa as the preferred payment option on eBay and waive all payment processing fees for Visa transactions closed on its site till May 2000. Visa cardholders could win a vacation package for two to attend the 2000 Sydney Olympics.

In the year 2000, eBay expanded into Japan through eBay Japan and launched its Canadian and Austrian sites. It strengthened its presence in Europe in 2001 through the purchase of French Internet auction firm iBazar. eBay also launched sites in Switzerland, New Zealand, and Ireland. It finalized a deal that year to provide its e-commerce capabilities to Microsoft developers and to add B2B auctions to its consumer operations. In addition, the company began offering virtual storefronts for retailers to sell fixed-price items and purchased HomesDirect, which conducted auctions of foreclosed property.

In January 2001, eBay launched eBay Premier, the fine art and other high-end merchandise auctions site (www.ebaypremier.com). However, eBay was disappointed with its performance and partnered with Sotheby, an international auction house in a deal that moved Sotheby's entire online business onto the eBay website, replacing eBay Premier. eBay also sold Butterfields and closed its Japanese operations after its dismal performance in that market.

In 2002, after careful planning, eBay selected EachNet.com, a Shanghai-based online trading site, as a potential partner for collaboration in the Chinese market. EachNet was China's first and largest online trading company. Unlike in the North American market where it had a dominant presence, eBay faced stiff competition in the second largest Internet market, i.e., China,²⁵ from local sites like Taobao.com and global rivals like Yahoo!. Taobao.com, started by Alibaba.com, a popular Chinese B2B portal, was becoming increasingly popular with sellers as it did not charge for its services. eBay, on the other hand, charged listing fees.

In 2003, eBay introduced its auction site in Hong Kong, which offered online trading in Chinese. The site was free of charge for the users and generated revenue through advertisements posted on its website. Analysts predicted that with its penetration rate of 72.5 percent, e-commerce in Hong Kong would grow at two times the global rate by 2008.

In January 2004, eBay acquired Baazee.com for US\$ 50 million in India. In 2004, eBay Korea had 10 million members that accounted for about 15 percent of Korea's e-commerce market. With 180,000 auctions and 1.28 million visitors every day, eBay Korea experienced tremendous growth. In November 2004, eBay launched its site in the Philippines. The site was maintained from its regional office in Singapore. By the end of 2004, in Asia, eBay had operations in Taiwan, China, South Korea, Hong Kong,

Singapore, and India.

In June 2005, eBay bought Shopping.com²⁶ for US\$ 620 million in cash. Analysts saw this move as an attempt by the company to bolster up its slowing growth rate. In December 2006, eBay EachNet entered into a JV, TOM eBay with TOM Online to compete in the intensely competitive e-commerce market. This move was seen as eBay's attempt to revive itself as it had failed to live up to expectations in China.

As of 2007, eBay was the world's largest online auction company with 233 million users and had revenues of US\$ 4249.8 million in September 2007 (Refer to Exhibit II for a summary of eBay financials).

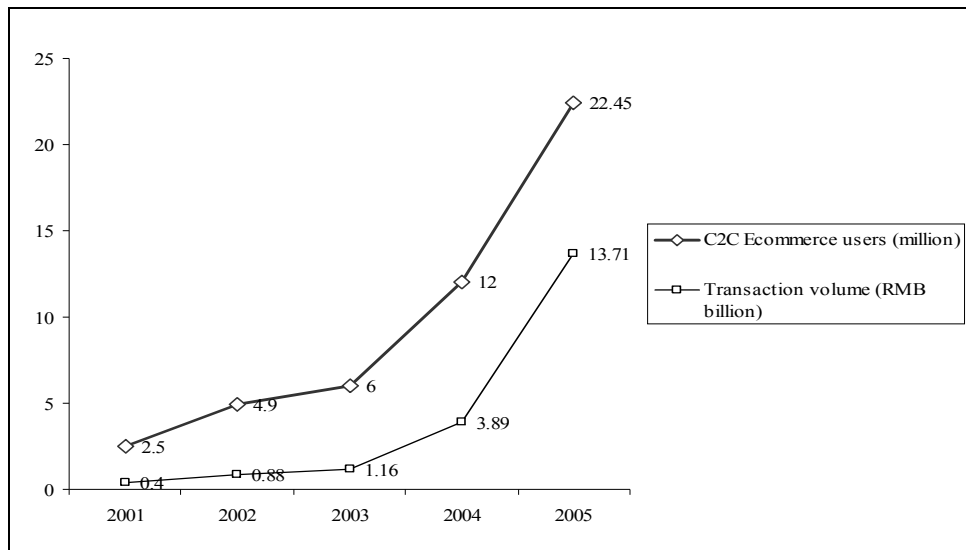
E-Commerce Market in China

As of 2007, China was the world's second-largest Internet market after the US. According to the China Internet Network Information Center²⁷ (CNNIC), the number of Internet users in China had reached 162 million by the end of July 2007. Of these, 122 million surfed the Internet using a broadband connection.²⁸ On an average, the Internet user in China spent 17.9 hours online per week, compared to the 11.4 hours per week spent online by a user in the US.²⁹ The Internet users in China comprised only 10.5 percent of the country's population of 1.3 billion, which meant that there was a huge potential for future growth.³⁰ China was important for Internet companies not only because of its large market size, but also for its vast talent pool. "Whoever wins China, will win the world," said Whitman, describing the importance of China as a market for the Internet companies.³¹

Though the concept of e-commerce was introduced in China in 1993, it took some time for it to catch on. But once it did catch on, e-commerce in China grew at a frantic pace. For instance, the market scale for e-commerce in China grew from RMB 120 billion in 2001 to RMB 680 billion in 2005.³² In comparison to the overall e-commerce market, the C2C market was smaller but had kept pace with the growth in the overall market (Refer to Figure I for the booming e-commerce market in China: 2001-2005).

Figure I

The Booming C2C ecommerce Market in China: 2001-2005



Adapted from iResearch, China C2C Ecommerce Research Report 2005.

The e-commerce market was a surging market in China. According to the iResearch Consulting Group³³ (iResearch), the online shopping market was estimated at RMB 12.26 billion for the second quarter of 2007. Considering the positive growth outlook for the e-commerce market, Baidu announced its plans to enter the Chinese e-commerce market by 2008. Commenting on its foray into this sector, Robin Li, Chairman and Chief Executive Officer, Baidu said, "Baidu's extensive user base and rich experience in Chinese language search makes e-commerce a natural step for expansion."³⁴

Despite huge opportunities, the Chinese e-commerce market was not without its

challenges. It was influenced by government regulations, logistics, and payment systems. The Chinese government enforced regulations related to Internet access, content regulation, encryption, and domain name.

The government also set certain provisions related to Internet access. There was a four-tier system for accessing the Internet. The first tier consisted of the Ministry of Information Industry³⁵ (MII) that acted as the main gateway for transmission of information to and from the World Wide Web. The MII operated an international gateway at the top of this system. The second tier comprised four government-owned Internet Service Providers (ISPs), which were called the interconnected networks. The third tier comprised privately owned ISPs that were linked through the interconnected networks to the Internet. The final tier included the Internet users. The users could gain access to the Internet either through the government or privately owned ISPs. Internet users were instructed to register themselves with local public securities authorities as part of Internet security regulations.

Domain regulations required e-commerce companies to register their domain names with the CNNIC. The encryption regulation forced e-commerce companies to obtain approval from the National Commission on Encryption Code Regulations (NCECR), an encryption regulation agency, for using Chinese products and encrypted imported products.

The regulations related to security involved censoring the content and preventing dissemination of sensitive information relating to the Chinese economy. Under this regulation, all Internet companies were obliged to censor sensitive content.

Payment systems were another problem as Chinese consumers were used to paying cash rather than using credit cards. The consumers raised doubts over the security of the payment systems, the quality of the purchased products, and after sales service. Tian Hou, analyst, C.E. Unterberg Towbin³⁶ said, “The online payment system is a real bottleneck for China... Even people who have [credit] cards in their wallets have them for status, not for convenience. They have the cards but they pay in cash.”³⁷

An inefficient logistics system, compared to other developed nation, was considered as another major constraint in the development of e-commerce. This was due to the underdeveloped transportation systems, inadequate use of technology, and inconsistent distribution systems which resulted in an unreliable logistics system.

In 2005, a survey conducted by the State Economic and Trade Commission (SETC) revealed that there were nine problems plaguing the development of e-commerce in China (Refer to Exhibit III for the nine problems faced in the sector).

In addition to complying with the regulations just mentioned and negotiating the various bottlenecks, analysts opined that it was important for Internet companies in China to know how to successfully launch a Chinese language website or design a search engine that would suit the complex Chinese language. The Chinese language made extensive use of pictograms³⁸ and ideograms³⁹. The characters were written without spaces between them, which made it difficult to distinguish one word or phrase from the next. Due to all these political, cultural, and linguistic factors, many international Internet companies had to seek local help to understand the Chinese consumers and deal with the local nuances.

Richard Ji, analyst, Morgan Stanley, cited several reasons for the failure of foreign Internet companies in China (Refer to Exhibit IV for reasons for the failure of foreign Internet companies in China). Though China was a tough market to crack, analysts felt that no global company could afford to ignore the Chinese market keeping the future in mind. China was making a transition from investment-led growth to consumer-led growth. The huge youth population in the country was at the heart of this change, they said.

Ebay in China

eBay entered China by acquiring a 33 percent stake in EachNet, the Delaware, USA-based company, with an initial investment of US\$ 30 million in 2002. In 2003, eBay acquired the remaining 63 percent stake for US\$ 150 million and the company was called eBay EachNet. With this acquisition, eBay was poised to take advantage of the growing Chinese e-commerce market.

eBay EachNet had a major presence in the Chinese online auctions market. In 2003, its market share was nearly 80 percent. It spent heavily on promoting itself in China through TV, outdoor, and online media ads.⁴⁰ However, since the launch of Taobao in 2003, eBay EachNet started gradually losing market share. Initially, Whitman dismissed the

competition in China as “a bunch of small competitors ... nipping at our heels.” However, in 2004, Taobao started gaining on eBay Eachnet. According to Taobao and iResearch, eBay Eachnet’s market share fell from 90 percent in the first quarter of 2004 to 53 percent in the last quarter of 2004, while Taobao’s market share increased from 9 percent to 41 percent during the same period.⁴¹ By the end of the following year, Taobao had overtaken eBay EachNet.

This was despite eBay and its CEO projecting the Chinese market as the driver of future growth for the company. According to Whitman, China could become eBay’s largest local market by 2010-2015. She said that the company was focusing on attaining the leadership position in the overall e-commerce market in China. In early 2005, announcing eBay’s decision to invest an additional US\$ 100 million in China, Whitman had said, “We are on a tear to be the undisputed winner in China and the additional \$100 million investment we announced last month should be a sign of an unmistakable commitment and an unstoppable determination to win that market.”⁴²

In the subsequent years, eBay EachNet’s market share slipped further. eBay EachNet’s market share in 2005 was 29.1 percent compared to Taobao’s 67.3 percent (Refer to Table I for market shares of C2C e-commerce companies in China).

Table I
Market Share of C2C e-Commerce Companies in China (2005)

e-commerce Companies	Market share (%)
eBay	29.1
Taobao	67.3
Paipai	2.2
YiPai	1.4

Source: “China Online Shopping Market Survey Report,” www.cnnic.cn, May 2006.

Taobao was ahead of eBay on various counts. Some of the parameters included the number of page views per user, which was 10.7 for Taobao and 7.4 for eBay in August 2005. At the same time, Taobao’s listings generated a Gross Merchandise Volume⁴³ (GMV) of US\$ 120 million compared to eBay’s GMV of US\$ 90 million. Also, the design of the eBay EachNet site did not suit Chinese consumers. Due to eBay EachNet’s inability to understand the local market conditions in China, Porter Erisman, Vice President, International Marketing, Alibaba, said in 2006, “The real source of eBay’s woes in Asia is its inability to understand local market conditions in this part of the world.”⁴⁴

eBay was not successful in every market it entered. It had failed to make an impact in Japan and had completely pulled out in the face of Yahoo!’s success in Japan. It had no plans to re-enter the Japanese market and planned to focus on sustaining its Chinese venture. Whitman said, “It’s the second-largest economy in the world, it’s the second-largest Internet market in the world... We need to think about it. If we go back, we can’t go back with a look-alike product. We have to go back with something different.”⁴⁵

eBay also had some success in China. Skype, the Internet phone business, which it acquired in 2005, had more customers in China than in the US. But eBay lagged behind Taobao in the online trading business. In 2006, eBay EachNet decided that free was a business model and stopped charging fees from its sellers. eBay also made efforts to use an escrow service, where payments would be held until the buyers were satisfied with their purchases. But there were still no significant signs of improvement in the company’s market share.

In September 2006, eBay EachNet announced that Martin Shixiong Wu (Wu), the company’s CEO for around a year, would resign from his position. Liao Guangyu, the general manager of PayPal China, was slated to take over from Wu. The company said that this move would help to improve the integration of the operations of eBay EachNet and PayPal China.

However, with eBay EachNet still lagging behind Taobao, there was intense speculation that eBay was preparing to exit the Chinese market. By the end of 2006, eBay had pumped US\$ 300 million into its Chinese operations, but its market share was a paltry 20 percent.⁴⁶ According to Mahaney, China accounted for just 3 percent of eBay’s global total. Though

it was generating sales of US\$ 30-50 million, the company was posting operating loss of US\$ 20-40 million, according to him.⁴⁷

Ebay's China Troubles

Within a span of three years eBay EachNet saw its market share eroding in the face of competition from Taobao. Commenting on Taobao's success, Jack Ma (Ma), founder and CEO of Alibaba, said, "When we started Taobao, even our own chief technology officer said, 'Jack, you are crazy. Don't forget eBay.' But we passed eBay in China in just two years."⁴⁸

Analysts felt that there were various factors behind eBay's problems in China. The biggest complaint against it was its lack of customer service. It did not provide a phone number that customers could call in case of any queries. On the other hand, Taobao enabled its buyers and sellers to communicate through an instant messenger service.

The eBay EachNet site was not tailored to the Chinese consumers. Taobao's auction site, on the other hand, was perceived to be more in sync with the Chinese consumers' buying behavior. It had a layout that was similar to a Chinese department store with separate sections for women's and men's departments. Moreover, eBay charged its users for transactions through its Chinese website whereas Taobao offered this service for free. This led to a major chunk of eBay EachNet users shifting to Taobao. However, eBay argued that it offered better quality products and services due to its listing fees. The company also criticized Taobao for providing services for free. Ma countered by saying that Taobao's success was a result of its ability to satisfy its customers. "Because we make the customer happy, the community is easy to build. For now, the easiest way to satisfy the customer in China is to provide Taobao's services free of charge,"⁴⁹ said Ma.

Taobao allowed its customers to interact with other users before buying a product. However, eBay kept the users' contact information a secret till a buyer had won the bid. Through this, eBay ensured that the users did not come into direct contact with each other until a transaction was completed.

eBay EachNet also faced problems with its payment system, PayPal, which was launched in 2005. PayPal offered online payment services to users on eBay EachNet by allowing transactions with 15 different banks. However, the concept of using bank cards was not prevalent among Chinese consumers as they were of the opinion that these were not a safe mode of payment. Hence, Chinese customers preferred Alipay over PayPal. Jonathan Lu, President, Alipay said, "Alibaba's e-commerce community is built on trust and it is also an essential part of our online payment platform. Alipay's escrow based system has solved the problem of trust for Chinese e-commerce users and is the safest way to trade online in China."⁵⁰

Analysts felt that eBay's headquarters in San Jose could not meet the expectations of eBay executives in China. The executives complained that the headquarters did not have any trust in the management team at China and handled decision-making inappropriately in their Chinese operations. The EachNet team felt that the eBay management had belittled it after the acquisition. Juan Fernandez, Management Professor, Europe International Business School, said, "One problem is that some executives at headquarters do not know [much about] what is going on in China. They only have experience in mature markets where a rule of law exists, so when they see management in China localizing and modifying corporate practices, they get upset."⁵¹

A significant mistake made by the eBay team in China was its notion of applying its US business model in China, analysts said. eBay did not localize its auction site to suit to the taste of Chinese customers. The company had a layout similar to its US site and that was reportedly disliked by majority of the Chinese customers.

eBay's problems were compounded when Taobao launched business-to-consumer services (B2C) in May 2006. Taobao would offer products and services of major companies like Apple Computer Inc., Haier Group, Motorola Inc., Nike International Inc., etc. This move was expected to deal a major blow to eBay EachNet as Taobao expected Alibaba's 10 million user base of B2B to visit Taobao's B2C site.

To add to eBay's woes, Alibaba announced its plans to make a strategic investment in Koubei.com, China's classified listing and community website, in October 2006.⁵² This investment was expected to give Alibaba considerable exposure to the fastest growing e-commerce segments in China. Tian Jian, Vice President, Alibaba investment and

acquisition group, said, "Community-based classified listings are an essential part of e-commerce. Besides buying and selling products online, people want a marketplace to trade services and share information about service providers. With our investment in Koubei, we're partnering with the team that pioneered the online classified marketplace in China and opening up another channel to grow our existing e-commerce community of more than 40 million consumers and businesses in China."⁵³

Joint Venture with Tom Online

Sensing the need for local support, eBay entered into a JV with TOM Online in December 2006. Whitman said, "One thing we've learned operating here for three or four years is that actually we're going to be better served by tapping into a local partner who has local knowledge."⁵⁴

TOM Online was a leading wireless Internet company in China that provided value-added multimedia products and services such as SMS, MMS, WAP, wireless interactive voice response services, content channels, search and classified information, free and fee-based advanced email services, and online games. TOM Online was a subsidiary of TOM Group Limited (TOM Group), a prominent media group in China. TOM Group was controlled by Li Ka-shing (Ka-shing), a billionaire based in Hong Kong, who was reputed to have excellent guanxi (connections) in the mainland China region. Analysts noted that TOM Online too aimed to diversify its revenue streams as around 90 percent of its earnings were from wireless value-added services.

eBay would hold a 49 percent stake in the JV while TOM Online would hold the remaining 51 percent. eBay also said that the new auction website developed by the JV partners would be launched in 2007 and that it would replace eBay's website in China. Under this partnership, eBay was expected to invest US\$ 40 million while TOM Online would contribute US\$ 20 million. Further, if mutually agreed upon, the companies could further invest an additional US\$ 10 million each.⁵⁵ The JV with TOM Online was the second major tie-up for eBay with a local company in China after EachNet's acquisition in 2003. Commenting on the JV, Whitman said, "eBay has helped pioneer e-commerce in China, and by combining our expertise with that of a strong local partner like TOM Online, we are even better positioned to participate in this growing market. This agreement is a sign of our continued commitment to delivering the best online buying and selling experiences in China."⁵⁶

A strategic shift

Many analysts considered eBay's new move indicative of the company's retreat from the Chinese market. Caris and Company⁵⁷ analyst, Tim Boyd, said, "It's an admission that they failed in China, on their own at least... But I think that's something the market already knew."⁵⁸ They saw the venture as a bail-out considering that Whitman had aggressively projected China as a key driver for eBay in the future in the face of slackening growth of eBay in the mature markets.

Some industry watchers pointed out that unlike Yahoo!, which had paid a hefty amount of money to get a stake in the promising Alibaba, eBay was putting in money for a minority stake in a JV with a company that was yet to make its presence felt in a significant way in the Chinese online trading market. BDA China⁵⁹ analyst Liu Bin said that the two companies' line of business was not compatible and as such both the companies would need time to learn to work with each other.⁶⁰ According to Prudential Equity Group⁶¹ analyst Mark J. Rowen, eBay's decision was akin to the company admitting defeat but he felt that the decision could help it reduce its operating losses in China.

Others felt that it was far from an exit strategy and viewed it as a strategic shift aimed at strengthening its position in the Chinese market. "Cutting losses and taking a minority stake in a locally owned business is a decent alternative for eBay,"⁶² said Scott W. Devitt, an analyst at Stifel Nicolaus. David Wolf, CEO of Wolf Group Asia Ltd.⁶³, said, "eBay's move to hand over its business to a team and a company that is fully focused on China is long overdue. It is proof that for foreign companies to compete in China's online industries... China cannot just be an 'important' market – it must be your core market. China was never 'core' for eBay, despite rhetoric to the contrary."⁶⁴

According to Raphael Amit (Amit), Professor of management, Wharton University of

Pennsylvania (Wharton), eBay's foray into the Chinese market was premature considering that its business model was dependent on electronic payment systems while credit card use in China was in its formative stage. With credit card usage slowly but surely, catching on in China, eBay had much to gain by staying put in China. Amit felt that in addition to the challenges, China also provided eBay with an opportunity to sustain growth for years.

Its choice of JV partner was also considered as a positive move by some industry watchers. They pointed out that TOM Online had a significant presence in mobile commerce, which could prove useful in a country where there were four mobile phone users for every computer user.⁶⁵ It was reported that there were some promising pilot programs running in some parts of China that sought to use mobile phones as the payment system in place of credit cards. In addition to this, some commentators felt that eBay could leverage on the excellent connections of Ka-shing to navigate the political and regulatory hurdles in China better.⁶⁶

Some analysts said that eBay's decision was also indicative of the pressure that the Chinese government regulations put on foreign companies to form joint ventures with domestic companies, even though the foreign companies were reluctant to do so fearing that their joint venture partners would eventually become their competitor in the global arena.

The Aftermath

The new entity started operating with the name 'Tom Yi Qu' (which means Tom eBay) in 2007. Wang Lei Lei (Wang) headed the JV, while Jeff Liao, head of eBay China, was also included in the management.⁶⁷

In mid-2007, it was reported that the JV had selected ad agency TBWA Shanghai for the launching assignment of its new e-commerce platform.⁶⁸ The campaign was expected to be launched in September 2007. In order to win the trust of its users, the JV used an escrow service, and also took steps to ensure that the people holding the auctions were reliable. It also placed some restrictions on the number of luxury goods that a user could sell on its site. "Whatever we do elsewhere to assure trust and safety, in China we have to do more,"⁶⁹ said Whitman.

In July 2007, Whitman said, "In China, our joint venture with TOM Online continues to go well, with the new website going live last week."⁷⁰ But figures seemed to suggest otherwise. In the months following the announcement of the new venture, eBay's market share in China witnessed further erosion. In the first six months of 2007, the market share of eBay in China fell from 16 percent to 7.2 percent, according to Analysys International⁷¹ (Analysys).⁷² In the interim, Taobao had increased its market share from 74 percent to 83 percent.⁷³ According to Analysys, the erosion in eBay's market share could be a fallout of "the upheaval of transferring eBay's Chinese auction services to the new company."⁷⁴ Many industry experts had already written off eBay's chances of recovery in China.

Outlook

China was well poised to unseat the US as the country with the largest number of Internet users in the first few months of 2008, according to Morgan Stanley. According to Chinese government figures, the number of Internet users in China had reached 210 million in 2007, a growth of 50 percent compared to 2006.⁷⁵ Moreover, there was tremendous scope for future growth as the penetration levels were low, with only 16 percent of the population using the Internet. Unlike the US, people aged below 30 years were driving the growth. For the year 2007, people below 30 years of age made up more than 70 percent of the Internet users. According to analysts, Internet companies that could crack the market would be rewarded handsomely.

China was also one of the fastest growing e-commerce markets in the world. In 2007, China's online retail sales grew to US\$ 3.8 billion, compared to US\$ 2.4 billion in 2006.⁷⁶ Given the attractiveness of the Chinese e-commerce market, analysts expected the competition to soon increase. With indications of Baidu entering the e-commerce market, eBay was expected to face fierce competition from it. Analysts opined that Baidu's popularity as a Chinese language search engine was due to its strong understanding of the subtleties of the Chinese language and culture. Industry experts felt that many domestic Internet companies had managed to gain popularity and market share because of their familiarity with the local environment and customers. Because of their intimate knowledge of the local language, culture, and dealings with the government, the local players had an

edge over their foreign counterparts in the Chinese Internet market.

But eBay faced a more immediate threat from Taobao since 80 percent of the people preferred Taobao to eBay. The reason touted for this was Taobao was free and the company might extend these services for free beyond its earlier mentioned deadline – 2008. In 2007, transactions at Taobao grew more than the market with a growth rate of 156 percent.⁷⁷ However, it was reported that it still haven't turned profitable as it was offering the services for free. Shortly after the formation of TOM eBay, Wang had criticized Taobao's business model saying, "Free lunches will not be served forever... I have no intention of competing with someone who is more interested in market share rather than profit."⁷⁸

According to a survey by China Market Research Group, a Shanghai-based market research company, in 2006, trust and excellent customer service were the major factors that Chinese customers looked for before they bought a product. Dwight Perkins, Economics Professor, Harvard University said, "Trust is important in China as elsewhere, but it is particularly important in China because of the weakness of the legal system and other more formal means of settling disputes. The way you build trust is by demonstrating over time that you are trustworthy."⁷⁹ Analysts felt that the issue of trust could be overcome by partnering with local banks, insurance firms, and even competitors.

Some analysts opined that TOM eBay would have to leverage on its understanding of the Chinese consumers and chart its own path in the online auctions market. They expected the TOM eBay partnership to bring together eBay's global knowledge of e-commerce with TOM Online's local knowledge of the Chinese.⁸⁰ Jenny Wu, an analyst at Morgan Stanley said, "It's good for eBay, because during the past two years at least it has been losing ground to Alibaba's Taobao, mainly because eBay lacks local expertise."⁸¹ However, not everyone was optimistic about eBay's future prospects in this market. A former eBay executive raised doubts over eBay's success in China and said, "I just don't think that eBay will be able to catch up to Taobao now. Maybe 6 months ago, but eBay simply made too many mistakes in China. They needed to listen to the EachNet team more who were closer to the consumers."⁸²

Ma too dismissed eBay's move to revive its Chinese venture and said, "I don't understand the whole deal... It sets apart PayPal. But Paypal has to be combined with e-commerce if it is to be successful,"⁸³ he said.

Analysts felt that the company had to do much more to develop the market in China. Professor of operations and information management at Wharton, Kartik Hosanagar, said that eBay had been largely unsuccessful in tapping the Chinese market as well as the Indian market despite making significant investments in both these countries. "eBay must figure out ways to have an impact elsewhere like it did in the United States,"⁸⁴ he said.

Exhibit I

Online Trading Companies in China

Taobao.com

Taobao.com, the leading online trading site in China, was launched in 2003 by Alibaba.com. According to Analysys International, the company garnered a market share of 83 percent in the Consumer-to-Consumer (C2C) market for the second quarter of 2007.⁸⁵ Taobao's popularity was attributed to various reasons such as efficient customer service, an active online user community that enabled buyers and sellers to exchange shopping information, and a secure payment system. It did not charge its sellers for listings on the site.

Taobao made attempts to constantly upgrade its site by foraying into B2C services in May 2006. With this initiative, Taobao planned to expand its e-commerce model by including products and services of major retailers and manufacturers. Taobao's transaction volume reached RMB 15.7 million in 2007.

Paipai.com

Paipai.com, an e-commerce site, was launched by Tencent, an Internet service portal and instant messaging provider, in September 2005. It was put into operation

in March 2006. Like eBay and Taobao, Paipai included online stores, a games area, and virtual equipment like account and game cards. As of December 2005, Paipai.com had 2.1 million registered users and a user hit count of over 20,000.⁸⁶

Compiled from various sources.

Exhibit II

eBay Inc Financial Summary

(In Millions of US\$)

Income Statement	Quarter ended Sep-07 (Quarterly)	Year ended Dec-06 (Annual)	Year ended Dec-05 (Annual)
Total Revenue	1,889.22	5,969.74	4,552.40
Gross Profit	1,442.70	4,712.95	3,734.30
Operating Income	-937.69	1,422.96	1,441.71
Net Income	-935.63	1,125.64	1,082.04

Source: www.finance.google.com

Exhibit III

Nine Problems in Development of e-commerce in China

- Network safety,
- Internet infrastructure construction,
- Social business credit problem,
- e-commerce related laws and regulations,
- Standardization problem,
- Network payment,
- Acceptance degree of enterprises on e-commerce,
- Network market capacity, and
- Lack of management talents

*Adapted from "EBay China Finally Provides Free Service,"
www.tmcnet.com, December 30, 2005.*

Exhibit IV

Reasons for Failure of Foreign Internet Companies in China

- Restrictive policies against overseas players.
- Difficulties in establishing business relationships with state-owned companies.
- Lack of good local content.
- Delays in communications between foreign headquarters and local operations.

Adapted from Rachel Rosmarin and Shu-Ching Jean Chen, "Ebay Seen Getting a China Hand," www.forbes.com, December 19, 2006.

END OF QUESTION PAPER

Suggested Answers

Integrated Case Studies - I (MB3J1): January 2009

Case Study

1. eBay entered China by acquiring a 33 percent stake in EachNet, the Delaware, USA-based company, with an initial investment of US\$ 30 million in 2002. eBay EachNet had a major presence in the Chinese online auctions market. In 2003, its market share was nearly 80 percent. But eBay EachNet soon lost its market leadership position to Taobao.com (Taobao). The number of page views per user in Taobao was 10.7 and is higher than compared to 7.4 for eBay. [<TOP](#)
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Reasons that can be attributed to Taobao's edge over eBay:

Consumer behavior: The growing clout of China as an emerging market can be illustrated by the following figures. There are 230,000 millionaires in China. But the national savings of China is about 9 trillion Yuan (almost 1 trillion dollars) which is more than 45% of the Chinese GNP. This provides useful insights into the Chinese psyche that is more on to saving rather than spending. The rate of consumption over the Chinese GNP does not exceed 50% where the world average is about 80%. This may be due to the system created by the Chinese government to overtax luxury items, discourages spending and encourages socialistic values.

Consumer behavior is influenced by many factors.

- Cultural heritage
- Perceived value of goods
- State of current global economy
- Saving behavior of people
- Government policies

Chinese markets are a matrix of micro segments that can be broken down according to differences in consumer tastes that often vary by

- Geography
- Product category
- Buyer segment

The Chinese market calls for a rigorous and customized approach to the traditional marketing funnel. It involves stage-by-stage measurement and management of customers' perceptions and action from brand awareness through loyalty. The best performing companies are able to correctly gauge their buyers' needs and values-price, product style, ease of use at each stage of the marketing funnel. They learn what convinces customers to purchase a product they have become aware of, what compels those who but to recommend the size and brand to others. To succeed in China, they should understand not only the size and growth rates of the micro segments that matter to them but also the spending power and buyer values in each segment.

Understanding buyer behavior is not an easy task in China.

- **Word of mouth publicity:** A country where word of mouth carries exceptional weight requires very careful assessment of buyer values. Chinese customers rely on a wider range of inputs for information about products than their counterparts in other markets.
- **Means of communication:** There is a high number of information sources for which usage is more than 50%. Direct mails which works well elsewhere is not used much in China. Multimedia kiosks and video boards have a big impact on China's new spenders.
- **Local companies:** International companies must remember that China has strong Chinese origin companies called "crouching Tigers" 95% of the customers in China are aware of these companies. They are open to overseas brands without being infatuated with them.
- **Segmentation of markets:** Segmentation of customers and markets is far from easy in China. It demands extra levels of market research and analysis to correctly gauge the size and scope of the market opportunities, along with a back-to-basics concentration on what drives conversions at each stage of the marketing funnel. There is no shortcut to the customization for the marketing approach. What works for BMW will not necessarily work for Honda and what is effective for Citigroup may not help Credit Suisse.

China was making a transition from investment-led growth to consumer-led growth. The huge youth population in the country was at the heart of this change. The eBay EachNet site was not tailored to the Chinese consumers. Taobao's auction site, on the other hand, was perceived to be more in sync with the Chinese consumers' buying behavior. eBay, has been losing ground to Alibaba's Taobao, mainly because eBay lacks local expertise. eBay needed to listen to the EachNet team more who were closer to the consumers.

- **Better knowledge of local culture:** Taobao had a layout that was similar to a Chinese department store with separate sections for women's and men's departments. The design of the eBay EachNet site did not suit Chinese consumers. The biggest complaint against it was its lack of customer service. It did not provide a phone number that customers could call in case of any queries. On the other hand, Taobao enabled its buyers and sellers to communicate through an instant messenger service.

Free services: Moreover, eBay charged its users for transactions through its Chinese website whereas Taobao offered this service for free. This led to a major chunk of eBay EachNet users shifting to Taobao. However, eBay argued that it offered better quality products and services due to its listing fees. The company also criticized Taobao for providing services for free. Ma countered by saying that Taobao's success was a result of its ability to satisfy its customers. "Because we make the customer happy, the community is easy to build. For now, the easiest way to satisfy the customer in China is to provide Taobao's services free of charge," said Ma

Interaction with other users: Taobao allowed its customers to interact with other users before buying a product. However, eBay kept the users' contact information a secret till a buyer had won the bid. Through this, eBay ensured that the users did not come into direct contact with each other until a transaction was completed

Payment system: Payment systems were another problem as Chinese consumers were used to paying cash rather than using credit cards. The consumers raised doubts over the security of the payment systems, the quality of the purchased products, and after sales service. Even people who have [credit] cards in their wallets have them for status, not for convenience. They have the cards but they pay in cash.

Logistic system: An inefficient logistics system, compared to other developed nation, was considered as another major constraint in the development of e-commerce. This was due to the underdeveloped transportation systems, inadequate use of technology, and inconsistent distribution systems which resulted in an unreliable logistics system.

Corporate practice: Analysts felt that eBay's headquarters in San Jose could not meet the expectations of eBay executives in China. The executives complained that the headquarters did not have any trust in the management team at China and handled decision-making inappropriately in their Chinese operations. The EachNet team felt that the eBay management had belittled it after the acquisition. One problem is that some executives at headquarters do not know [much about] what is going on in China. They only have experience in mature markets where a rule of law exists, so when they see management in China localizing and modifying corporate practices, they get upset.

Business model: A significant mistake made by the eBay team in China was its notion of applying its US business model in China. eBay did not localize its auction site to suit to the taste of Chinese customers. The company had a layout similar to its US site and that was reportedly disliked by majority of the Chinese customers.

Products offered: Taobao launched business-to-consumer services (B2C) in May 2006. Taobao would offer products and services of major companies like Apple Computer Inc., Haier Group, Motorola Inc., Nike International Inc., etc. This move was expected to deal a major blow to eBay EachNet as Taobao expected Alibaba's 10 million user base of B2B to visit Taobao's B2C site.

2. a. eBay was founded by Pierre Omidyar (Omidyar), who launched an online auction site called Auction Web (www.eBay.com being the domain name) in September 1995, creating a marketplace that would enable people to trade with each other. In order to encourage buyers and sellers to have a friendly interaction, Omidyar established a trading community. He urged them to resolve their problems amicably as the number of complaints from buyers and sellers began to mount. He also encouraged users to interact and communicate with him by mail in case they faced any problems. In September 1997, Auction Web officially changed its name to eBay Inc and was incorporated under the new name.

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Growth strategies in US: Growth strategies adopted by eBay in the US can be classified into organic and inorganic strategies. Both the strategies aimed at increasing the market share of eBay and provided better consumer satisfaction.

Feedback forum: "Feedback Forum" is one of the growth strategy introduced by Omidyar to create a place where users could get a chance to know about their trading partners, view their reputations and express their opinions about them. According to this system, the credibility of the buyer and seller would be known when the trading partner rated a transaction as positive, negative, or neutral. These ratings helped users determine whether a buyer or seller was trustworthy. This was a bid to prevent scams and frauds occurring on the site.

Online Bulletin board: Online Bulletin board feature was added to its site and was designed to limit Omidyar role and place more of a responsibility on the community. These boards serve the needs of new customers who do not know how to create a listing on the site or who require an advice on the bidding process. With this strategy, Omidyar aimed to reduce the costs that were being incurred on customer support.

Customer support representative: Jim Griffith, a customer on the eBay site was appointed as the first customer support representative at eBay. It can be treated as a good growth strategy as appointing one of the customers itself as a customer support representative will be a great help to the remaining users and also helps in increasing the user base.

Further growth: Due to increase in the number of users, more investment was required for Omidyar. So Omidyar approached Benchmark Capital, a US based venture capital firm seeking further investment in their company. Benchmark invested US\$ 5 million in eBay with a 22 percent stake in the company.

Efficient management: Omidyar and Skoll felt the need for bringing in an efficient manager who can use his/her knowledge and skill in consumer technology and brand building to build a management team and help eBay to cope with its increasing user base. As a result Meg Whitman, an MBA from Harvard, joined eBay as President and CEO of the company.

Making eBay public: Another most important growth strategy taken by Whitman was making eBay public. She felt that some structural changes to be made to the site in order to make it more professional and profitable. On September 24, 1998, Whitman initiated an Initial Public Offering (IPO) by offering 4.025 million shares to the public at US\$ 18 per share. The issue received a tremendous response from the market and the stock closed at

US\$ 47.

Acquisitions:

- In May 1999, it acquired Butterfield & Butterfield (Butterfield), an auctioneer famous for fine arts & collectibles. After the acquisition, eBay launched 'eBay Great Collections', which offered a collection of high quality and high price items from auction houses and dealers from around the world.

The company also acquired Kruse International, one of the world's largest brick and mortar companies in the collectibles cars auction business. But it later sold butterfields closed its Japanese operations after its dismal performance in that market.

In January 2004, eBay acquired Baazee.com for US\$ 50 million in India. In 2004, eBay Korea had 10 million members that accounted for about 15 percent of Korea's e-commerce market. With 180,000 auctions and 1.28 million visitors every day, eBay Korea experienced tremendous growth.

In June 2005, eBay bought Shopping.com for US\$ 620 million in cash. Analysts saw this move as an attempt by the company to bolster up its slowing growth rate.

Launched regional sites: eBay launched 53 regional sites, addressing around 50 large metropolitan areas in the US, starting with eBay LA. These sites helped the company to encourage trade in items that were too bulky or expensive to ship, items of local interest, and items that people preferred to view before purchasing.

Alliances and partnerships: eBay entered into alliances and partnerships with various companies.

- In April 1999, it entered into an alliance with America Online (AOL). Whitman signed a US\$ 75 million deal and the company announced it would pay US\$ 75 million over four years to AOL in exchange for AOL traffic being driven to eBay's website.

Around the same time, eBay entered into an alliance with Mail Boxes Etc. (MBE), a famous franchiser of packing and shipping services and iShip.com, a leading provider of multi-carrier Web-based shipping services. MBE provided convenient drop-off and pick-up locations and informed buyers and sellers of the actual locations of goods in transit. iShip provided information to eBay users regarding shipping costs and options.

eBay formed a partnership with AutoTrader.com to sell used cars through a common site www.eBay-autotrader.com. AutoTrader users could sell either by listing their cars on AutoTraders' classified site or by paying US\$ 25 and auctioning off their vehicle.

Also in March 2000, eBay entered into a marketing alliance with Visa. eBay was to promote Visa as the preferred payment option on eBay and waive all payment processing fees for Visa transactions closed on its site till May 2000. Visa cardholders could win a vacation package for two to attend the 2000 Sydney Olympics.

New technological initiatives: eBay encountered a major problem in June 1999, when its website went down for 22 hours (June 10-11, 1999). eBay announced new technological initiatives to minimize the possibility of such outages in future.

Business-to-Business (B2B) trading: In early 2000, eBay announced its entry into business-to-business (B2B) trading. The 'eBay Business Exchange' service offered 34 business-related categories, including computer hardware, software, professional tools, industrial equipment, office equipment, and electronics.

b. **Strategies in China:**

Acquisition: eBay entered China by acquiring a 33 percent stake in EachNet, the Delaware, USA-based company, with an initial investment of US\$ 30 million in 2002. In 2003, eBay acquired the remaining 63 percent stake for US\$ 150 million and the company was called eBay EachNet. The e-commerce market was a surging market in China. China was the world's second-largest Internet market after the US. The Internet users in China comprised only 10.5 percent of the country's population of 1.3 billion, which meant that there was a huge potential for future growth. China was important for Internet companies not only because of its large market size, but also for its vast talent pool. eBay was poised to take advantage of the growing Chinese e-commerce market.

Promotions: eBay spent heavily on promoting itself in China through TV, outdoor and online media ads.

Since the launch of Taobao in 2003, eBay EachNet started gradually losing market share. Then eBay started implementing various survival strategies.

Survival strategies:

- In 2005 it acquired Skype, which had more customers in China than in US. Skype, acquired in late 2005 for \$3.1 billion, has been a financial albatross around eBay's neck. eBay acquired Skype to improve the technology in its site. The people can interact with each other through Skype VoIP. This will further enhance the auction eBay site. This will be an added advantage to eBay web site.

eBay EachNet decided that free was a business model and stopped charging fees from its sellers. It stopped charging fees from the Chinese sellers in order to be in competition. But to earn it raised charges on other countries sellers. This created further decrease in the customer base worldwide.

eBay also made efforts to use an escrow service, where payments would be held until the buyers were satisfied with their purchases. This was how eBay tried to improve the services in order to compete with the local players. The customers believed that Taobao is trust worthy and the eBay products were not like that, eBay held the payments of buyers until they get satisfied with the products. So that customers can perceive that eBay is also a trust worthy business player.

The general manager of PayPal China, was slated to take over from the previous CEO. The company said that this move would help to improve the integration of the operations of eBay EachNet and PayPal China.

Sensing the need for local support, eBay entered into a JV with TOM Online in December 2006. eBay would hold a 49 percent stake in the JV while TOM Online would hold the remaining 51 percent. eBay also said that the new auction website developed by the JV partners would be launched in 2007 and that it would replace eBay's website in China.

Under this partnership, eBay was expected to invest US\$ 40 million while TOM Online would contribute US\$ 20 million. Further, if mutually agreed upon, the companies could further invest an additional US\$ 10 million each. The JV with TOM Online was the second major tie-up for eBay with a local company in China after EachNet's acquisition in 2003.

3. A business model is a term used to describe a profit-producing system that has an important degree of independence from the other systems within an enterprise. The term is widely used for a broad range of informal and formal descriptions of the purpose, offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies. A business model can be described using the following building blocks:

[<TOP](#)
[≥](#)

1. **Value proposition:** The products and services a business offers a value proposition "is an overall view of products and services that together represent value for a specific customer segment. It describes the way a firm differentiates itself from its competitors and is the reason why customers buy from a certain firm and not from another.

eBay Inc. is an American Internet company that manages eBay.com, an online auction and shopping website in which people and businesses buy and sell goods and services worldwide. In addition to its original U.S. website, eBay has established localized websites in thirty other countries.

2. **Distribution channel:** It refers to the various ways in which a company delivers products and services to customers. This includes the company's marketing and distribution strategy.

eBay offers various products and services. Its innovative product search technologies connect people with so many products and services that are offered in the related category. Though there are no intermediaries between the seller and the buyer it provided the user interface that can be accessed easily. eBay can be accessed either by the individual or by the organizations. It's the service oriented company providing person-to-person trading. eBay sells products at a fixed price or through bids. Soon after buyer selects the product he has to pay for that product or service. Once the payment made by the buyer, the seller will dispatch the product only after receiving payment except in the case of cash on delivery.

3. **Customer relationship:** This refers to the links a company establishes between itself and its different customer segments. The process of managing customer relationships is referred to as customer relationship management.

Anytime customers face a problem, they can contact eBay's Customer Support team on email or through Live Help. eBay has dispute resolution center to resolve disputes among trading partners. eBay has community help boards, where eBay users and staff moderators help answer questions and solve problems together. eBay customer support is committed to providing the best customer support to all of its members. To achieve this goal, customer support representatives are trained in specific areas and receive ongoing education about the latest eBay Web site changes. Customers contact customer support through email us, contact us, live help links.

4. **Core capabilities:** This refers to the capabilities and competencies necessary to execute a company's business model.

eBay's business relies on its software and hardware infrastructure, which provides substantial computing resources at low cost. Their considerable investment in developing infrastructure has produced several key benefits. eBay drives explosive growth using Sun Technology and Sun Services. Founded in 1995, eBay Inc. pioneers communities built on commerce, sustained by trust, and inspired by opportunity. eBay enables e-commerce on a local, national and international basis with an array of Web sites—including the eBay marketplaces, PayPal, Skype, Kijiji, Rent.com and Shopping.com—that bring together millions of buyers and sellers every day.

To power its massively-scaled resource tiers including both commercial and custom databases, eBay relies on a spectrum of Sun servers, storage and software solutions, which reduce the company's total cost of ownership, optimize application performance and help eBay manage its rapidly growing and massive volume of data. Sun Managed Services

provides around-the-clock responsiveness for all data center issues related to the database and search tiers, while Sun Educational Services delivers customized training courses for IT teams worldwide.

5. **Configuration of activities:** Here the significant activities are buying, bidding and selling.

Selling: In order to sell the seller has to list the product. He has to submit the item category most relevant to the product, title of the product, photograph of the product, information relating to the product, start price at which he wants the bidding activity start, preferable payment method, and shipping charges etc. Sellers can sell their products at a fixed price or through bid.

Bidding: Bidding on eBay's auction-style listings is called proxy bidding and is essentially equivalent to a Vickrey Auction, with the following exceptions. The winning bidder pays the second-highest bid plus one bid increment amount (i.e. some small predefined amount relative to the bid size), instead of simply the second-highest bid. However, since the bid increment amounts are relatively insignificant compared to the bid size, they are not considered from a strategy standpoint. The current winning bid is not sealed, but instead is always displayed. However, at any given moment, the highest bidder's bid is not necessarily displayed, since this amount may be higher than the amount required to win the auction.

Buying: Buyer can buy the product which is of fixed price offered by seller or he can go for bidding for products offered by sellers. If the product is offered for a fixed price, buyer can directly pay for that product. If the product is offered on bid he has to win the bid for the product in order to purchase it.

6. **Partner network:** This refers to the business alliances which complement other aspects of the business model.

eBay entered into partnerships with other companies and government agencies to improve production and services. eBay also entered into a partnership with AOL, EachNet, TOM online, UP4sale.com, Butterfield & Butterfield, Billpoint, iBazar, Pay pal, Skype etc. to help share and distribute each other's technologies.

7. **Revenue Streams:** This refers to the way a company makes money through a variety of revenue flows.

eBay derived most of their revenues from fees they receive from the sellers. Browsing and bidding on auctions is free of charge, but sellers are charged two kinds of charges:

- When an item is listed on eBay a nonrefundable Insertion Fee is charged, which ranges between 30 cents and \$3.30, depending on the seller's opening bid on the item.

A fee is charged for additional listing options to promote the item, such as highlighted or bold listing.

A Final Value (final sale price) fee is charged at the end of the seller's auction. This fee generally ranges from 1.25% to 5% of the final sale price.

eBay generated revenue through advertisements posted on its website.

eBay notifies the buyer and seller via e-mail at the end of the auction if a bid exceeds the seller's minimum price, and the seller and buyer finish the transaction independently of eBay. The binding contract of the auction is between the winning bidder and the seller only.

8. **Cost structure:** This refers to monetary consequences of the means employed in the business model.

In 1997, the company received approximately \$5 million in funding from the venture capital firm Benchmark Capital. eBay went public on September 21, 1998, the issue received a tremendous response from the market and the stock closed at US\$ 47. eBay

incurs cost on maintaining the server, paying salaries to employees and introducing the various products also in the acquisition of various products .

A good business model begins with an insight into human motivation and adds in a rich stream of profits. eBay's utility and ease of use have made it one of the world's best known brands almost entirely through word of mouth from satisfied users.

Strengths of the business model:

- **No time constraints:** Bids can be placed at any time (24/7). Items are listed for a number of days (usually between 1 and 10, at the discretion of the seller), giving purchasers time to search, decide, and bid. This convenience increases the number of bidders.

No geographical constraints: Sellers and bidders can participate from anywhere that has internet access. This makes them more accessible and reduces the cost of "attending" an auction. This increases the number of listed items (i.e., number of sellers) and the number of bids for each item (i.e., number of bidders). The items do not need to be shipped to a central location, reducing costs, and reducing the seller's minimum acceptable price.

Intensity of social interactions: The social interactions involved in the bidding process are very similar to gambling. The bidders wait in anticipation hoping they will "win." Much like gambling addiction, some bidders may bid primarily to "play the game" rather than to obtain products or services. This creates a highly loyal customer segment.

Large number of bidders: Because of the potential for a relatively low price, the broad scope of products and services available, the ease of access, and the social benefits of the auction process, there are a large numbers of bidders.

Large number of sellers: Because of the large number of bidders, the potential for a relatively high price, reduced selling costs, and ease of access, there are a large number of sellers.

Network economies: The large number of bidders will encourage more sellers, which, in turn, will encourage more bidders, which will encourage more sellers, etc., in a virtuous circle. The more the circle operates, the larger the system becomes, and the more valuable the business model becomes for all participants.

Captures consumers' surplus: Auctions are a form of first degree price discrimination and they attempt to convert part of the consumers' surplus, defined as the area above the market price line but below the firm's demand curve, into producers' surplus.

Joy of winning: Part of the fun pertaining to the entire bidding process is seeing whether or not you will "win" the auction and get the desired item. This aspect of the online auction process attracts many bidders who find the win just as rewarding as the item.

Weaknesses of eBay's business model

- **Stolen products:** Classified advertisements and other independent sales venues, sometimes

draw criminals wishing to sell stolen products, but for law enforcement organizations, finding stolen goods offered online is sometimes easier than more traditional detection methods.

Uneven representation of items: Sometimes uneven representation of items offered for sale. Descriptions may omit important information, and photos may not be adequate. Potential bidders can typically protect themselves by reading the text, studying photographs and asking questions of the seller before bidding. Studies show that a large proportion of unsatisfactory online purchase experiences are the result of careless consumerism.

Unfair market protection: Within the online auction community this is commonly viewed as an attempt at unfair market protection and trade restraint. Reduced overhead sometimes enables independent online sellers to offer goods at lower prices than large retailers.

eBay's localized approach:

Value proposition: eBay had a monopoly on Internet auction business in China till the entry of Taobao. After losing its market share to Taobao eBay formed joint ventures with PayPal and TOM online. Since the Chinese customers did not trust PayPal and preferred Alipay for making payments. eBay's market share in China witnessed further erosion even after the joint venture. Thus, joint ventures did not contribute to the value proposition.

Distribution channel: eBay did not attempt to change any of its distribution channels to suit Chinese consumers.

Customer relationship: eBay tried to maintain good customer relationships by using Customer Support team, Live Help, dispute resolution centers and community help boards, where eBay users and staff moderators help answer questions and solve problems together. But in China this was inadequate because the Chinese consumers look for trust and excellent customer services before they bought a product due to the weakness of the legal system and other more formal means of settling disputes.

Partner network: Partnering with local banks, insurance firms, and even competitors would be a value proposition left for eBay.

Revenue Streams: eBay EachNet decided that free was a business model and stopped charging fees from its sellers. eBay also made efforts to use an escrow service, where payments would be held until the buyers were satisfied with their purchases. But there were still no significant signs of improvement in the company's market share.

4. The entry of MNC was considered to be the end of local players in markets. With the evolution of new markets and the change in the mindset of the customer, local companies are more successful than before in keeping the MNCs at bay. Critically analyze this statement giving relevant examples from the business world.

Since the late 1970s governments on every continent have allowed the winds of global competition to blow through their economies. As policy makers have lowered tariff barriers and

[<TOP](#)
[≥](#)

permitted foreign investments, MNCs have rushed into those countries. US, Europe and Japanese giants appeared to quickly overrun local rivals and grab the market for almost every product and service. After all they possessed the state-of-art technologies and products, enormous financial resources, powerful brands and world's best management talent and systems.

David and Goliath?

Poor nations such as Brazil, China, India, and Mexico, often under pressure from developed countries, let in transnational companies, but they did so slowly, almost reluctantly. They were convinced that global Goliaths would wipe out local enterprises in one fell swoop. In those countries, smart domestic enterprises are more than holding their own in the face of foreign competition. They have staved off challenges from multinational corporations in their core businesses, have become market leaders or are catching up with them, and have often seized new opportunities before foreign players could. Many of them dominate the market today not because of protectionist economic policies, but because of their strategies and execution. The skeptics should have remembered that David slew Goliath - not the other way around.

Some local successes

- In China, daily use of the search engine Baidu exceeds that of Google China by fourfold; QQ, from instant-message leader Tencent, is ahead of MSN Messenger; and online travel service Ctrip has held off Travelsky, Expedia's eLong.com, and Travelocity's Zuji.com.

In India, Bharti Airtel has taken on Hutchison Telecom, which sold its Indian operations to Vodafone in 2007, and emerged as the leader in the cellular telephone market.

In Mexico, Grupo Elektra, which has created one of the country's biggest retail networks, has taken the battle to Wal-Mart.

In Russia, Wimm-Bill-Dann Foods is the biggest producer of dairy products, ahead of Danone and Coca-Cola.

The local companies' success doesn't augur well for the developed world's corporations, many of which are seeking growth and profits in emerging markets. Many MNCs have planned to expand their commitments to developing countries over the next five years. According to the Economist Intelligence Unit, rapidly developing economies will account for 45% of world GDP and 60% of annual GDP growth by 2010. At the same time, several Western and Japanese corporations have been unable to enter or have retreated from emerging markets.

Some phenomenal failures

Yahoo and eBay have pulled out of China, and

NEC and Panasonic have withdrawn from the Chinese market for cellular handsets.

Reasons for spectacular failures

Part of the problem is that many transnational enterprises mistakenly believe that emerging markets are years behind developed nations' and that the former's markets will eventually look like the latter's. Multinational corporations assume it's merely a matter of time before their existing business models and value propositions start delivering results in developing countries. Developing economies neither are behind developed ones nor show signs of converging with them. The emerging markets are different, behind in some ways and advanced in others.

- For instance, China's telecommunications infrastructure is newer and better than that in most parts of the United States. At the same time, roughly 300 million Chinese live on less than \$1 a day, according to the World Bank.

In India, educated elite who command international wages flourish in a nation with high rates of illiteracy.

In Russia, abundant venture capital coexists with murky property rights and

intimidating bureaucratic barriers.

These disparities aren't likely to disappear soon, and they're creating unique markets. The obstacles and opportunities that characterize emerging markets render useless most cookie-cutter strategies. A simple example: In India, lack of reliable internet access renders online customer service useless. However, wireless telecommunication networks and widespread use of mobile telephones allow companies to help customers, even in rural areas, through text messages and handset-based internet portals. Only companies that are unfazed by such contradictions are likely to succeed.

Western companies often forget that entrepreneurship has recently exploded in most developing countries because of internal reforms. Governments have slashed red tape, and capital is cheaper than ever - and those changes are stoking competition. Emerging markets have become so volatile that multinational companies can't tackle them with strategies they developed decades ago and have since refined in mature home markets.

Some strategies MNCs should copy from locals

One, unlike global companies, local leaders are not constrained by existing products or by preconceived notions about customer needs. They customize products and services to meet different consumer requirements, and they initially go after economies of scope.

Two, their business models overcome roadblocks and yield competitive advantages in the process.

Three, they turn globalization to their advantage, deploying the latest technologies by developing or buying them.

Four, many of the homegrown champions find innovative ways to benefit from low-cost labor pools and to overcome shortages of skilled talent.

Five, they go national as soon as possible to prevent regional rivals from challenging them.

Finally, the domestic dynamos possess management skills and talent that multinational companies often underestimate.

The above strategies are discussed below in detail.

Create customized products or services. The homegrown champions possess a deep understanding of the consumers in their countries. They know people's preferences by region or even city, by income level, by age group, and by gender. These companies also grasp the structures of the raw-materials, components, and finished-goods markets in which they operate. They are therefore able to provide consumers with a low level of customization inexpensively. These local leaders develop offerings tailored to several niche markets and learn to create a large variety of products or services cost-effectively. Some companies develop sophisticated user-generated customization technologies.

In China, consumers favor instant messaging on PCs and off-text messaging on cellular telephones over e-mail. Despite the presence of U.S. heavyweights - such as Microsoft (which launched a Chinese version of MSN Messenger three years ago), Yahoo, and recently MySpace - Shenzhen-based Tencent is the leader in the Chinese market. Its free messenger, QQ, had a market share of 70% to 80% in 2006, compared with 15% for MSN Messenger, according to Shanghai-based iResearch. QQ's cute penguin mascot and ultra-simple interface endear it to China's internet users, 70% of whom are younger than 30. In addition to the free chat program and chat rooms, QQ offers games, virtual pets, and ringtone downloads.

U.S. players have tried to capitalize on users' desire to form cyber communities, but Tencent has taken a different route: It taps into the Chinese craving for freedom of expression. QQ offers digital avatars that users can personalize online, from the clothes they wear to the virtual cars they drive. People can choose from a dizzying array of virtual outfits and accessories, each costing just RMB 1 or 2. The Chinese love the idea of customizing their online messengers, and in less than a decade QQ has become the market leader. "QQ" has even become a verb, and the phrase "QQ me" has been used in pop songs. Since its founding in 1998, Tencent has made steady progress: It had 220 million active users (many Chinese have more than one online identity) and US\$375 million in revenues in 2006.

Innovative packaging

The companies package products innovatively to make them affordable. In India's \$500 million

hair care market, the well-entrenched multinational incumbent Hindustan Unilever, or America's Procter & Gamble and France's L'Oreal are not having it easy. CavinKare, a local company, is giving them a run for their money with its market share of 16%. The Chennai-based startup, established in 1983, packs shampoo in sachets which are convenient to use and to store.

Develop suitable business models

Develop business models to overcome key obstacles. Multinational corporations often complain about insurmountable problems - structural issues such as a lack of distribution channels, or infrastructural hurdles like limited telecommunications bandwidth-that prevent them from doing business in their usual way. Smart local companies are adept at identifying the key challenges that their markets pose and, from the get-go, at designing strategies to overcome or sidestep those obstacles. Sure, multinational enterprises later copy the same tactics, but by then the local ones have sharpened them. For instance, the global leaders in video games, such as Microsoft, Nintendo, and Sony, haven't made much headway in China because of software piracy. Does that mean China doesn't have much of a market for games? Of course not. Chinese companies such as Shanda, which entered the industry in 2001, have developed a thriving game business by developing massively multiplayer online role-playing games (MMORPGs) instead. These products are impossible to pirate since they are live experiences created by technologies that link many players over the internet. China's youth, eager for entertainment options, have warmed to the idea.

Innovative strategies

Innovative strategies sometimes create new businesses in addition to giving local champions an edge. In Mexico, Grupo Elektra wanted to be a successful retailer, but it created a banking business along the way. The company realized early that to make money, it had to sell big-ticket items such as washing machines and refrigerators. Many middle-and low-income Mexicans could buy consumer durables only by taking loans or paying in installments. They couldn't get credit easily because Mexico's commercial banks didn't consider them creditworthy or know how to evaluate their repayment potential. Grupo Elektra started offering consumer financing and, effectively, selling products on installment plans. Once the company offered credit, its business took off. In 1987 Grupo Elektra operated 59 stores; today it runs more than 1,600, making it one of the largest retailers in Mexico. Imitation is a form of followership: Wal-Mart, which is Mexico's largest retailer by sales, obtained a banking license in November 2006 to offer financial services in all its 997 Mexican stores.

Deploy the latest technologies

Contrary to popular perceptions, local winners' products and services often incorporate the latest technologies, as the cases of Shanda and Ten-cent show. New technologies keep operating costs low and enable companies to deliver good-quality products and services. That helps them outperform competitors that believe they can satisfy local consumers with older technologies. Unburdened by past investments or old processes, younger companies in particular invest in the state of the art to lower costs and offer customers novel features.

New technologies can help old companies get a second wind after economic liberalization. Gujarat Cooperative Milk Marketing Federation (GCMMF), India's largest dairy company, manufactures and markets a range of dairy products under the brand name Amul. Despite the fierce competition that has come with the opening up of India's dairy industry to big business, the enterprise has managed to stay ahead, in part because it has invested in the latest technologies.

Take advantage of low-cost labor, and train staff in-house. Many local champions have at their core a business model that taps a pool of low-cost labor instead of relying on automation. Consider, for instance, Focus Media, which has become China's largest outdoor advertising firm. It has placed LCD displays that it engineered in-house in more than 130,000 locations in 90 cities to create a national advertising platform.

Take advantage of low-cost labor, and train staff in-house

Many local champions have at their core a business model that taps a pool of low-cost labor instead of relying on automation. Consider, for instance, Focus Media, which has become China's largest outdoor advertising firm. It has placed LCD displays that it engineered in-house in more than 130,000 locations in 90 cities to create a national advertising platform. Focus Media could link the LCD screens electronically - as any blue-blooded transnational company would-

but it does not. Using people keeps the company's operating costs low while enabling it to offer clients a great deal of flexibility. At the other end of the labor spectrum, skilled talent is hard to find and difficult to retain in emerging markets. Successful companies such as Grupo Elektra, China Merchants Bank, and India's ITC invest heavily in in-house training.

Scale up quickly

In many emerging markets, when a new business opportunity becomes apparent, several companies crop up to capitalize on it. The size of countries like China, India, and Brazil - particularly the large number of provinces and cities-allows regional players to flourish. However, only companies that operate nationwide can reap the benefits of scale. Many homegrown champions go after scale economies after generating economies of scope.

Expansion often entails mergers and acquisitions. Focus Media, for instance, faced many rivals scattered across China's cities when it started out in 2003. It pursued an aggressive acquisition-led strategy, which soon gave it the nationwide reach to attract advertisers and diminish the competitiveness of regional rivals. By scaling up quickly, Focus Media vaulted past two global leaders in China's outdoor-advertising industry: America's Clear Channel Communications and France's JCDecaux.

Create regional entities

Some local champions create regional entities to speed up organic growth. For example, Goodbaby has set up 35 companies, each operating in a Chinese province or a city, to strike local distribution agreements and to open new points of presence quickly. That has spawned one of the most extensive marketing and sales network.

Invest in talent to sustain rapid growth

Invest in talent to sustain rapid growth. In market after market in emerging economies, invading multinational corporations encounter domestic rivals with the entrepreneurial zeal and the knack to keep growing quickly for a long time. They discover, to their shock, that there are great local managers in these countries. In fact, most transnational giants underestimate the management depth and capability of rivals that have the additional advantage of not needing to negotiate with headquarters in a distant First World city. Many companies face the risk of meltdown when they grow at double-digit rates for years. There are no silver bullets to prevent that altogether, but smart organizations minimize senior management turnover and institutionalize management systems to tackle the complexities of rapid growth.

Conclusion

Globalization is clearly a double-edged sword. The advantages of being a transnational corporation in emerging markets have declined dramatically in recent times. Smart local companies have used the benefits of globalization to close gaps in technology, capital, and talent with their rivals from the developed world. Although the average local competitor is weak, transnational corporations would do well to rethink their strategies. After all, it often takes only one strong homegrown champion to shut a multinational out of an emerging market.

❖ **Please note: Students can use any other relevant examples to justify their analysis.**

5. E-Commerce deals with the buying, selling, and distribution of information, products, and services through computer networks. E-commerce is expanding because of the developments in internet. E-Commerce ensures minimum inventory control, improved customer service, and global reach.

[<TOP](#)
[≥](#)

Opportunities: China was important for Internet companies not only because of its large market size, but also for its vast talent pool.

- **Favorable Demographics (young people):** China is a country with huge population. China has a huge potential growth in e-commerce. As of 2007, China was the world's second-largest Internet market after the US. According to the China Internet Network Information Center (CNNIC), the number of Internet users in China had reached 162 million by the end of July 2007. This is only 10.5% of the total population and it is expected to grow in the future. Of these, 122 million surfed the Internet using a broadband connection. The market scale for e-commerce in China grew from RMB 120 billion in 2001 to RMB 680 billion in 2005. In comparison to the overall e-commerce market, the C2C market was smaller but had kept pace with the growth in the overall market.

Online hours spent: On an average, the Internet user in China spent 17.9 hours online per week, compared to the 11.4 hours per week spent online by a user in the US. The Internet users in China comprised only 10.5 percent of the country's population of 1.3 billion, which meant that there was a huge potential for future growth.

Surging market: The e-commerce market was a surging market in China. According to the iResearch Consulting Group (iResearch), the online shopping market was estimated at RMB 12.26 billion for the second quarter of 2007.

Drawbacks: Despite huge opportunities, the Chinese e-commerce market is not without its challenges. The following are the drawbacks of e-commerce market in China:

- **Government regulations:** The political agendas of some governments may be beneficial for markets, while those of others may harm their interests. The Chinese government enforced regulations related to Internet access, content regulation, encryption, and domain name. Chinese e-commerce market was highly influenced by government regulations. Several internet security regulations are imposed by the government. These regulations made foreign players to think twice to move into the Chinese market. The government also set certain provisions related to Internet access. There is a four-tier system for accessing the Internet. Domain regulations required e-commerce companies to register their domain names with the CNNIC. The encryption regulation forced e-commerce companies to obtain approval from the National Commission on Encryption Code Regulations (NCECR), an encryption regulation agency, for using Chinese products and encrypted imported products. The regulations related to security involved censoring the content and preventing dissemination of sensitive information relating to the Chinese economy. Under this regulation, all Internet companies were obliged to censor sensitive content.

Language: Chinese language is very complex, made up of pictograms and ideograms. It is difficult to distinguish the words and phrases. This makes it difficult for website or search engine design. For the foreign players it is a difficult task to develop a website or search engine that suits to the complex Chinese language. Due to this international internet companies are need to seek the local help to understand the Chinese consumers and to deal with the local matters.

Consumer behavior: Consumer perceptions, attitudes and behavior play an important role on the market. Chinese consumers are reluctant in using credit card. They have many doubts over the security of the credit card payment system. They possess a credit card for status symbol but not for purchasing. They purchase only on cash. They are not ready to go for online purchase, because of several doubts on quality of the products and after sales service. Because of these reasons the internet user of Chinese is only 10.5 percent of the country's population. It is expected to grow in future.

Logistics system: Customer always expects prompt service. Logistics system plays an important role in providing prompt service and achieving better responsiveness. An efficient logistics system leads to the success of the business. In China, the logistics system was inefficient when compared to other developed nations. Underdeveloped transportation systems, inadequate use of technology, and inconsistent distribution system are the reasons for unreliable logistics system. It is a major constraint for the development of e-commerce in

China.

Management talent: In order to deal with Chinese e-commerce market, local assistance is needed compulsory. But a deficiency in local management talent is a constraint for the development of e-commerce market in China.

Consumer orientation: China was making a transition from investment-led growth to consumer-led growth. The youth population in the country was the primary reason for this move. Companies looking towards the Chinese e-commerce market need to understand this transition. Failure to accommodate for this transition will lead to disorientation of the consumer.

Regional Disparity: Internet development is not balanced in China. From October 1997 to January 2002, the eastern Internet users take up 75.43% of the whole population, while that of central region stand about 14.25%, and in the western part the number is 10.3%. That is to say, the total number of the latter two has not stood one second of the eastern part. Also, there are differences in domain names. In the eastern part, the domain name takes the percentage of 85.7%, and 7.5% in central part, 6.76% in western part. These regional disparity is an hindrance for the uniform growth of e-commerce market in China.

Behavior: The most pronounced impact of culture lies in the populace. As China is a high-context and low trust country, trust mostly are established through similarity or identity, whereas the institutional-based trust is relatively difficult to build in China. That is to say, people as well as companies believe more of their own recognition or acquaintance's words than technological or institutional promises. When applying in E-commerce, we can clearly see that investors will not easily believe in online trading simply because of its high-secure technology and fluent working process. Moreover, they are easily to be inspired by an ease appraise of their local business fellows rather than the long technical words of multi national corporations. Besides, long educated by Confucius, people in China have a strong community-tendency behavior. No one wants to be showing one. This philosophy can not only explain the low innovation adoptability but also show investors' caution in accepting online trading.

Economy & Internet Environment are comparatively Weak for E-Commerce Development: It is clearly noted that China is still very weak in whatever economic environment or the Internet infrastructures. Though the GDP base is large, yet GDP per Capita is small. It is even worse for Internet penetration whose rate is still lower than 5%. The lower growth rate internet may leads to take more time for the foreign players to reach their break-even-point.

Nine Problems in Development of e-commerce in China

- Network safety,

Internet infrastructure construction,

Social business credit problem,
e- commerce related laws and regulations,
Standardization problem,
Network payment,
Acceptance degree of enterprises on e-commerce,
Network market capacity, and
Lack of management talents.

[< TOP OF THE DOCUMENT >](#)