

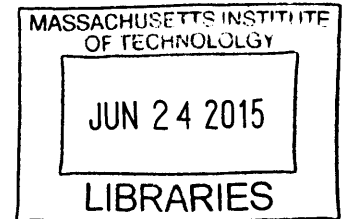
**"Marketplace" or "Mall"? Business Model and Strategy for a  
Startup in China's B2B E-commerce Market**

**ARCHIVES**

By

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# **"Marketplace" or "Mall"? Business Model and Strategy for a Startup in China's B2B E-commerce Market**

By

**Chen Lin**

Submitted to MIT Sloan School of Management  
on May 8, 2015 in Partial Fulfillment of the  
requirements for the Degree of Master of Science in  
Management Studies.

## **ABSTRACT**

E-commerce companies face a strategic decision to choose the business model. Should they choose the Marketplace model, an online Intermediary on which suppliers sell their products directly to buyers? Should they choose Mall model, on which intermediaries purchase products from suppliers and sell them to buyers? Or should they choose the Hybrid model, which blends the Marketplace and Mall models.

While most literature focuses on the Marketplace model and discusses its pricing and efficiency issues, Hagiu and Wright's papers focus on the tradeoff between Marketplace and Mall, and more importantly, propose six criteria to decide the right model. My thesis will apply the theory to choose the right business model for an E-commerce startup and design the strategies to implement this model. My thesis will be a practical contribution to this field.

My thesis will examine the current E-commerce market, analyze the tradeoffs of different models, choose the right model for the startup, and recommend strategies to implement this model.

**Thesis Supervisor:** Michael A. Cusumano  
**Title:** SMR Distinguished Professor of Management

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## Introduction

In recent years, E-commerce has generated profound influences in China as well as the whole world in various ways. Productivity of almost all industries has significantly increased. Overhead cost is dramatically reduced and remote business transactions become instant. E-commerce is also changing people's lifestyles. Larger numbers of product selections are provided and shopping is no longer time-consuming.

In coming decades, E-commerce is going to continuously innovate the world. Many E-commerce companies have succeeded and thrived. However many more companies are still struggling for survival or have already disappeared in competitions. Adopting a right business model is one of the most critical steps for E-commerce companies' success. Moreover, the application of business models is an evolving journey. Choosing a right business model at the very beginning doesn't guarantee success forever. Only continuous exploration and innovation of a better business model keeps those famous E-commerce companies competitive and powerful.

This thesis discusses the business model and strategy for a startup in China's B2B E-commerce market. In chapter one, we study the definition and influence of E-commerce, the differences between E-commerce and traditional commerce, and the global E-commerce market. In chapter two, we introduce three business models of E-commerce and analyze them with practical case studies. In chapter three, we compare "Marketplace" and "Mall" models by pointing out their pros, cons and adopting criteria. In the last chapter, we analyze China's unique B2B E-commerce market, challenges of "Marketplace" model, and opportunities of

“Mall” model. Then we choose the “Mall” model for the B2B E-commerce startup by checking with Hagiwara and Wright’s 6 criteria. Finally, we discuss five implementation strategies for the “Mall” model.

## **Chapter 1: E-commerce Market Overview**

### Introduction

Today, E-commerce is playing an increasingly important role on both business and personal life. Consumers' shopping habits are changing greatly especially in the last ten years. Instead of thinking about which store or supplier they would choose, consumers prefer searching items online and clicking the "buy it now" button. E-commerce offers more selections at relatively lower price. What's more important is that E-commerce saves time, effort and energy. In this chapter, we will first define what E-commerce is and what influence it has. Then we will compare E-commerce with traditional business. Finally, we will study the landscape of global E-commerce market.

#### 1.1 Definition of E-commerce

E-commerce can be defined as purchasing and selling of goods or services via electronic channels such as the Internet. E-commerce is divided into three categories: Business-to-Business (B2B), Business-to-Consumer (B2C), and Consumer-to-Consumer (C2C). B2B involves companies doing business with companies. One example is when manufacturers sell products to distributors. B2C involves companies doing business with general consumers. One example is when retailers sell products to end consumers. C2C involves individuals buying and selling goods on online marketplaces (Arline, 2015).

## 1.2 Influence of E-commerce

E-commerce has a great influence on the society and the economy. It has created a new method for customers to buy and sell products, improving efficiency and effectiveness. E-commerce brings benefits to organizations, individuals, and societies.

For organizations, E-commerce expands market exposure to global reach, reduces cost, improves logistics and operations, and extends working hours to 24/7. For individuals, it offers more variety of products and service, more chances for better and cheaper products, twenty-four-hour shopping, and better service. For society, it creates more working opportunities, raises standard of living, reduces traffic and pollution, and provides service to more rural areas.

However, e-commerce also has negative impacts on both consumers and retailers. The first problem is privacy. It is easy to collect personal information, shopping habits, or preferred goods. Many e-commerce companies use those kinds of data to classify customers, send targeted advertisements, and establish market plans. However, they should be aware of the risk of intrusion on a consumer's privacy. Another problem is security. Unlike traditional transactions, online transactions face technical risks such as computer viruses and system bugs. Furthermore, online transactions cannot guarantee that consumers who make the payment actually own the credit card. The third problem is customer complaints. E-commerce generally has a higher return rate than traditional industry, because customers cannot see the goods prior to purchase. However, return of goods would be much more difficult than buying goods, raising many customer complaints.

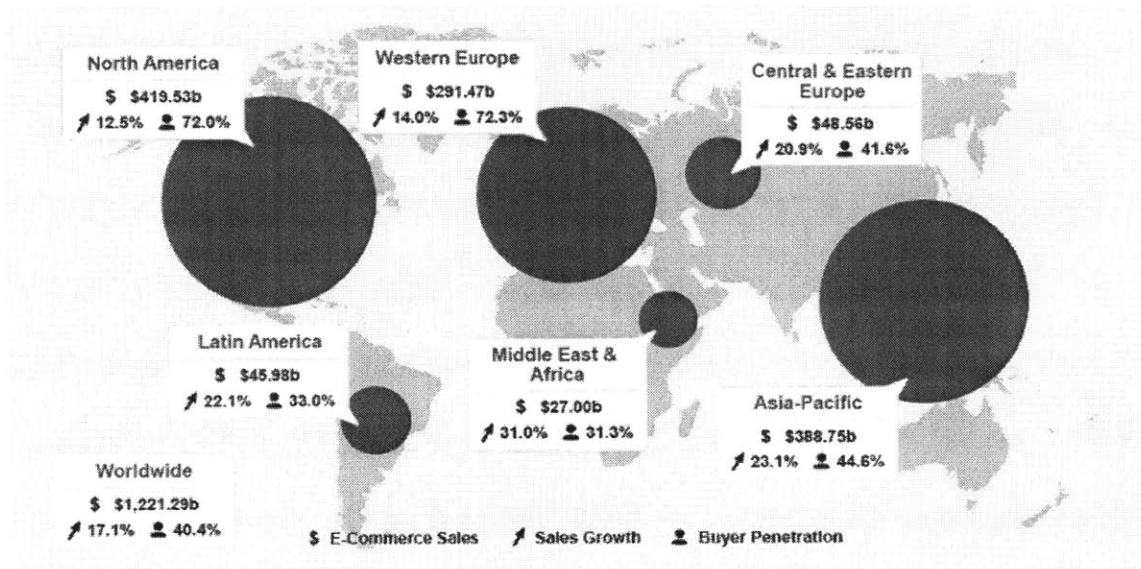
### 1.3 Comparison of e-commerce and traditional commerce

E-commerce outperforms traditional commerce in several aspects. First, e-commerce is time-efficient. Consumers just sit in front of their computers to search, compare, and make deals. They don't need to leave their homes or offices to shop, saving much time in traffic. Customers also save time on searches because e-commerce makes it easier to compare similar products. Second, e-commerce doesn't have time limits. It offers service twenty-four hours a day. Buyers and sellers can deal at any time. Third, e-commerce increases efficiency. Sellers can serve multiple buyers simultaneously and buyers can compare multiple sellers at the same time. Finally, e-commerce reduces cost. Unlike traditional commerce, e-commerce doesn't need large space and many employees, saving cost on rent and labor. E-commerce also reduces distribution cost by selling directly to consumers, while traditional commerce has many intermediaries in its distribution channel. Therefore, e-commerce can offer customers lower prices and better service.

### 1.4 Global e-commerce market

The global B2B e-commerce market reached total sales of \$1.22 trillion in 2013. North America is the largest e-commerce market. Asia-pacific region is the second largest market, with 388 billion in sales. Asia-Pacific region is also the largest contributor to global e-commerce growth. In terms of buyer penetration, penetration rates in mature markets are much higher than those of emerging markets. Seventy-two percent of Internet users in North America bought goods or services online, compared to 44% in Asia (Richter, 2013).

Graph 1: Global e-commerce sales and online buyer penetration rate 2013



Source: marketer

## Conclusion

This chapter gives us an overview of the landscape of E-commerce. E-commerce, whether B2B, or B2C, or C2C, has both positive and negative effects for customers and the society. However, the advantages of E-commerce outweigh the disadvantages. Shopping becomes easier for customers and the productivity of the business and even the society have increased considerably. E-commerce will continuously have greater impact with 20% growth rate in the global market. Next chapter, we will further study different business models of E-commerce.

## Chapter 2: Business models of E-commerce

### Introduction

Just as the traditional industry has different business models such as department stores, supermarkets, wholesalers, etc., E-commerce has three major business models: Marketplace, Mall, and Hybrid. Different companies choose business models according to specific products, services, and most importantly strategies. In this chapter, we will discuss the three major business models in E-commerce, including definitions and case studies. In this chapter, readers will understand the differences between the business models and their application in the real world.

### 2.1 What is a platform?

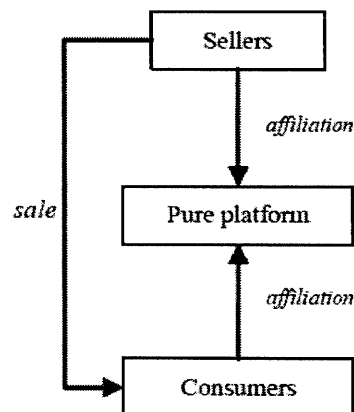
The term *platform* first came to use as a word meaning “foundation of components around which an organization creates a related but different set of products.” In Michael A. Cusumano’s book *Platform Leadership*, the “platform” is defined as an “industry platform”, which has two important differences from traditional “product platform”. First, it is a foundation or core technology that has little value to users without complementary products or services. The platform owners need other companies to build related essential complements to make the platform powerful (in some cases platform owners develop complements by themselves). For example, smart phones are just ordinary phones with limited value without Internet services or mobile applications. Second, industry platform

creates network effects. The increasing number of platform users contributes to growing positive feedback loops at amazing rates. Complementary services lead to direct network effect and the number of users drives indirect network effect to the platform. Most importantly, a network effect means that the more external adopters in the ecosystem, the more valuable the platform becomes (Cusumano, Staying Power, 2010).

## 2.2 “Marketplace”

### 2.2.1 Definition

“Marketplace” is a type of online Intermediary on which suppliers sell their products directly to buyers (Hagiu & Wright, Marketplace or reseller?, 2014). “Marketplace” is also called “two-sided network”, with sellers and buyers on both sides. Sites such as Taobao, EBay, and Apple store are perfect examples where those marketplaces serve as an information or a transaction platform but leave the control of trading to buyers and sellers.



Source: Andrei and Wright 2014



## 2.2.2 Cases studies

### *Taobao*

Taobao was established in 2003 by Jack Ma, CEO of Alibaba.com. Back then, the online shopping market was dominated by eBay China, with more than seventy percent share. However, by 2006, Taobao overtook eBay China as the largest platform and by 2008, Taobao held over eighty percent of the market. How did Taobao overwhelm eBay in the online shopping space (Taobao vs. Ebay China, 2010)?

It has adopted three business strategies. First, it has the “Completely Free of Charge” strategy. While eBay China charged listing and transaction fees to sellers, Taobao announced that it did not charge any listing fees and transaction fees. Free service is the key strategy to gather popularity and attract buyers and sellers in a short time. Although Taobao doesn’t charge for listing and transaction fees, it charges advertising fees and shop decoration fees from sellers. Second, it uses promotion strategies. Between 2004 and 2005, Taobao announced strategic alliances with Chinese Internet portal websites such as Sohu and MSN portal. It also invested heavily on movies and TV programs to expand its brand. The influences of advertising made Taobao receive good marketing. Third, it has innovation in payment. It created a new third-party payment platform – Alipay. Alipay enabled Taobao buyers to pay sellers indirectly. Buyers first pay to the Alipay. After confirming the delivery and quality of products, the buyers authorize Alipay to pay for sellers. This innovation on one hand protects the right of buyers from fraud, and on the other hand forces sellers to improve qualities of products and services (Group SIX, 2012).

Taobao is a typical Marketplace for online shopping, where sellers list their products and

buyers shop for products. For example, P&G sets up a flagship shop on Taobao as a direct sale channel to consumers. On this two-sided network, Taobao provides product information and facilitates transactions for both buyers and sellers.

### **Marex**

Marex was a Miami-based start-up that later became a public company at NASDAQ. The company was founded in 1992, providing industry research reports. In 1999, the company changed its mission and rename itself Marex. Marex raised more than \$52 million from investors, but also accumulated losses of more than \$73 million from 1997 to 2002. The company is a story of “good idea gone bad due to uncontrolled spending, some bad luck, and too little probing of what customers wanted- and didn’t want”.

Marex’s founder, David Schwedel, came up with the idea to link boat builders with boat dealers and component suppliers, replacing mail and faxes with an Internet-based marketplace platform. Between 1999 and 2001, Marex spent more than \$16 million on software development and technology purchase and nearly \$12 million on sales and marketing. The goal continued to be the creation of an online marketplace. The original plan for generating revenue was charging transaction fees on business going through the exchange. However, this model fell into disfavor as most e-commerce ventures failed on this model. The company returned to the subscription model.

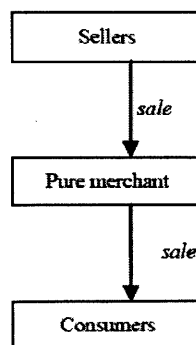
Finally, Marex came down to earth in late 2001. Several senior executives resigned. The company had been badly out of control and wasted far too much money. Professor Michael Cusumano summarized its failure into three mistakes. The first mistake was misplaced faith in

the marketplace and transaction-fee concept, which was hard to evaluate in the late 1990s. The second mistake was the belief in a monthly service-fee concept. Not enough companies were willing to pay \$150 a month without evidence that they would save at least that much. A third mistake was to put so much stock in the relationship with a large boatbuilder. The relationship was critical for raising money, but it did little to generate revenue. But the biggest mistake was the lack of control over spending, both on software technology that took too long to get working and on sales and marketing that brought too few results (Cusumano, *The Business of Software*, 2004).

## 2.3 “Mall”

### 2.3.1 Definition

“Mall” is a “type of online Intermediary on which intermediary purchases products from suppliers and sells them to buyers” (Hagiu & Wright, *Marketplace or reseller?*, 2014). “Mall” is also called “reseller” or “one-sided network” model. Apple iTunes, Walmart, Zappo.com are Mall examples that serve like a merchant.



### 2.3.2 Case studies

#### RealNetworks

According to OneSource.com, RealNetworks (Real) is “a provider of network-delivered digital media products and services. The Company provides the digital media services and products to consumers, mobile carriers and other businesses”.

Real's original business model was Marketplace, where consumers download streaming media for free and content companies paid for the server software. Real had dominated the market and made modest profits until it came under attack from Microsoft. Microsoft supplied its Windows Media Player (WMP) for free while bundling its streaming server software in its NT server. As content companies switched to NT, customers switched to WMP with them. By 2003, WMP accounted for 42% of the market, compared to 19% for Real's player. Real also faced threats from Yahoo, which introduced a similar subscription music service for five dollars per month. Yahoo could afford to price aggressively, since bundling subscription music into its portal would not only increase user retention rates, but also increase revenue from cross-marketing.

Real's response to competition was to switch to the Mall model. Real leveraged the existing relationships with consumers and content companies to charge ten dollars per month for unlimited streaming to any PC. Real found allies through partnerships with cable TV system operators and telecom carriers. Subscription music made cable modem sticker, because consumers had high switching costs to change vendors and had troubles to configure new players and recreate new playlists. Real also bundled its service with Sprint's wireless service. Sprint subsidized digital music playback on their phones in order to reduce churn rates

(Eisenmann, Parker, & Alstynne, 2006).

Although Real did not take possession of the streaming it distributed, it had the exclusive right to bundle and price the content. The ten dollar a month fee was entirely Real's decision rather than the content companies'. Through this unlimited streaming service, Real transformed from Marketplace to Mall.

### **Zappo.com**

Zappos was first established in 1999 as a Marketplace to facilitate online shoe transactions between customers and suppliers. Although Zappos laid off half its staff because of the dot com bubble burst, the company recovered and reached sales of \$32 million in 2002. However, Zappos was still not profitable at that time. In 2003, the company decided to transform itself to Mall (Zappos: Delivering Happiness to Stakeholders, 2012). The company found that buyers favored great retail experiences, fast delivery, favorable return policies, and standardized information about product characteristics. Zappos found that it could not meet customers' expectation if it continued to operate as a Marketplace. Therefore, Zappos began to hold its inventory and control the whole value chain, from order to fulfillment to delivery. After transforming to Mall model, the company first became profitable in 2007. In 2010, Amazon acquired the company for \$1.2 billion, but agreed to let Zappos operate independently (Hagiu & Wright, Do You Really want to Be an eBay?, 2013).

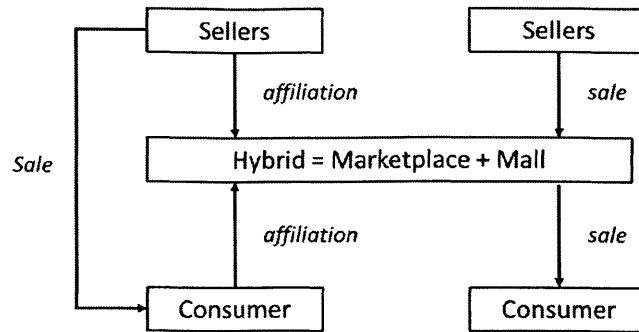
Zappos focuses on building long-term relationship with customers by offering great retail experiences, free shipping, and excellent customer service. The site is designed for an easy shopping experience. For example, customers can clearly view pictures of a product from

different angles. Zappos also views returns as the opportunity to maintain long-term relationships and offers a hundred percent money back guarantee for a year. For example, Zappos's most profitable customers returned half of what they purchased, compared to 35% of the industry average. However, those customers become very loyal to Zappos and make many purchases. Zappos also builds a customer service system, which makes it very unique in the industry. It encourages customers to call at any time and does not limit the time for every call. Employees help customers to shop and encourage them to buy different styles or colors to try, a reason that the return rate is higher than industry average. Zappos considers great customer service to be the key to customer retention and also create a word-of-mouth attraction for new customers. Over 75% of the purchases from repeat customers is a good indication of Zappos' excellent customer service (Zappos: Delivering Happiness to Stakeholders, 2012). All of those services can be offered only under the Mall model.

## 2.4 "Hybrid"

### 2.4.1 Definition

Intermediaries can choose a hybrid of Marketplace and Mall models. There are different kinds of hybrids. Intermediaries can act as marketplaces for certain products while acting as resellers for the other products such as Amazon.com. They can also act as marketplaces connecting two sides but controlling the prices and services similar to Uber. The Hybrid model is getting popular since it takes advantage of both the marketplace and mall models.



## 2.4.2 Cases Studies

### Amazon

Amazon is known as the largest Internet retailer in the world. In 1995, it began as an online book seller applying the “Mall” model then quickly widened its business to music, movies, electronics and even household goods. It offers the largest selections of products on its website and sells at a relatively lower price with a small profit. But Amazon doesn’t hold inventory for every item on its website. It only stocks fast-moving products with high market demand. In order to have a wider selection of products, Amazon also acts as a marketplace for other retailers to sell their products and takes a cut from every purchase. Those retailers, normally selling slow-moving products, are responsible for their own price setting, inventory management, shipping and advertising. As a result, Amazon has increased their available products online without adding overhead cost, which makes it a leading long-tail retailer. To further extend the long-tail retailer model, Amazon introduced the sale of used products through its seller marketplace and brought in another source of revenue for the company.

Amazon is also famous for its Kindle tablets. It sells Kindle tablets both on its website and through other traditional or electronic retailers. Kindle is an electronic book reader and a

media device. Virtual books are sold on Kindle, becoming an effective supplement for the book selling business. Surprisingly, Amazon doesn't make money by selling Kindles. They even sell Kindles at a loss. They just use the Kindle to attract consumers to buy electronic books, games, and videos to compensate for the loss. As well as physical products, Amazon sells Internet services charging for an annual fee, such as Amazon Prime, which provides free two-day shipping on retail purchases, free access to the Kindle library, on-demand video streaming, etc.

This company is operating multi-lines of business with a "Hybrid" model. Price and convenience are core value propositions of the company, which enables it to develop and strengthen good customer relationships. These value propositions are going to drive sustainable growth and continuous innovation to Amazon (Noren, 2013).

## **Uber**

Uber is a mobile-app-based transportation network, which differentiates it from the traditional transportation network (Rusli, 2014). This Uber app is integrated with Google map. When customers request an Uber car, they can set their meeting point on the screen and see how far away the nearest cars are. After customers confirm hailing a car, drivers confirm the order via the app and inform the customer they are on the way. Customers can even see driver's information, including photo, phone number, and rating when cars are going to the meeting location. Once the car arrives, the driver greets the customer by name and the customer hops in. Once the customer arrives at the destination, they just hop out and their card is charged by the app. Customers don't need to deal with cash, change, tips and receipts.



The app also reminds customers to rate drivers and provide feedback (Brown, 2013).

It seems that Uber was applying a “Marketplace” model as it was just a platform between passengers and drivers. They don’t own any car for transportation. However, Uber is a “Hybrid” model. What differentiates it from the “Marketplace” model is that Uber sets rates and manages transactions between passengers and drivers. What’s more important is that Uber is responsible for after-sale service such as drivers’ rating, customer feedback and complaints.

Up until 2013, Uber has been valued at \$3.76 billion and operated in more than thirty-five cities worldwide. It completely changes passengers’ riding experience and creates more job opportunities for drivers (Hagiu & Wright, Do You Really want to Be an eBay?, 2013).

## Conclusion

Although companies choose different business models according to their products, services and strategies at the beginning, the models are adjusted according to the varying situations. A company may totally abandon the Marketplace and change to the Mall, and vice versa. Choosing the right business model is extremely critical because it ensures success for the company and effectively avoids potential commercial risks. This leads to the question: What is the right model for an E-company? In the next chapter, we will compare different models and identify the criteria for selecting the right model.

## Chapter 3: Choose the Right Business Model

Introduction:

Every E-commerce company faces a fundamental strategy decision of which business model to adopt: Mall, or Marketplace, or Hybrid. The past decade has seen a marketplace bubble. New marketplaces are created every day, which makes it easier for buyers and sellers to interact directly, bypassing traditional middlemen. One reason is the success of eBay and Alibaba in B2C and B2B market respectively. Another is that Marketplace looks financially more alluring than Mall. Marketplaces usually take a cut from each transaction. As a result, their operating costs are low and their percentage margins are high. Because Malls must buy and sell their offerings, they typically have higher revenues but also higher capital and operating costs and lower percentage margins (Hagiu & Wright, Marketplace or reseller?, 2014).

The attractions of Marketplace have enticed many companies to try to apply this model without considering the challenges of Marketplace and ignoring the opportunities of Mall.

### 3.1 Challenges of “Marketplace” model

#### **Challenge 1: Pricing the Platform**

Pricing is more complicated for Marketplace than traditional industries. Marketplaces have to decide the subsidy side and money side. There is a cross-side network effect: if there are more subsidy side users, the money side users are more willing to pay. If your subsidy side

user can transact with a rival platform's money side user, your resources are wasted. For example, Netscape subsidized individual users, hoping website owners would buy their server software. However, competitors such as Microsoft also provided similar server software. The website owners did not have to buy Netscape. Regarding user sensitivity to price, Marketplace should subsidize the price-sensitive side and charge the side benefiting from the growth of the subsidy side. Regarding user sensitivity to quality, for example, Adobe provides free software for readers, while charging writers who value a 500-million user base (Eisenmann, Parker, & Alstyne, 2006).

### **Challenge 2: Winner-Take-All Dynamics**

The economy of scale may lead to the winner-take-all situation. Platforms must decide whether to share or fight to the death. The decision risk is much higher when the market allows fewer rivalries to exist. Sometimes, wrong decisions can greatly hurt the company, such as SONY's battle of Betamax videocassette standard. You need to consider three aspects: multi-homing costs, network effects, and the user's preference for special features. If the multi-homing cost is high, network effect is strong, and no preference for special features, a networked market is likely to be served by a single platform. The DVD industry meets all three criteria and is likely to be served by one platform. Therefore, potential platform competitors face a choice: fight to the death or cooperate. Industrial participants chose to cooperate and jointly created a DVD format.

First-mover advantages are not always decisive. Later movers can also avoid the position mistakes, use the latest technology, and reduce cost. For example, Google lagged behind

Yahoo for several years, but provided a simple and fast-loading homepage. It also copied Overture's paid-listing model to generate revenues from searching. Now Google becomes the dominate search engine in the market (Eisenmann, Parker, & Alstynne, 2006).

### **Challenge 3: The threat of Envelopment**

Existing platforms also face the challenge of being enveloped by adjacent platforms, which have overlapping user bases. When your new rival offers your platform's functionality as part of a bundle, your platform will meet real danger. Since the new rivalry provides the same functionality with a lower total price, stand-alone platform providers cannot afford to cut the price and they cannot copy a comparable bundle. For example, Real's original business model was a Marketplace: users downloaded player for free and content companies paid for the server software. Later, Real was under attack from Microsoft. It offered free players like Real, but it bundled the server software with its NT Servers. In this way, the content companies bought NT Server to get a free streaming media server software. By 2003, 42% of Internet users in North America used WMP, compared to 19% for Real's player (Eisenmann, Parker, & Alstynne, 2006).

### **Challenge 4: Chicken-egg problem**

The hardest part of any business is the beginning, but this is especially true for Marketplace companies because you have a classic chicken-egg problem. The problem is that buyers will not join your platform if you don't have enough sellers. Sellers won't either if you don't have enough buyers.

### **Challenge 5: Double company problem**

It's worse than it sounds because you also have the "double company problem": You're trying to build two successful companies at the same time. For example, Priceline has to create integrations between hotel management systems and their database. At the same time, they also run television ads and build a user-friendly website. These are distinct operations, different clients, and different technology - almost like two separate companies (Cohen, 2010).

### **Challenge 6: High Capital Requirement**

Since Marketplace has to attract both sellers and buyers, it requires huge investment in advertising, marketing, technology and operation. It is extremely difficult for companies with limited funds, especially in a market where there are already big players. For example, during the famous Taobao vs. eBay rivalry, Taobao first spent \$20 million on advertising in 2003. Then in 2004, eBay invested \$100 million on advertising and promotions, covering every channel, including websites, TV, and broadcasting. In 2005, Taobao announced \$130 million for promotion, finally defeating eBay and taking fifty-seven percent of the market share (netease, 2009).

## 3.2 Opportunities for Mall

### **Better Customer Experiences**

By controlling the products, Mall enables a better consumer experience. You have

visibility into your stock level, know where the product is physically located, and control the pick, pack and ship process. This means that you minimize the likelihood of accepting an order only to later discover that you don't have the product. It also means that you can optimize dispatch time. The bottom line is that being in control of the product enables you to deliver faster and with higher accuracy, and respond effectively to customer inquiries about shipping status (Somaia, 2013). Moreover, since you have more control on the quality of the products, customers are less likely to complain about product quality.

The mall model also provides better pre-sale and post-sale customer services by providing well-trained salespeople and a standard process. Unlike in Marketplace, where customers have to deal with different sellers with different skills and processes, in Mall, well-trained salespeople can provide high quality services to customers. When a customer wants to purchase many different products, the salesperson can be a point-of-contact and give advice, saving the selection cost and time for customers. Finally, if a customer wants to complain or return a product, Mall makes it easier and more convenient with standard process and one point-of-contact.

### **Solutions to High Capital Requirement**

Although Mall has high capital of holding inventories, the e-commerce company can keep minimum inventory at the beginning. Other possible ways of mitigating capital intensity while remaining in control of the product include vendor credit, consignment sales (where products are in the possession of the E-commerce company but are not paid for upfront) or back-to-back purchasing (where the E-commerce company places the order on a vendor/supplier after receiving an order from a consumer). For example, ASOS, a UK-based online lifestyle retailer,

has net working capital of less than two percent of sales while operating an inventory model (Somaia, 2013).

### 3.3 “Marketplace” or “Mall”: study of the adoption criteria

Despite those challenges, marketplace model has proved to be a powerful business model. The attractions of multisided platforms have enticed many companies to try to apply the model in cases where the Mall model would have a better chance to succeed. For instance, all attempts to create an eBay-style marketplace for patents have been shut down, redirected, or scaled back (Hagiu & Wright, Do You Really want to Be an eBay?, 2013).

Hagiu and Wright also proposed criteria to choose the right model. If you answer yes to any of the six questions, then Mall is probably a better choice.

1. Are there significant economies of scale to be exploited?
2. Can your company create and extract more value by bundling or selling complementary products?
3. Do buyers derive significant benefits from aggregation?
4. Is your company able to create a better buyer or seller experience by taking control of transactions?
5. Do buyers need to be protected from sellers or vice versa?
6. Does one side have a disproportionate information or bargaining advantage?

## Conclusion

Although Marketplace seems attractive, its challenges include the “chicken egg problem”, “double company problem”, and “high capital requirement”, as stated earlier. The “Mall” model has advantages of better customer service and higher-quality products. The barrier for a “Mall” model about high capital can be addressed by outstanding inventory management.



## **Chapter 4: Implement “Mall” for a startup in China’s B2B E-commerce Market**

### **Introduction**

China is a very unique market for B2B E-commerce in the world. A majority of B2B companies in China have succeeded because they offer tremendous numbers of export products of high quality. In China B2B industry, most sellers are domestic producers and most buyers are foreign importers. As a result, focusing on the implementation to improve customer service for foreign importers becomes particularly important to B2B companies. In this chapter, we will apply Hagiu and Wright’s criteria to decide the right business model for a startup. A business plan is designed for the startup.

#### **4.1 China’s B2B E-commerce Market Analysis**

##### **4.1.1 History and development**

China’s first e-commerce website was established in 1995. From 1997 to 1999, some well-known e-commerce websites such as Alibaba, Taobao, and Dangdang were founded and grew steadily. But after the Internet bubble burst in 2002, the expansion of e-commerce severely slowed down. After experiencing depression from 2003-2005, e-commerce began to revive from 2006. In 2008, the global financial crisis offered e-commerce a great opportunity that many small or medium-sized manufactures expanded the domestic market by using e-commerce. From then on, with improvement of Internet infrastructure and rapid growth in domestic economy, China has been experiencing rapid growth in e-commerce. In 2014, China overtook the US as the largest e-commerce market in the world.

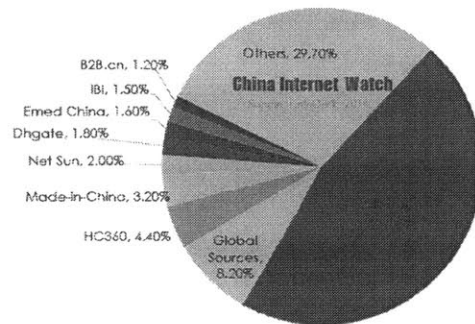
#### 4.1.2 Market Structure and Big Players

According to EnfoDesk report, China's B2B market reached \$1.16 trillion in 2013, with a 19.7% average annual growth. The market revenue in 2013 was \$2.76 billion, 25.1% increase compared to last year. EnfoDesk report also predicted that 2013 was the first year of a new growth cycle of China's B2B market (Sida, 2014).



In 2013, Alibaba, Global Source, and HC360 were the three biggest players in China's B2B e-commerce market with 59.3% market share. The top eight B2B websites capture nearly 70% of the total share. However, the market share of the top eight players is continuously declining. In 2013, the market share fell by 2.9%. This decline can be attributed to the rapid development of vertical e-commerce websites, which concentrate on a certain industry. For example, Mysteel focuses on serving the steel market, enjoying an increase of market share in 2013 (Sida, 2014).

### China B2B Market in 2013



Source: enfodesk,2013

### Alibaba

Alibaba is the largest e-commerce company in China and in the world. It was founded in 1999 by Ma Yun (Jack Ma). Alibaba connects suppliers and buyers throughout the world, providing selling and buying information to both sides. It is a comprehensive domestic and foreign platform, which covers most industries.

According to Alibaba's financial report, in 2009, its registered users reached 45.27 million, with 34.79 million from China and 10.48 from overseas. In 2013, its revenues reached about \$5.8 billion and its net income reached \$1.3 billion. Eighty percent of China's online shopping market is dominated by Alibaba. Alibaba's three main websites—Taobao, Tmall and Alibaba.com hosts millions of buyers and sellers.

### GlobalSources

GlobalSources is a multi-channel B2B platform. Its distinctive characteristic is it holds many exhibitions each year. Like Alibaba.com, it targets the export trade in the Greater China region—Main land China, Hong Kong, Taiwan, and Macau.

The combination of online and offline interaction is GlobalSources' competitive advantage. GlobalSources owns many monthly magazines such as ESM. It also holds exhibitions every year. The most famous one is "Private Sourcing Events." In these exhibitions, suppliers can contact with buyers directly, necessary supplements for online interactions.

GlobalSources' other competitive advantage is its large number of high quality and loyal international buyers. Now the world's top twenty retailers are using the global resources service.

### **Made-in-China**

Ever since Made-in-China was established in 1996, it has focused on foreign trade promotion for Chinese manufacturers. According to Made-in-China's annual report of 2010, more than 70% visitors are from abroad, of whom 25.8 % are from Europe, 22.2 % are from North America, 16.5% are from the Middle East, and 14.6% are from Southeast Asia.

Unlike Alibaba that covers most industries, Made-in-China concentrates on several industries such as machinery, handicrafts, and clothing. Although Made-in-China is not as influential as Alibaba, it still has advantages in certain industries. Particularly for small and medium-sized enterprises (SMEs) with a limited budget, Made-in-China is a great choice.

### **4.1.3 Market trend**

The revenue of B2B e-commerce is projected to reach \$8 billion in 2017, with a 20.0% growth rate in the next few years (see graph below). Strong demands, government support, and online transaction service, which depend on each other, are the engines of rapid growth

in B2B commerce market (iResearch, 2014).



#### 4.1.4 Facilitators for growth

##### ***Strong demands***

The vast majority of Chinese small and medium-sized enterprises or SMEs, have increasing demands for B2B e-commerce. SMEs still have difficulties in information symmetry and financing. B2B platforms satisfy SMEs by providing purchase and sale information, advertising, authentication, and other marketing and promotion services. Although the global economy is in recovery after the financial crisis, China's strong domestic trade increases B2B market.

##### ***Government support***

The Chinese government also encourages and supports B2B e-commerce by setting policies and providing financial support. E-commerce industry is listed as a national strategic industry. For example, the government of Zhejiang province set a "transformation to e-

commerce” policy that encourages small and medium-sized enterprises to use B2B e-commerce platforms.

### ***High cost of traditional industries***

Traditional industries are facing escalating costs, with the increase of costs in land, rent, and oil. These costs account for more and more portion in the commodities. For the same commodity, the average price in traditional industry is 31.2% higher than that of e-commerce industry. Therefore, since the cost of traditional industry is high, more and more customers will switch to e-commerce industry (Jin, 2011).

### ***Innovations in service***

B2B platforms begin to provide online transaction and online financial services, which solve SMEs’ financial problems. SMEs lack operation funds, but now they can apply loans from large B2B platforms. Online transaction also speeds up the collection of money.

Banks are also becoming more and more involved in e-commerce. For instance, Hua Xia Bank launched a B2B e-commerce financial product to provide electronic capital payment, settlement and regulatory services to the sellers who manage daily business activities through electronic channel (iResearch, 2013). This product meets the demands of financial business. B2B platforms use this financial product not only to provide comprehensive financial services, but also to customize service models to satisfy different needs of sellers.

## 4.2 Challenges of Marketplace Model in China's B2B E-commerce Market

### ***Price wars***

Many B2B e-commerce platforms are becoming a battlefield of price war. Sellers used to selling at brick-and-mortar shops often find that online Marketplace is extremely competitive.

In most of China's B2B platforms, the number of sellers is much larger than the number of buyers. Their products are often displayed alongside competitive offers. Sellers have to offer lower price to capture buyers, resulting in lower profits. In many cases, even if sellers lower the price, they cannot sell as much as expected to actually make a profit. What's worse, labor cost and raw material cost are rising dramatically in China. Many small sellers are facing financial problems and giving up B2B platforms gradually.

### ***Fraud***

Security and credit are foundations of e-commerce. However, there are still many frauds in e-commerce field. In 2010, a hundred million customers became victims of fraud, losing more than \$300 million. 81.2% of netizens (habitual users of the Internet) are afraid of fraud when shopping online (Jin, 2011).

### ***Unauthoritative Authentication***

Although Many B2B e-commerce platforms authenticate their sellers, the authentication is unauthoritative. For example, Alibaba authenticates sellers by name, identification, and factory. However, this kind of authentication has no difference from registration, because

authentication is conducted by the B2B platform itself not by the third-party organization. B2B e-commerce platforms will punish sellers when buyers complain, but the brand images have already been negatively affected.

#### 4.3 Choose the right business model for the startup – “Mall”

Ewing Global is a B2B startup focused on international trading. The company was founded in 2014 and its major business is hotel suppliers. It started from the Dubai market and successfully signed its first order of \$300,000 order with Holiday Inn Dubai. Now, the company wants to move to E-commerce and the first question is choosing the right business model.

Using Hagiu’s model, we evaluate this startup against the six criteria.

##### 1. Are there significant economies of scale to be exploited?

Yes. The hotel supplies, such as towels and bed sheets, are high-demand products and are sold more efficiently by one large reseller than by many small sellers. Ewing Global can capitalize on economies of scale in purchasing, infrastructure investment, delivery, customer support, and so on. For example, Li & Fung, the world’s leading middleman for apparel fabric, aggregates demands from many clients to obtain lower prices, make faster deliveries, and help suppliers better utilize their capacity (Hagiu & Wright, *Do You Really want to Be an eBay?*, 2013).

##### 2. Can your company create and extract more value by bundling or selling complementary products?



Yes. Just like Walmart and Costco, Ewing Global can lure customers into its website with prices at cost on certain goods, bringing heavy traffic to the website. Then Ewing can make a higher margin on other products. This strategy can create a word-of-mouth effect, which is crucial for a startup at an early stage.

3. Do buyers derive significant benefits from aggregation?

Yes. Hotel suppliers include thousands of products, from towels to tableware to furniture. Customers have trouble dealing with different small sellers and have the products delivered separately. Therefore, the selection cost and delivery cost of purchasing from different sellers is much higher than purchasing from one big reseller. Ewing, as a reseller, can provide the one-stop shopping experience for customers and help to save the delivery cost.

4. Is your company able to create a better buyer or seller experience by taking control of transactions?

Yes. Although marketplaces such as Alibaba and Globalsources have feedback systems for buyers and sellers, these mechanisms are not always sufficient to ensure quality and reliability. Ewing Global can improve the buyer experience by guaranteeing product quality, delivering products on time, and providing better after-sales services.

5. Do buyers need to be protected from sellers or vice versa?

No. International trading is a relatively open and transparent market. There is no special need to protect sellers or buyers.

6. Does one side have disproportionate information or bargaining advantage?

No. There are many sellers and buyers in the marketplaces. The marketplaces make information such as price and parameters very transparent. You can easily compare products on the website.

We have answered 'Yes' to four of the six questions; therefore the Mall model is a better strategy for Ewing Global.

#### 4.4 "Mall" Implementation Strategies for the Startup

##### **4.4.1 Customer Segmentation**

Ewing targets hotel customers who care more about product quality and service, and are less sensitive to price. Those kinds of customers are mostly troubled by the high selection cost and risk of fraud, problems that are prevalent in China's B2B marketplaces. Therefore, they are more willing to deal with one reseller and pay a higher price for better quality and service. For example, hotels with three-star rating or more are ideal candidates.

##### **4.4.2 Supplier Strategy**

There two principles for supplier strategy. First, select very limited number of suppliers in each category. Ideally, there are 2-3 small and medium-sized suppliers. Those suppliers must have capabilities to produce high-quality products and are willing to build long-term relationships with Ewing. Small and medium-sized suppliers are easier for Ewing to cooperate and control. Meanwhile, the limited number of suppliers enables a healthy competition

among suppliers, offering Ewing the best price and more options.

In a word, there is a reciprocal relationship between Ewing and those suppliers. They help each other, grow together, and build long-term relationship.

#### **4.4.3 Promotion Strategy**

Ewing's promotion strategy consists of offline promotion and online promotion. Ewing already has business and networks in Dubai, which has an advanced hotel industry. As a famous resort, Dubai attracts tourists from all over the world. Because of the World Expo 2020, Dubai plans to almost double the number of hotel rooms, raising the number of hotel rooms to as many as 160,000 (Baltaji, 2014). Therefore, Dubai is an ideal market to promote Ewing. Ewing can leverage existing networks to make customers understand Ewing's E-commerce model and competitive advantages. Meanwhile, Ewing could also launch online advertising and adopt SEO technology to bring traffic to its website.

#### **4.4.4 Operation Strategy**

As a startup, Ewing has limited funds. Furthermore, in the B2B market, the transaction amounts are very large. Therefore, it is impossible for Ewing to hold inventory at an early stage. However, Ewing can adopt back-to-back purchasing, where the E-commerce company places the order on a supplier after receiving an order from a buyer. The back-to-back purchasing strategy allows Ewing to control the products while mitigating the capital intensity.

After Ewing grows big enough, it could build its own fulfillment center in major areas such

as Dubai. The fulfillment center stores standardized and consumable goods such as plates or towel, enabling faster delivery and better customer experiences.

#### **4.4.5 Development strategy**

The business model is not unchanged but evolving. The company can move on the continuum between the pure Mall model and pure Marketplace model. As Amazon evolves from Mall to a hybrid, when there are enough buyers, Ewing may incorporate third-party sellers into its platform to provide more selection to the buyers. Ewing can also invest in the suppliers to take real control of its suppliers, getting an even lower price and better products.

#### **Conclusion**

After we analyze the China's B2B market, challenges of Marketplace, and opportunities of Mall, the Mall model is recommended for the new B2B startup in China. It enables new B2B companies to build a long-term relationship with buyers by offering high quality products, end-to-end customer services and aggregated scale. Innovative supply network design and inventory management are required to ensure a considerable profit for current highly competitive B2B markets in China and even in the world.

## Conclusion

From the analysis of business models of E-commerce, we can summarize three lessons learned. First choose the right model. The attractions of Marketplace have enticed many companies to apply the model in cases where the Mall model would have a better chance to succeed. For example, in China's B2B E-commerce market, the success of Alibaba or Globalsources proved the success of Marketplace. However, it is not the case for the startup focusing on hotel suppliers. Using Hagiu and Wright's six criteria for selecting a business model, we can understand that the Mall model can achieve economies of scale, extract much more value by bundling, and create a better customer experience. The second lesson is that business models change over time. Companies such as Zappo.com and RealNetworks completely changed from Marketplace to Mall, while companies such as Amazon evolved into a hybrid model. The Model is changed proactively to fit the corporate strategy or passively changed because of competitions. To survive in E-commerce market, companies should always be innovative and ready to change. The third lesson is the challenges of Marketplace. Although it is a dominate model in E-commerce, Marketplace is facing great challenges that even major players are at stake. From Eisenmann, Parker and Alstyne, we know that when the market evolves slowly, the late mover advantages may be more salient. Even if your platform achieves a winner-take-all and dominates the market, it may still be "enveloped" by an adjacent platform when the new rival offers your platform's functionality as a part of a bundle.

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