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The Alibaba Group-Yahoo! Partnership After Five Years

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"Why do we need a financial investor with no business synergy or technology?"

Jack Ma lieutenant and Alibaba.com CEO David Wei spoke these harsh words about Yahoo! Inc. in September 2010. These comments followed a January 2010 Alibaba statement calling Yahoo! "reckless" for supporting Google's claim that China's government was hampering its business via state-led hacking and censorship.[1] The strain on the partnership illustrated how the relationship had changed since it began in August 2005. At that time, Jack Ma had partnered with Jerry Yang at U.S. Internet search giant Yahoo! in a transaction that saw Ma cede shares in exchange for a $1 billion investment and ownership of Yahoo! China. In 2005, Ma was excited about leveraging the strategic and financial benefits of the partnership. Yang wanted to partner with one of China's savviest Internet entrepreneurs to help increase Yahoo! China's market share in the fast growing China online search market.[2]

Alibaba cofounder Jack Ma and Yahoo! cofounder Jerry Yang were friends who both sought to change the direction of their businesses in 2005. For Alibaba, it was time to move past the debilitating global dotcom bust and SARS crisis and expand. It was too soon for an IPO, but the web firm needed a substantial injection of cash to buy out early stage investors and maintain its rapid growth. Strengthening its core businesses and expanding into new ventures would not be inexpensive. A strategic investment from Yahoo! seemed to make sense as it offered the cash, global brand and search technology that would help Alibaba grow and improve its products.[3]

Yahoo! needed to change its China strategy. After a promising start in the search market there, China search giant Baidu and U.S. competitor Google had taken much of its market share. By 2005, it only had 15.6% of the search market and no workable strategy for rebuilding its market share.[4] Ceding Yahoo! China to Alibaba seemed to make sense because Alibaba would nurture the Yahoo! brand as it deployed its online expertise in China to win the battle for search. Yahoo!'s investment would help Ma continue Alibaba's rapid growth and represented a unique opportunity to invest in a China market leader pre-IPO.

By 2010, the situation surrounding the partnership had changed. Alibaba had very successfully gone public three years before. Yahoo! China only had 1% of the China search market. Both Alibaba and Yahoo! had partnered with competitors on search in efforts to unseat Baidu and Google in China and elsewhere. Still, Yahoo!'s business model showed no sign of competitiveness.[5]

Sensing weakness, Microsoft had previously attempted an opportunistic takeover of long-time search rival Yahoo!. Alibaba was chafing under the influence of this weakened strategic investor. Yahoo!'s boardroom power and influence over Alibaba's international expansion strategy increasingly felt restraining. Employing about 22,000 people in Greater China, India, Japan, Korea, the United Kingdom and the United States, Alibaba was rapidly globalizing and determined to have control over its own destiny.[6]

Was it time to end this financial and strategic partnership? Had it made sense in 2005?

Top Dotcoms and ecommerce in China

The growing availability of Internet connections and dotcom boom-related investments supported the birth of dotcoms and the ecommerce industry in China in the late 20th and early 21st century. The Chinese government initially was slow to realize the potential of the Internet and uncertain of how to regulate it. It then changed its attitude determining that it could use the Internet to continue to exert influence and develop China's economy.[7] Rapid investment in Internet infrastructure followed. Simultaneously, foreign and domestic capital began pouring into ecommerce start-ups in China as the global dotcom mania began in the late 1990's. Chinese entrepreneurs attracted these investments as they innovated and localized foreign business models to participate in the new market.[8]

These foundational investments helped the strongest ecommerce companies survive in China despite the global dotcom crash in the beginning of the 21st century. After low initial profits, a rapid increase in online users with rising disposable incomes drove fast growth in ecommerce. By 2009, there were 338 million Internet users in China.[9] Of these, about 30% had shopped online, but Alibaba vice president Liang Chunxiao expected that number to double by 2015 (see Exhibit 1 for additional historical and projected estimates).[10]

Online spending and dotcom revenue growth mirrored the rise of China's new netizens. In 2009, transaction value in all ecommerce grew by 21.7% to 2.8 trillion RMB according to the Ministry of Commerce. Online shopping value accelerated 105.8% to 258.6 billion RMB.[11] In 2010, Deutsche Bank estimated that personal consumption growth in ecommerce in China would have a five year CAGR of 42% reaching a market size of 1.52 trillion RMB and making up 7.2% of total domestic retail by 2015 (see Exhibit 2 for additional historical and projected estimates).[12]

According to an iResearch, Inc. report on online shopping in China in 2009, more online shoppers were men than women (58% to 42%) while nearly two-thirds were unmarried. Nearly 90% belonged to the 18-35 age group while 85.8% had at least a junior college education or technical degree. 83.9% of shoppers had monthly incomes less than 4,000 RMB with the group earning less than 500 RMB per month making up 18.3% (see Exhibit 3 for complete statistics).[13]

First-movers consolidated their leads in the early 2000s driving out smaller, local competitors and non-localized, foreign competitors. For example, Alibaba was one of the initial leaders in business to business trade ("B2B") in China and had not relinquished its lead by 2010. While it was the second major player after eBay into the consumer to consumer ("C2C") market in China, its more localized Taobao site soon forced eBay to largely retreat from China.[14]

Taobao not only dominated eBay, but maintained a substantial market share lead over domestic rivals such as Tencent, Inc.'s Paipai auction site. It had 83.8% of the market while second place Paipai only had a 9.9% share in 2009 (see Exhibit 4). Transaction volumes have risen rapidly for Taobao reaching 208.3 billion RMB in 2009 from 1 billion RMB in 2004.[15] Main competitors Paipai and EachNet as well as

Baidu's Youa site did not fare as well having much slower growth (see Exhibit 5). In 2009, C2C online shopping was still growing quickly, beating out online business to consumer ("B2C") growth (see Exhibit 6 for flow charts comparing B2C and C2C transactions).

Alibaba's Alipay and other online payment processing systems helped pave the way for ecommerce transactions to multiply. Credit cards were not as widely available in China as these payment systems. While third-party payment platforms were used by 58.7% of online shoppers who answered a 2009 survey administered on 103 Internet sites, credit and debit card options combined were used by only 23.4% (see Exhibit 7 for profile of online payment method usage).[16]

Search was another key sector in the China dotcom space. Modeled on Google, Baidu eventually triumphed in the paid-search competition of the early 2000s in China. Using search technology better customized to the Chinese language and directing users to unlimited free music downloads, it captured a large part of Yahoo! China's market share.[17] Google and local search engines fought Baidu hard, but they could not topple it from its leadership position. In early 2010, Google seemed defeated as it relinquished market share when it moved most of its servers offshore following hacking and censorship concerns.[18]

China portal Sohu's Sogou search engine tried to gain market share following Google's exit, but Baidu still had 70% of the search market at second quarter end 2010.[19] Like many other dotcoms in China, Baidu expanded into other products. It followed Alibaba's lead by expanding beyond its core business into ecommerce with the online auction site Youa.com in 2008. However, Youa did not compete significantly with leaders Taobao and Paipai by late 2010.[20]

Like its contemporaries, Shenzhen-based Tencent initially localized a popular foreign dotcom business model and then innovated and expanded into other businesses. Founded in 1999, Tencent started with a simple instant messaging ("IM") service called QQ. It later added online auction site Paipai and other services. By 2010, its IM user base had expanded to around 500 million members.

QQ's accomplishment was even more impressive given this user base exceeded the number of Internet users in China at the time. By expanding into the mobile market accessible to a wider range of wage earners, it had moved beyond the Internet's wealthier demographic. Tencent then leveraged this sizable user base into profits by charging for add-ons to the free QQ service and by attracting users to its other products in social networking, media, games and ecommerce. Online advertisers contributed to the bottom line by paying Tencent for placement in front of such a large audience.[21]

Yahoo!: A First Generation Dotcom

Yahoo! was part of the first wave of web-based companies called dotcoms that emerged in the 1990s. Jerry Yang and David Filo developed and released the initial version of Yahoo! while graduate students in the United States in 1994. The firm listed on the NASDAQ exchange in 1996. The company struggled during the 2000 and 2001 dotcom crash, but reemerged to acquire other companies in an attempt to expand its business.[22] While Yahoo! struggled to reinvent itself, Google began building up its dominance in paid search relegating Yahoo! to an increasingly secondary role.

As investors became frustrated with Yahoo!'s stagnation in the first decade of the 21st century, Jerry Yang and others rotated through the CEO position attempting to reenergize Yahoo!'s business model. Carol Bartz was the CEO at the end of 2010. She began her tenure in January 2009, but the stock price stayed mired in the slump it began in late 2008 (see Exhibit 8 for Yahoo! stock price/volume chart). As of 2009, Yahoo! had 13,900 employees who produced $6.5 billion in annual revenue (see Exhibit 9 for simplified income statement).[23]

Alibaba Emerges

Alibaba's story is tightly linked to the story of its lead founder, Jack Ma. Ma's excellent English led him to start his career as an English teacher in his hometown of Hangzhou, China. His entrepreneurial instinct helped him leverage this skill to develop a small translation business. This in turn gave him his first opportunity to visit the U.S. and learn about the Internet in 1995.[24]

Inspired by this technology, Ma developed his first dotcom company, China Yellow Pages, upon returning from the U.S. He sold it to Hangzhou Telecom in 1997 and then was drawn to Beijing for a brief stint at the Ministry of Foreign Trade to create trade-focused websites. Ever the entrepreneur, Ma soon forsook this stability to start up a new Internet company. His charisma and drive encouraged many of his colleagues to join him in returning to Hangzhou to found this new firm in February 1999 in Ma's apartment.[25] It would be called Alibaba after the hero of *One Thousand and One Nights* who used the command "Open Sesame" to find a treasure trove.

The Alibaba.com business plan was simple, but profitable: charge fees to businesses to trade with other businesses located anywhere in the world at low cost and low hassle on its website. This was not necessary for industrial giants that had funds to set up global operations, but SMEs did not have these resources. Alibaba enabled them to compete on sourcing costs. Businesses of any size could search the online storefronts of cheap, certified suppliers all over the world to find the most cost competitive. For example, an American small business could buy products from a family-owned Chinese factory on Alibaba.com after negotiating pricing and terms.

Alibaba relied almost solely on membership fees and value-added services for revenue. Exporters in China could pay for the coveted China Suppliers Club/Gold Supplier membership to gain third party certification of their legitimate businesses. This lowered marketing costs for SME's and helped to increase their visibility and sales on Alibaba.com. By the late 2000's, more than 22,000 China Suppliers had joined paying from $5,120 to $15,400 (40,000-120,000 RMB) for membership.[26]

During the dotcom boom years, Ma managed to secure $25 million in financing from Goldman Sachs, Fidelity, Japan's Softbank and others from 1999 to 2000.[27] This helped accelerate Alibaba's expansion plans. Offices in Silicon Valley and London sprang up anticipating high future growth. As the year 2000 came to a close, Alibaba.com had categorized seven hundred types of product information by type of product and country of origin. A daily intake of 3,500 lines of product information from suppliers and buyers reflected the warm reception Alibaba.com was receiving from entrepreneurs.[28] At the end of 2001, the group had turned its first profit. But then the dotcom crash started to take its toll.

As many of the dotcom companies began to unravel into bankruptcy, Alibaba had to fight hard to survive in the early 21st century. It largely retrenched to its home market in China and refocused on its core business. In 2002, Jack Ma's team introduced the TrustPass certification system to the internal China market following its initial release to international exporters.[29]

This TrustPass system further allowed Alibaba.com suppliers to prove their authenticity by submitting to document verification and additional vetting. TrustPass members were able to upload pictures and additional product information to attract sellers. They could get preferred access to buyer inquiries and then contact these potential customers at no extra cost. Importantly, TrustPass members also began to use Alibaba's trusted Alipay online payment system when it came online in late 2003. Revenue from the TrustPass service may have helped Alibaba realize an overall profit in 2002. Linking Alipay to TrustPass helped Ma to increase profits by cross-selling his products.

Alibaba's initially China-focused TradePass software followed. Businesses could better track their client information, translate product information into English and access additional tools to smooth trade. TrustPass and TradePass allowed buyers to find good suppliers by tracking transaction volume and reliability.[30] They served Alibaba.com's customers by increasing trust and transaction volumes. They also helped Alibaba diversify and strengthen its revenue streams.

Alibaba survived the dotcom crash, but then the SARS panic introduced great uncertainty in China in 2003. Severe Acute Respiratory Syndrome was a highly contagious and deadly disease. Large-scale quarantines became routine, driving fears about the effect on China's economic growth. After one Alibaba employ became infected, the company was placed on strict quarantine.[31]

SARS was serious, but still only a short-term problem. More important was how to expand Alibaba. Growth in ecommerce was starting to accelerate in China. What would Ma do next?

Taobao

Just before SARS struck, Jack Ma began strategizing to take over the online auction market from eBay and its China partner and future subsidiary EachNet. Its Taobao site would be like eBay in creating an auction site for consumers to buy and sell from each other. Ma's challenge was to differentiate Taobao from eBay in order to narrow eBay's first-mover advantage.

First, Ma invested. In July 2003, he pumped 100 million RMB into Taobao to help support market share growth until it became profitable. For its part, Taobao rapidly deployed a large sales force to drive membership growth and close the profit gap. eBay/EachNet had exclusive agreements with China's main Internet portals for advertising, so Ma used physical advertising, text advertising and partnered with the popular MSN IM service from Microsoft to market his new business.[32]

Taobao quickly passed eBay to become the C2C market leader in China. Chinese users disliked eBay's transaction fees, so Taobao disposed of these fees. Instead, it derived its revenue from value-added services and advertising. More importantly, local customers distrusted paying for goods over eBay's PayPal online payment system before receiving their order. Introduced in October 2003, Alibaba's Alipay payment system solved this problem by holding funds in escrow until transactions were completed. Alipay then distributed a percentage of the fee to Taobao, Alibaba.com or whichever third party Internet sites it was used on. No credit cards were needed in the consumer credit scarce country.

As a domestic company, Alibaba had stronger regulatory relationships and assistance in helping Alipay connect into China's banks and credit system quickly. Customers, businesses and government were all more satisfied with Alipay and Taobao. In the end, eBay signaled retreat in 2006 by ceding 51% of its China interests to Li Ka-shing's media interest, TOM Group.[33]

Alibaba and Yahoo! Partner

Fresh from early success in the online C2C auction business, Jack Ma quickly moved to further expand his business. In August 2005, Alibaba Group agreed to exchange a 40% stake (35% voting interest) for Yahoo! China and a $1 billion investment from Yahoo!. The strategic and financial benefits as well as Jack Ma and Jerry Yang's long-time friendship helped lead to a successful transaction valued in total at $4 billion.[34] When Alibaba and Yahoo!'s leadership announced the transaction, they spoke about its benefits.

> Yahoo!'s investment underscores our long-term commitment to the Chinese market. We believe the combination of Yahoo! and Alibaba is the best approach for Yahoo! to win in this region, said Terry Semel,

> chairman and chief executive officer of Yahoo!. Together, we will create one of the largest Internet companies in China, and our combined assets will make us the only company that has a leading position in all the key sectors that are driving explosive Internet growth in China such as search, commerce and communications.
>
> Teaming up with Yahoo! will allow us to deliver an unmatched range of e-commerce services to businesses and consumers in China, said Jack Ma, chairman and chief executive officer of Alibaba.com. With the addition of Yahoo! China to Alibaba.com's business, we're expanding our services to provide a leading search offering to China's Internet users. In China, Alibaba.com is winning in B2B, winning in C2C, winning in online payments and now we're going to win in search.
>
> We have always had a long-term commitment to China and even more so to the development of its Internet industry, said Jerry Yang. We're confident that Yahoo! is putting its resources behind the right management team, which operates according to similar values as we do, and shares the same vision for providing the most essential and relevant services to consumers and businesses.[35]

When the transaction closed on October 24, 2005, Jack Ma added that "We look forward to growing the Yahoo! brand in China to create opportunities for consumers and businesses in China and around the world."[36] Ma then rapidly used Yahoo!'s investment to buy out early stage investors and expand his business. He used $360 million of the investment to redeem Softbank's share of the crucial Taobao property so that it would be wholly owned by Alibaba Group.[37] By March 2006, he had deployed $750 million of Yahoo!'s investment.[38] The financial part of the deal had largely served its purpose.

Executing the strategic part of this strategic partnership would prove the more difficult part of the relationship. Company cultures were different. Ma purchased Yahoo! China after its staff's morale had diminished and several different management teams had been unable to achieve profitability in the years since its China entry in 1999.[39]

A first-mover and initial market leader, Yahoo! China had seen its healthy market share in search competed away by domestic champion Baidu and global leader Google. From 2004 to 2005, Baidu's market share in search surged from 33.1% to 46.5% while Google's inched up from 22.4% to 26.9%. In the same period, Yahoo! China saw its market share fall by nearly half from 30.2% to 15.6%.[40]

Maybe Jack Ma could unlock Yahoo! China's potential, but it would be difficult. He was now entering the search, email and content generation business. He also now owned an online advertising concern and an online authentication and verification service. Perhaps a local tech entrepreneur like Ma might have greater success with these products.[41]

Ma first tried to simplify Yahoo! China's website to be more like Google before reversing course and focusing on content generation. He led a campaign for an *American Idol*-like online program called *Yahoo! Searches for the Stars*. Yahoo! China would need to focus on popular entertainment content to differentiate itself and develop new revenue streams Ma thought. Yahoo!'s advertising expertise was also important as it helped Taobao extract additional revenue from online ads.[42]

Ma was happy to own part of a great brand like Yahoo!, but he also knew that he had to realize synergies with the rest of Alibaba Group for the transaction to make sense. The key was to use Yahoo!'s search technology to make Taobao and Alibaba.com even more effective products. As a portal, Yahoo! China could help direct traffic to these other businesses, too. Yahoo's auction site had succeeded in Japan and Taiwan, so Ma doubtlessly hoped to leverage this experience to beat the remaining competition.[43]

Alibaba.com's IPO

Yahoo!'s investment helped set the stage for Jack Ma's decision to go public with Alibaba.com. In November 6, 2007, Alibaba Group's Alibaba.com Limited unit debuted 17% of its shares on a Hong Kong market that drove up its offering price nearly three times from 13.50 HKD (1.74 USD) to 39.50 HKD (5.09 USD) (see Exhibit 10 for Alibaba.com stock price/volume chart). Ma's group raised USD1.5 billion in the largest Internet IPO since Google's in 2004 valuing the company at USD26 billion by market close. That company was just one part of Alibaba Group.[44]

Ma's goal for the IPO was to list a profitable part of Alibaba Group: Alibaba.com. Alibaba.com's IPO proceeds were to be used to support its development and the expansion of lower margin, non-listed businesses like Taobao. They could incubate outside of public scrutiny sacrificing short-term profits for long-term market share gains.[45]

Alibaba.com was already a leader in its field and ready for an IPO. According to Analysys International, "in the quarter ended June 30 [2007], Alibaba accounted for 43 percent of total transactions in the so-called business-to- business e-commerce market in China, more than triple its nearest rival, Global Sources Ltd." David Wei said that, Yahoo! had helped in this success. According to a Bloomberg interview at the time, he said, "Yahoo! Inc. is helping the company to get access to U.S. users."[46] Still, Yahoo's strength in China was more questionable. Not only was Yahoo! lagging in online search, but it was not among China's top portals in 2007. That year they were Sina, Sohu, NetEase and Tencent's QQ site. These four captured more than 75% of the 12.35 billion RMB ($1.85 billion) in revenue generated by Internet portals that year. Yahoo! was not making in-roads in the portal competition.[47]

Post IPO

Following its Alibaba.com unit's IPO, Alibaba Group continued its fast growth. By 2010, Jack Ma's enterprises reached users in over 240 countries and regions. They now included not just Alibaba.com, but also related sites geared to domestic trade in China (1688.com), trade to and from Japan (Alibaba.co.jp) and wholesale trade for small buyers (aliexpress.com). Alibaba.com's network boasted 53 million members. Taobao had 500 million product listings, 210 million registered users and 40 million unique visitors per month making it one of the world's top 20 most visited websites. Launched in 2008, B2C service Taobao Mall allowed brick-and-mortar shops to sell to online consumers and cross-sold Taobao's C2C services and Alibaba's B2B services. The Taobao network included an expanding list of partner websites. In 2009, Taobao's transaction volume exceeded $29 billion and it dominated its competitors with an 83.8% market share (see Exhibit 4).

Alipay's growth was no less pronounced since its 2004 beginning. By 2010, it had 470 million registered users and processed 7 million transactions daily in multiple currencies. Ma's group also included online software company Alisoft, online advertising exchange Alimama and Alibaba Cloud Computing.[48]

Relationship with Yahoo! Post IPO

Relationships with Yahoo! became much more complex after Alibaba.com's IPO. Initially, Yahoo! assisted Alibaba.com in expanding in the U.S. market, but then Microsoft's hostile takeover bid for Yahoo! on January 31, 2008 distracted the leadership of both companies.[49]

In August 2008, Ma first signaled his interest in buying back Yahoo!'s stake in his company as the possible Microsoft takeover of Yahoo! loomed. The 2005 Alibaba-Yahoo! deal gave Alibaba the right to purchase back the shares from Yahoo! if Yahoo! was purchased. Ma no doubt worried about the implications of Microsoft suddenly owning a large stake in his company. Possibly more worrying was that Softbank might also want to bid for the stake. Its purchase of Yahoo!'s shares could give it a controlling 73% stake in Alibaba Group.[50] Although SoftBank normally only held minority stakes in its Internet partners, a worried Ma tasked his CFO to spend most of his time evaluation their options.

“It would be very positive for Alibaba if they buy Yahoo's stake, Eric Wen, an analyst at MainFirst Bank AG in Hong Kong,” said at the time. “The biggest benefit of Alibaba's management having more control is that they'd also have more incentive to improve the company's performance,” said Wen.[51]

After Yahoo! fended off Microsoft’s takeover attempt, Alibaba temporarily lost its chance to exit the Yahoo! partnership. In the meantime, Yahoo! China had become an afterthought at Alibaba. For example, Jack Ma initially thought Yahoo! China’s portal could help build on classified site Koubei.com’s success, so he merged the two companies in June 2008. In August 2009, Koubei.com left Yahoo! China to integrate with the Taobao platform.

The next month Yahoo! loosened its ties with Alibaba by selling its Alibaba.com holdings for $147 million. [52] The sale did not affect Yahoo!’s Alibaba Group investment. J.P. Morgan hypothesized that Yahoo!’s financing needs drove the sale. Alibaba was happy that Yahoo! was selling down its investment and increasing liquidity, but no further moves were made. The relationship was continuing to drift.

Jack Ma called his shift of focus to leveraging Alibaba Group assets to drive Taobao’s business the Big Taobao strategy. Its key goal was to expand its share of the ecommerce market by making Taobao a one-stop ecommerce service provider. Ma created a cross-business leadership team of senior managers from Taobao, Alipay, Alibaba Cloud Computing and Yahoo! China to execute the Big Taobao strategy in March 2010.[53] It was clear where Ma was focusing.

December 2009 was an inflection point in the Alibaba-Yahoo! relationship. In China that month, Baidu and Google.cn were ranked the number one and number three most visited websites respectively. Taobao placed a strong number five. Yahoo! did not make it into the top ten (see Exhibit 11). On December 4, 2009, Yahoo! shocked Alibaba by outsourcing development of its search technology to Microsoft in order to challenge Google.[54] Investors had unrelentingly criticized Yahoo! for not selling itself to Microsoft when its stock price was at a relative high point. Now Yahoo! was attempting to compromise by pursuing a half-way approach of cooperation in the tough search market in lieu of a takeover. Alibaba was stunned. No longer could Alibaba depend on Yahoo! developing search technology to make its group of e-businesses more competitive. By late 2010, industry sources noted that Yahoo! technology played only a minor role in search at Alibaba’s Taobao unit.

The partnership further fractured along cultural lines. When Google claimed in January 2010 that an organized hacking attack emanating from China was causing it to reexamine its China operations, Yahoo! announced it was “aligned” with Google’s position on hacking and related censorship concerns. Alibaba reacted furiously as the evidence seemed limited to it.[55] The affair escalated into a full diplomatic spat between the U.S. and China further widening the rift between the two companies.

In May 2010, Jack Ma decided to expand Taobao internationally. He reengaged with Yahoo! through its partially-owned Yahoo! Japan Shopping unit. Alibaba’s Yahoo! ties as well as Softbank’s financial ties to both Alibaba and Yahoo! Japan helped facilitate the deal. Yahoo! Japan Shopping offered to list 50 million Chinese products while Taobao-related TaoJapan would list 8 million Japanese products for Chinese consumers.[56]

This cooperative deal was followed by Ma’s next offer to purchase Yahoo!’s stake in Alibaba in the same month. With Yahoo!’s sale expected to face a stiff tax bill of about 40%, Ma proposed a tax efficient structure for selling the Alibaba stake to Yahoo!’s executives. Yahoo! replied with a new offer that Alibaba did not accept.[57]

In August 2010, Alibaba agreed to purchase 16% of Beijing-based Sohu's search unit Sogou. Sohu operated China's fourth most visited web portal at the time. This would make Alibaba a partner with China's number three search engine after Baidu and Google. Now Yahoo! had a search partnership with Microsoft and Alibaba had one with Sohu.[58]

By September 2010, Jack Ma's team was openly frustrated with Yahoo!. Commenting on Yahoo!, Alibaba.com CEO David Wei said, "The biggest thing that has changed is Yahoo lost its own search-engine technology. The biggest reason for such a partnership doesn't exist."[59] Alibaba also didn't need Yahoo!'s money anymore. In an early 2011 interview Ma said, "Capital for us is really not as important as it is for other companies and groups."[60]

Despite entreaties from Alibaba, Yahoo! was not interested in selling its stake in the group. Yahoo!'s CEO Carol Bartz noted that Alibaba had been "constantly" approaching her to sell, but no deal was done. Yahoo! separately stated that it was still "very supportive of the operation direction" of Alibaba. Jack Ma couldn't force Yahoo! to give up its stake.[61]

With other Alibaba businesses well positioned, Jack Ma needed to resolve the Yahoo! situation. Bartz began to speak about asserting more control over Alibaba by exercising Yahoo!'s option to add its second board member to the five person board after October 25, 2010. If this happened, Alibaba would have a majority foreign-controlled board as Softbank's head, Masayoshi Son, also sat on the five person board. Ma's team warned Yahoo! that such a situation would hamper Alibaba's growth by making it subject to much tighter government regulation in China. This could limit Alibaba's ability to gain government support for publicly listing its valuable private units like Taobao.[62]

Yahoo! had to weigh this danger with the opportunity to gain more power to push for faster listings of Taobao and Alipay and reassert control over its forgotten Yahoo! China brand. Yahoo! had already made moves to revive its presence in China by allowing its Hong Kong unit to accept advertising business from mainland companies. This move was partially prompted by Ma's abandoning of Yahoo! China's classified ads business.[63]

Jack Ma also worried that Yahoo!'s increasing power on his board could give Yahoo! the power to limit his companies' ability to compete internationally. A 2005 shareholder's agreement with Yahoo! gave Yahoo! control over any consumer business expansion in Germany, France, the United Kingdom, South Korea and the U.S. Realizing so much success with Alibaba.com small business users in the U.S., Ma no doubt worried about any expansion restrictions that Taobao might face. For now, industry sources pointed out that the cultural challenges of expanding abroad were a more important limitation, but what if Taobao decided it was ready to enter these markets and Yahoo! disagreed?[64]

Fortunately for Ma, he had some power to limit Yahoo!'s influence. Before the Alibaba Limited IPO, he restructured Alibaba Group to create a poison pill defense preserving his control. He owned 80% of Hangzhou Alibaba which held the Internet content provider (ICP) license that gave Alibaba Limited permission to operate in China. He could withhold the license if others tried to take control of Alibaba Limited. Jerry Yang was no longer the sole authority at Yahoo! able to mediate with his old friend Ma if it came to this brinkmanship.[65]

Would Yahoo! try to remove Alibaba founder and leader Jack Ma? Maybe Yahoo! didn't really want more influence over Alibaba's operations, but instead was just waiting to extract additional value form Taobao's IPO as Bartz had argued for in September 2010.[66] Yahoo!'s Alibaba investment had already made a large profit climbing from the initial $1 billion cash infusion ($4 billion deal value) to an estimated $11 billion in value including Taobao. A Taobao IPO could help Yahoo! further unlock value from its investment and force Alibaba to offer it better terms for a buyout. Unfortunately for Yahoo!, Ma had repeatedly denied near-term interest in a Taobao public offering.[67]

Jack Ma soon agreed to partner with Microsoft to create a new search engine called Etao that would focus on herding Internet traffic to Taobao. Etao's beta version came online on October 9, 2010. Ma quickly decided to add Sohu's Sougu search technology to Etao, but no mention was made of Yahoo! China's technology.[68]

Alibaba didn't see much strategic sense in maintaining the Alibaba-Yahoo! relationship. Yahoo!'s brand was not only flagging in China, but also in the U.S. Its competitiveness with Google was increasingly in doubt. One month before Alibaba and Yahoo! sealed their partnership in August 2005, Google barely led Yahoo! in U.S. online search with a 36.5% share versus Yahoo!'s 30.5% according to market researcher comScore, Inc. By the end of 2010, Google's share had expanded to a dominant two-thirds of the market while Yahoo!'s share had almost halved to 16.1%.[69] Their market caps reflected their divergent paths. Yahoo!'s market cap declined by 60.8% to $21.8 billion from year-end 2005 to year-end 2010. In the same period, Google's market cap moved by nearly the same magnitude, but in the opposite direction. It grew 54.9% to $191.0 billion. Yahoo! looked even weaker compared to technology leader Apple. On the back of innovations such as the iPhone and iPad, its market cap grew by 387.1% to $297.2 billion at the end of 2010.[70] Jack Ma said, "It's not like I ruined Yahoo! China, it wasn't good in the first place. Yahoo! America has declined. Only after entering Yahoo! China did we discover Yahoo! America had problems. So people say Yahoo! China wasn't managed well, so what? The criticism doesn't hurt."[71] Alibaba may have wished it had picked a different partner.

Yet, returns on the partnership looked different from Yahoo!'s financial point of view. By November 2010, Yahoo!'s stakes in Alibaba Group as well as Yahoo! Japan were valued at about half of Yahoo!'s total $22 billion market value.[72] Although Jack Ma disagreed with such high valuations, even J.P. Morgan calculated that the market value of Yahoo!'s remaining 30% stake in the publicly-listed Alibaba Limited was $2.9 billion (see Exhibit 12). Yahoo!'s own official accounting of its stake reflected a lower value still (see Exhibit 13). The key difference was over how to value privately held Taobao and Alipay. February 2011 revelations that Alibaba.com salespeople had systematically helped set up fraudulent storefronts on the website led to the dismissal of executives including CEO David Wei.[73] This scandal distracted Ma, but he would have to come back and resolve the Yahoo! issue eventually.

Could Jack Ma and Yahoo! find a way to make a deal? Did a transaction between two friends, Jack Ma and Jerry Yang, in 2005 still hold value for two public corporations over five years later? Had it made strategic sense initially in 2005?

Exhibits

Exhibit 1: Online Shopping Actual and Estimated User Growth, 2007-2013[74]

Note: "Online Shoppers" are defined as Internet users who shop online at least once every six months.

Exhibit 2: Online Shopping Industry Data, 2007-2013[75]

Exhibit 3: Profile of China's Online Shoppers, 2009[76]

Category	Subcategory	Percentage
Gender	Male	58.0%
	Female	42.0%
Relationship Status	Single	64.1%
	Married	35.9%
Age	Under 18	1.0%
	18-24	44.8%
	25-30	33.3%
	31-35	11.4%
	36-40	5.2%
	40+	4.3%
Education	No High Schoo	2.6%
	High School	11.6%
	Junior College	32.6%
	University	43.0%
	Masters	9.2%
	Doctorate+	1.0%
Monthly Income (RMB)	Under 500	18.3%
	500-1,000	7.8%
	1,000-1,500	11.9%
	1,500-2,000	14.1%
	2,000-2,500	11.7%
	2,500-3,000	10.4%
	3,000-4,000	9.7%
	4,000-5,000	6.2%
	5,000-6,000	3.8%
	6,000-10,000	4.2%
	10,000+	1.8%

Exhibit 4: Third Party Online Shopping Sites' Market Shares[77]

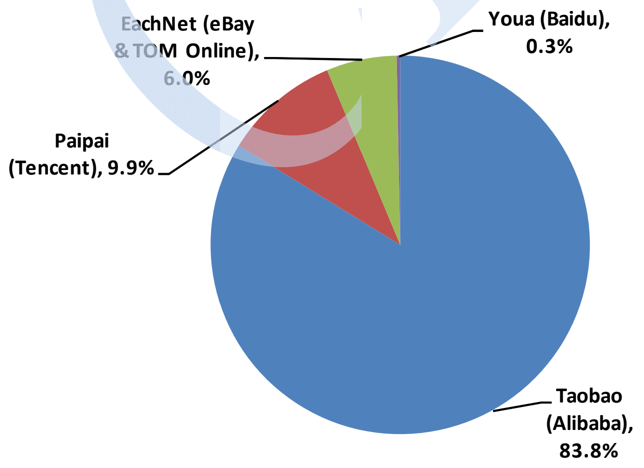
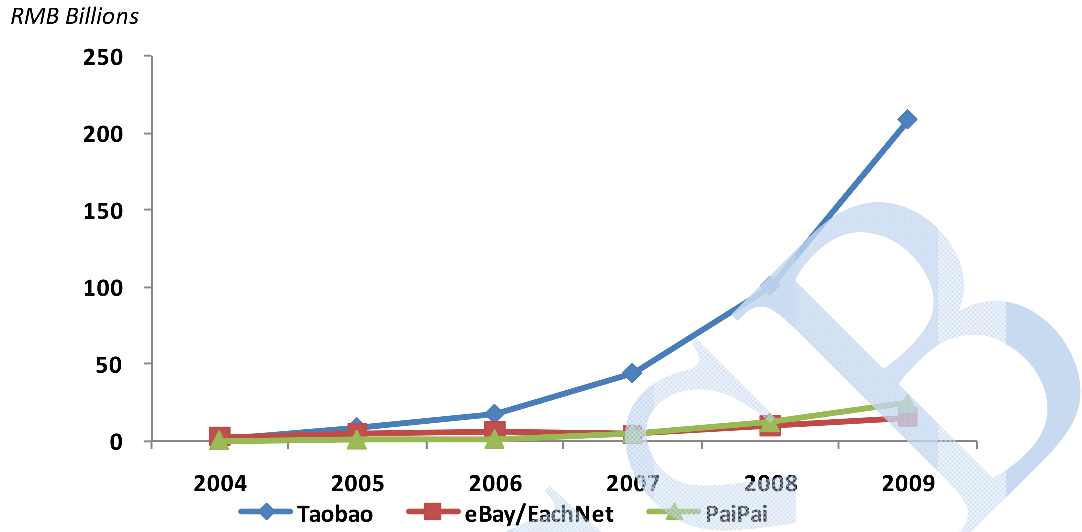


Exhibit 5: Third Party Online Shopping Platforms Transaction Volume Growth, 2004-2009[78]



RMB Billions	2004	2005	2006	2007	2008	2009
Taobao	1.0	8.0	16.7	43.3	100.0	208.3
eBay/EachNet	2.5	5.0	6.0	4.0	9.4	14.9
PaiPai	0.0	0.4	0.8	4.5	11.9	24.5

Exhibit 6: Flow Chart of B2C and C2C transactions[79]

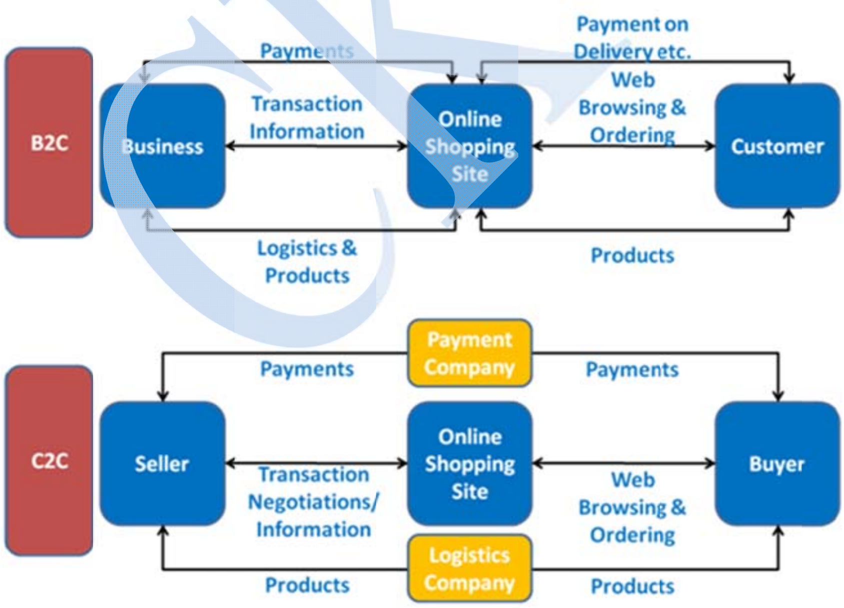


Exhibit 7: Usage Profile of Online Shopping Payment Methods, 2009[80]

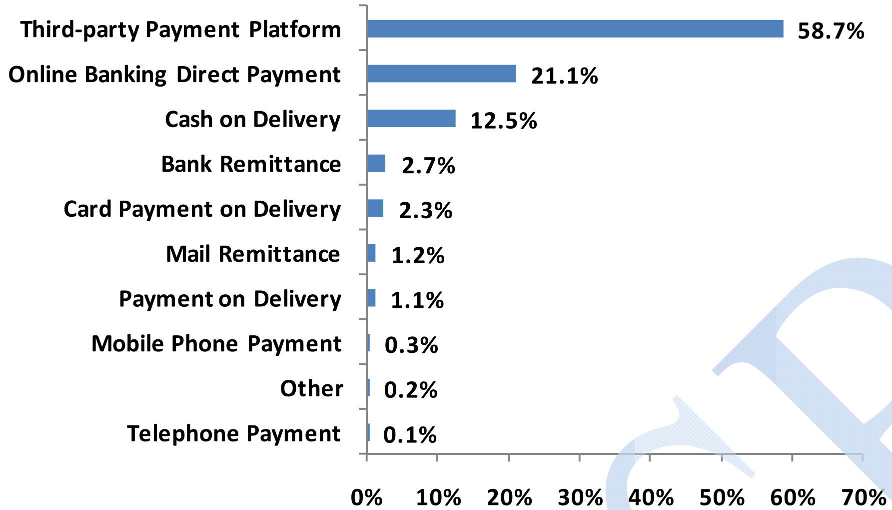


Exhibit 8: Yahoo! Stock Price (in USD) & Volume Chart from Before Alibaba Transaction, June 7, 2005-November 8, 2010[81]

Exhibit 9: Yahoo!'s Simplified Income Statements, 2007-2009[82]

	Years Ended December 31,		
	2007	2008	2009
	(In thousands, except per share amounts)		
Revenues	$ 6,969,274	$ 7,208,502	$ 6,460,315
Gross profit	4,130,516	4,185,140	3,588,569
Net income	642,005	424,686	605,289
Less: Net income attributable to noncontrolling interests	(2,850)	(5,765)	(7,297)
Net income attributable to Yahoo! Inc.	$ 639,155	$ 418,921	$ 597,992
Net income attributable to Yahoo! Inc. common stockholders per share—diluted	$ 0.47	$ 0.29	$ 0.42

Exhibit 10: Alibaba Three Year Stock Price (in HKD) & Volume Chart, November 8, 2007-November 8, 2010[83]

Exhibit 11: China's Top 10 Websites: December 2009[84]

Ranking	Internet site	Description
1	Baidu.com	Search engine
2	QQ.com	Instant messaging, gaming, shopping, news
3	Google.cn	Search engine
4	Sina.com.cn	News, blog services
5	Taobao.com	Online shopping
6	Google.com	Search engine
7	163.com	News, online game
8	Sohu.com	Instant messaging, news, games, networking
9	Kaixin001.com	Social networking
10	Youku.com	News, video sharing

Note: The ranking is based on 1 month traffic (daily visitors, page views) rank.

Exhibit 12: J.P. Morgan Estimates of Yahoo!'s Asian Assets[85]

Yahoo! Japan		Alibaba	
Shares Outstanding (M)	58.1	Shares Outstanding (M)	5,045
Price (Yen)	29,490	Price (HKD)	15
Yen per $US	81.456	HKD per $US	7.759
Price ($US)	362	Price ($US)	2
Market Cap ($M)	21,042	Market Cap ($US)	**9,689**
Yahoo!'s % Ownership	35.0%	Yahoo!'s % Ownership	29.6%
Market Value ($M)	7,365	Market Value ($M)	2,868
Investment	(559)	Investment	(1,576)
Tax Rate	35.0%	Tax Rate	0
Tax on Liquidation	2,382	Tax on Liquidation	452
After Tax Market Value ($M)	**4,983**	**After Tax Market Value ($M)**	**2,416**

Exhibit 13: Yahoo!'s Investments in Equity Interests[86]

As of December 31, investments in equity interests consisted of the following (dollars in thousands):

	2008	2009	Percent Ownership of Common Stock
Alibaba Group	$2,216,659	$2,167,007	44%[1]
Alibaba.com	51,999	—	0%
Yahoo! Japan	905,672	1,329,281	35%
Other	3,115	—	
Total	$3,177,445	$3,496,288	

Note 1: Share ownership fully diluted is approximately 40%.

Exhibit 14: Alibaba Group's Financials[87]

The following table presents Alibaba Group's U.S. GAAP financial information, as derived from the Alibaba Group financial statements (in thousands):

Alibaba Group

	Twelve Months Ended September 30,					
		2007		2008		2009
Operating data:						
Revenues	$	290,193	$	456,808	$	730,336
Gross profit	$	208,476	$	317,139	$	537,974
Loss from operations(1)	$	(59,582)	$	(236,017)	$	(39,460)
Net (loss) income(2)	$	(58,860)	$	1,909,009	$	(19,932)
Net (loss) income attributable to Alibaba Group(2)	$	(58,860)	$	1,870,093	$	(57,346)

Notes:

1) The loss from operations of $236 million for the twelve months ended September 30, 2008 is primarily due to Alibaba Group's impairment loss on goodwill and intangible assets for which the Company has no basis in its investment balance.
2) The net income of $1.9 billion for the twelve months ended September 30, 2008 is primarily due to Alibaba Group's sale of an approximate 27 percent ownership in Alibaba.com from Alibaba.com's IPO.

Source: Yahoo's 2009 10-K

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