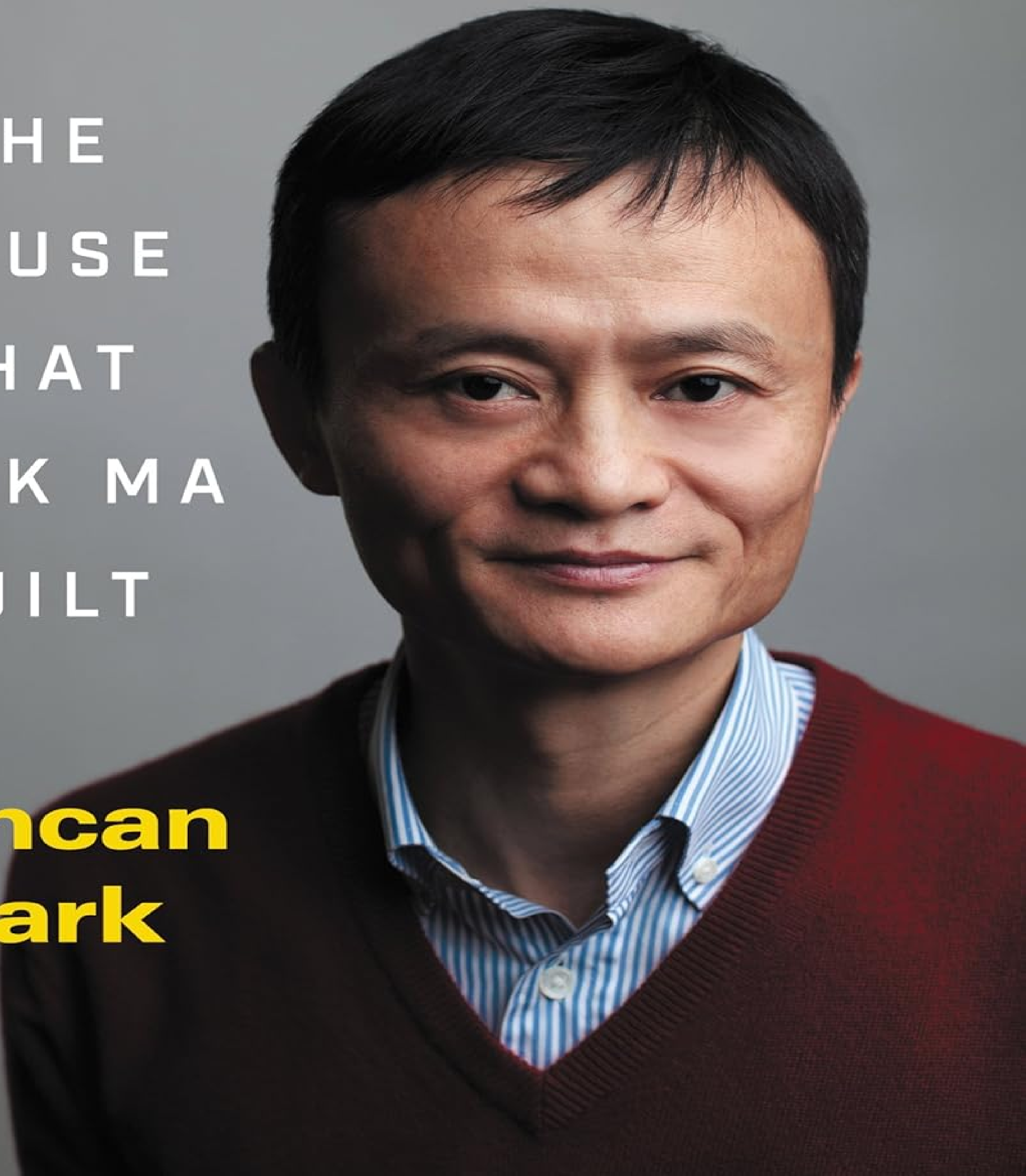
"The story of Alibaba's rise—along with Jack Ma's—offers a fascinating window onto China's staggering transformation. Duncan Clark tells the story with flair." —*Wall Street Journal*

Alibaba

THE HOUSE THAT JACK MA BUILT



Duncan Clark

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DUNCAN CLARK

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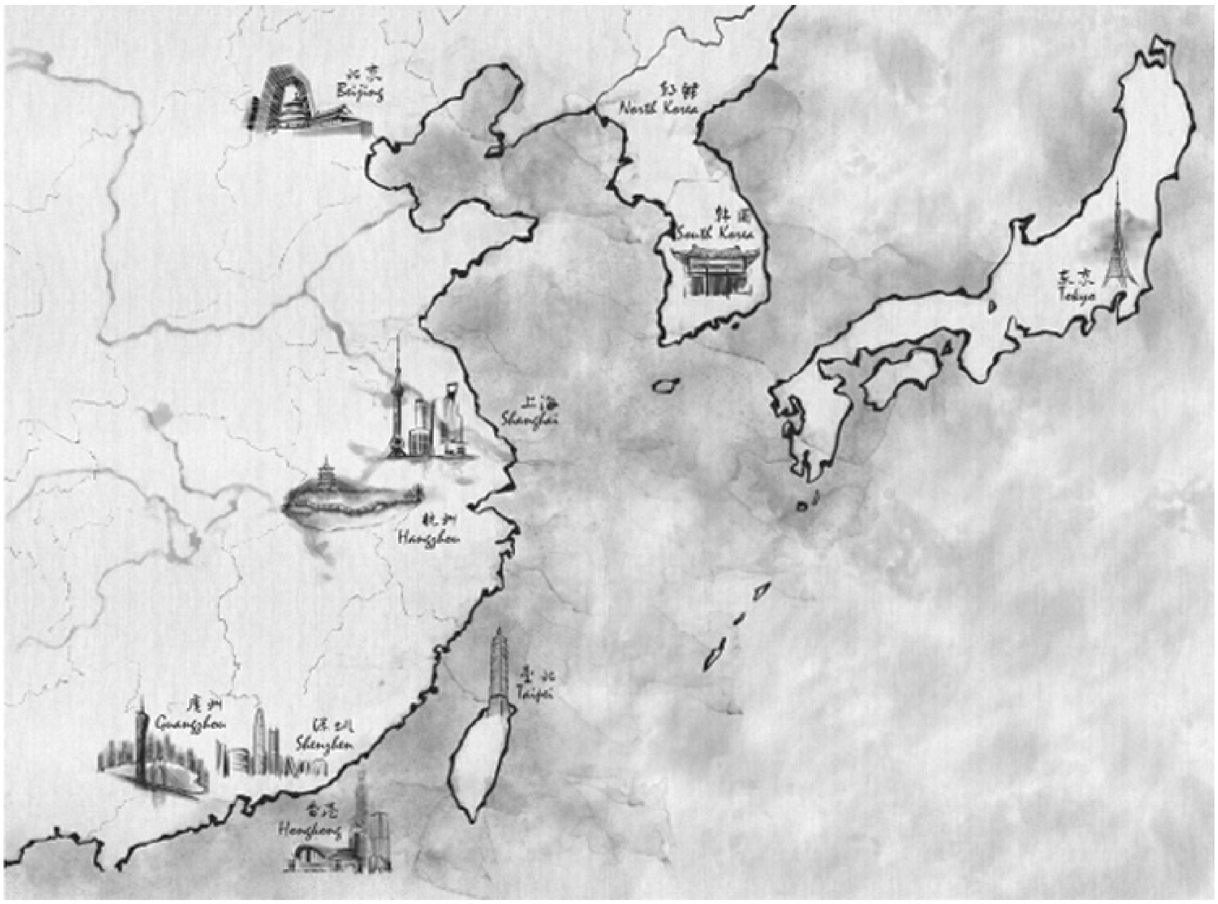

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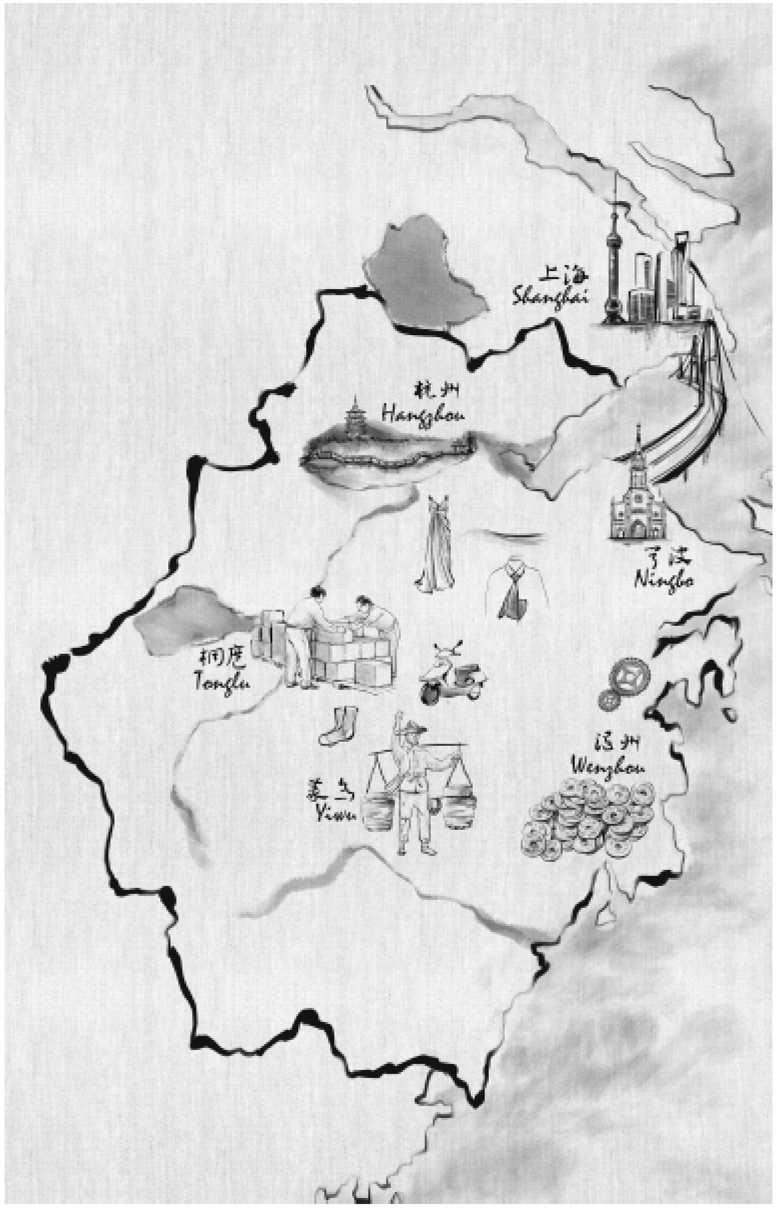
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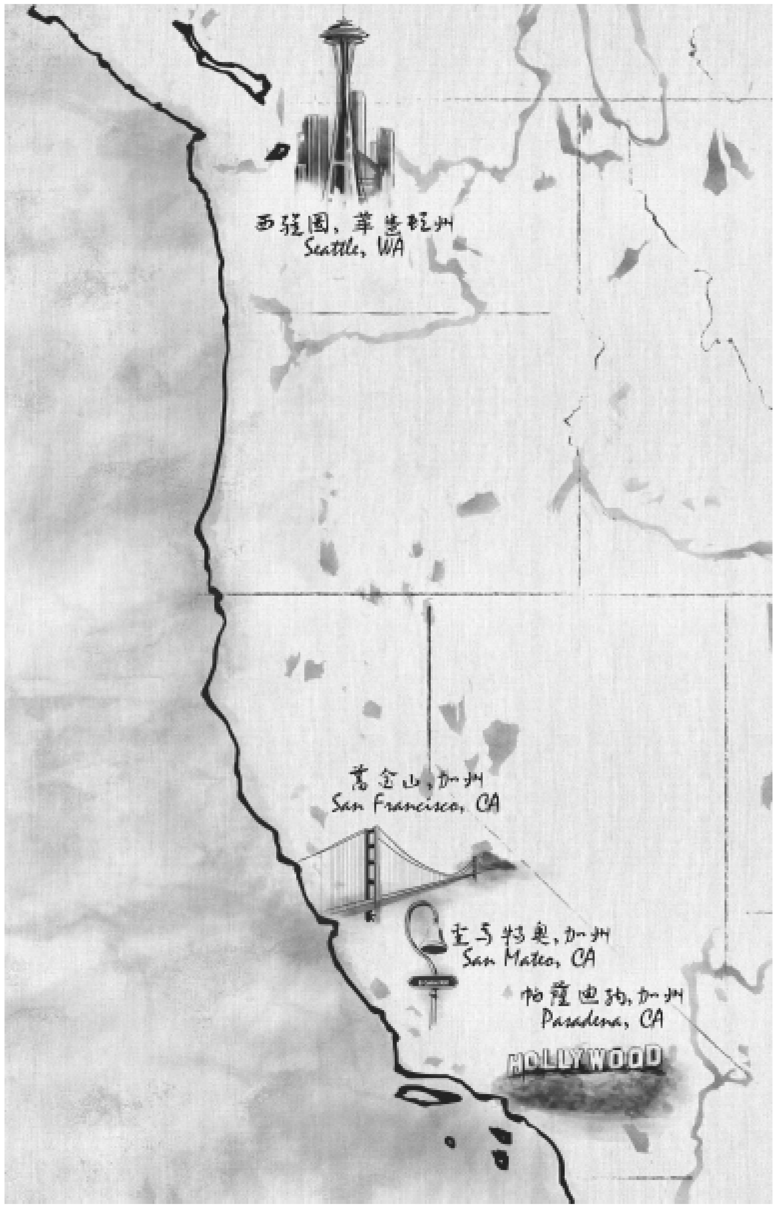
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Introduction

Alibaba is an unusual name for a Chinese company. Its founder, Jack Ma, a former English teacher, is an unlikely corporate titan.

Yet the house that Jack built is home to the largest virtual shopping mall in the world, soon to overtake Walmart in the amount of goods sold. The company's IPO on the New York Stock Exchange in September 2014 raised $25 billion, the largest stock market flotation in history. In the months that followed, Alibaba's shares soared, making it one of the top ten most valuable companies in the world, worth almost $300 billion. Alibaba became the most valuable Internet company in the world after Google, its shares worth more than Amazon and eBay combined. Nine days before the IPO, Jack celebrated his fiftieth birthday, the soaring value of his stake making him the richest man in Asia.

But since that peak Alibaba's life as a publicly listed company has not gone according to plan. Its shares fell by half from their post-IPO peak, even briefly falling below the initial offer price. Investor concerns were sparked in early 2015 by a surprising entanglement with a government agency over intellectual property, then fueled by the slowing Chinese economy and volatile stock markets, which dragged down Alibaba's shares in their wake.

Despite the ups and downs of the stock market, with a dominant share of the e-commerce market, Alibaba is uniquely well positioned to benefit from the rise of China's consuming classes. Over 400 million people, more than the population of the United States, make purchases on Alibaba's websites each year. The tens of millions of packages generated each day account for almost two-thirds of all parcel deliveries in China.

Alibaba has transformed the way Chinese shop, giving them access to a range and quality of items that previous generations could only dream of. Like Amazon in the West, Alibaba brings the convenience of home delivery to millions of consumers. Yet this comparison understates Alibaba's impact. Taobao, its online shopping website, has given many Chinese people their first sense of being truly valued as a customer. Alibaba is playing a pivotal role in China's economic restructuring, helping move the country away from a "Made in China" past to a "Bought in China" present.

The Old China growth model lasted three decades. Based on manufacturing, construction, and exports, it delivered hundreds of millions out of poverty but left China with a bitter legacy of overcapacity, overbuilding, and pollution. Now a new model is emerging, one centered on catering to the needs of a middle class expected to grow from 300 million to half a billion people within ten years.

Jack, more than any other, is the face of the new China. Already something of a folk hero at home, he stands at the intersection of China's newfound cults of consumerism and entrepreneurship.

His fame extends well beyond China's borders. A meeting (and a selfie) with Jack is coveted by presidents, prime ministers and princes, CEOs, entrepreneurs, investors, and movie stars. Jack regularly shares the stage with the world's political and corporate elite. A masterful public speaker, more often than not he outshines them. To go onstage after Jack is a losing proposition. In a remarkable reversal of protocol, President Obama even volunteered to act as moderator for Jack at a Q&A session during the November 2015 APEC meeting in Manila. At the World Economic Forum in Davos in January 2016, Jack dined with Leonardo DiCaprio, Kevin Spacey, and Bono, along with the CEOs of the Coca-Cola Company, DHL, and JPMorgan Chase. The founder of another China Internet company remarked to me: “It was almost as though Alibaba’s PR department was writing Obama’s script!”

Tom Cruise and Jack Ma in Shanghai, September 6, 2015, at the Chinese premiere of *Mission: Impossible—Rogue Nation,* which was financed in part by Alibaba Pictures. *Alibaba*

Facebook founder Mark Zuckerberg has been demonstrating his commitment to learning Mandarin Chinese in speeches he has made since 2014, starting at Tsinghua University in Beijing. But Jack, English teacher turned tycoon, has been wowing crowds in both English and Chinese at conferences around the world for over seventeen years.

I first met Jack in the summer of 1999, a few months after he founded Alibaba in a small apartment in Hangzhou, some hundred miles southwest of Shanghai. On my first visit, I could count the number of cofounders by the toothbrushes jammed into mugs on a shelf in the bathroom. In addition to Jack, there included his wife, Cathy, and sixteen others. Jack and Cathy had wagered everything they owned on the company, including their home. Jack’s ambition then, as it remains today, was breathtaking. He talked of building an Internet company that would last eighty years—the typical span of a human life. A few years later, he extended Alibaba’s life expectancy to “a hundred and two” years, so that the company would span three centuries from 1999. From the very beginning, he vowed to take on and topple the giants of Silicon Valley. Within the confines of that modest apartment this should have seemed delusional. Yet there was something about his passion for the venture that made it sound entirely credible.

I became an adviser to Alibaba in its early years, helping Jack and his right-hand man, Joe Tsai, with the company’s international expansion strategy and recommending to them some of its first foreign employees. Alibaba has assisted me in my research for this book by arranging interviews with senior management and providing access to the company in various locations.

But this is an entirely independent account. I have never been an employee of the company and have no professional relationship with them today. My insights come in part from my brief role during the dot-com boom as an adviser to Alibaba and from the proximity that this early contact has afforded since. Yet in writing this book, I have been guided also by my personal experience living in China since 1994, when the Internet first came to the country's shores, and by my professional career. With support from my previous employer Morgan Stanley,[1] in the summer of 1994, I founded BDA China, a Beijing-based investment advisory firm, which today numbers more than one hundred professionals, consulting to investors and participants in China's technology and retail sectors.

As part of the remuneration for my advisory service, in early 2000, Jack and Joe granted me the right to buy a few hundred thousand shares in Alibaba at just thirty cents each. When the deadline was up to buy the shares, in early 2003, things weren't looking so good for the company. The dot-com bubble had burst and Alibaba's (original) business was struggling. In an error of colossal proportions, I decided not to buy the shares. In the weeks after the company's September 2014 IPO, this mushroomed into a $30 million mistake.[2] I would like to thank you very much for purchasing this book. Writing it has proved (somewhat) cathartic as I explore the stories of others, like Goldman Sachs, who underestimated Jack's tenacity and sold their early stake too soon, and eBay, who dismissed his firm as a rival, only to be forced out of the China market within a few years.

Jack is different from most of his Internet billionaire peers. He struggled in math as a student and wears his ignorance of technology as a badge of honor. His outsize ambitions and unconventional strategies won him the nickname "Crazy Jack." In this book, we will explore his past and quirky personality to learn the method to his madness.

China's e-commerce market differs in important ways from the United States and other Western economies, the legacy of decades of state planning and the important role still played by state-owned enterprises. Alibaba has sought out and exploited the inefficiencies these have created, first in e-commerce, now in media and finance. His vision for the company—or his own philanthropic endeavors—now extends to grappling with China's greatest challenges, in reforming health care, education, and its approach to the environment.

Yet Alibaba's main business today remains e-commerce, a market it helped create and which it currently dominates. Is there more room for it to grow? Competitors are waiting in the wings. Also watching closely is the Chinese government. As Alibaba consolidates more market power than any other private company ever has, can Jack keep the government on his side?

Although most of its operations are in China, Alibaba is pursuing an ambitious international expansion. Newly appointed president Michael Evans: "We like to say that Alibaba was born in China, but we were created for the world."

Before we look at the remarkable story of how Alibaba came to be, and its goals for the future, let's start by taking a tour of what Jack calls the "iron triangle," the key underpinning of the company's dominance today: its strengths in e-commerce, logistics, and finance.

Chapter One

The Iron Triangle

China changed because of us in the past fifteen years.
We hope in the next fifteen years, the world changes because of us.
—Jack Ma

On November 11, 2015, in Beijing, in the iconic bubble-like structure bathed in blue light known popularly as the "Water Cube," the venue for the aquatics events in the Beijing Olympics held seven years earlier, it wasn't water that flowed but streams of data. For twenty-four hours, without interruption, a huge digital screen flickered with maps, charts, and news crawls, reporting in real time the purchases of millions of consumers across China on Alibaba's websites. In front of hundreds of journalists broadcasting the event across China and around the world, the Water Cube had been repurposed as mission control for the Chinese middle class and the merchants marketing to them. A four-hour live TV special, the 11/11 Global Festival Shopping Gala, was broadcast to help keep shoppers up until midnight, featuring actors such as Kevin Spacey, who appeared in a filmed montage as his character from *House of Cards,* President Frank Underwood, endorsing Alibaba as the place to buy disposable "burner" cell phones. The gala show culminated in a skit featuring Jack's face as the new Bond girl before he appeared in a tuxedo walking alongside Bond actor Daniel Craig for some onstage antics in the final countdown to midnight.

In the first eight minutes of 11/11/15, shoppers made more than $1 billion in purchases on Alibaba's sites. And they kept on shopping. As the world's largest cash register tallied the takings, Jack—seated next to his friend, the actor and martial artist Jet Li—couldn't resist taking a photo of the huge screen with his cell phone. Twenty-four hours later, 30 million buyers had racked up over $14 billion[1] in purchases, four times greater than 11/11's U.S. equivalent, Cyber Monday, which occurred a few weeks later, after Thanksgiving's Black Friday discount day.

Shortly after midnight, Chinese media reporting the sales figures recorded by Alibaba's Singles' Day promotion on November 11, 2015. *Duncan Clark*

In China, November 11 is Singles' Day,[2] a special annual promotion.[3] In the West, the date commemorates veterans of past wars. But in China, November 11 is the most important day of the year for the merchants fighting for the wallets of the country's newly minted consumer class.

On this day, also known as Double Eleven (*shuang shiyi*),[4] people in China indulge in a frenzy of pure, unadulterated hedonism. Jack summed up the event: "This is a unique day. We want all the manufacturers, shop owners to be thankful for the consumers. We want the consumers to have a wonderful day."[5]

From just twenty-seven merchants in 2009, over forty thousand merchants and thirty thousand brands now participate in Singles' Day. Total sales in 2015 were up 60 percent from the $9 billion of the previous year. On that occasion, celebrated at Alibaba's Wetlands campus in Hangzhou, the company's chief strategy officer Dr. Zeng Ming described the scene in terms reminiscent of Dr. Frankenstein watching his creation stirring from the dead: "The ecosystem has its own will to grow." Alibaba's executive vice chairman Joe Tsai echoed the sentiment: "You're seeing the unleashing of the consumption power of the Chinese consumer."

This power has long been suppressed. Household spending in the United States drives two-thirds of the economy, but in China it barely accounts for one-third. Compared to developed countries, Chinese people don't consume enough. The reason? They save too much and spend too little. To fund their future education, medical expenses, or retirement, many families accumulate substantial amounts of mattress money or "precautionary savings." Also, lacking the range or quality of products on offer in the West, consumers in China until relatively recently had little enticement to spend more on themselves.

Addressing an audience at Stanford University in September 2015, Jack observed that "in the U.S. when the economy is slowing down it means people don't have money to spend." But, he joked, “You guys know how to spend tomorrow’s money or future money or other people’s money. China’s been poor for so many years, we put our money in the bank.”

Old habits die hard, but a new habit—buying online—is changing the way consumers in China behave. Alibaba is at the forefront of this shift. Its most popular website is Taobao.com, China’s third most visited website and the world’s twelfth. A common saying today in China is *wanneng de taobao,*[6] meaning “you can find everything on Taobao.” Amazon has been called “the Everything Store.” Taobao too sells (almost) everything, everywhere. Just as Google is synonymous with searching online, in China to “*tao*”[7] something is shorthand for searching for a product online.

Alibaba has a much greater impact on China’s retail sector than Amazon does in the United States. Thanks to Taobao and its sister site, Tmall, Alibaba is effectively China’s largest retailer. Amazon, by contrast, only became one of the top ten retailers in America in 2013.

Although Alibaba launched Taobao in 2003, it was only five years later that it really came into its own. Until then China’s countless factories churned out products mostly for buyers overseas, shipped to stock the shelves of retailers like Walmart and Target. But the global financial crisis in 2008 changed everything. China’s traditional export markets were thrown into a tailspin. Taobao pried open the factory gates to consumers in China instead. The Chinese government’s response to the 2008 crisis was to double down on the Old China model—pumping money into the economy that fueled a massive real estate bubble, excess capacity, and yet more pollution. As the bills came in, it became clear that the much-needed rebalancing of the Chinese economy toward consumption could no longer be postponed. And Alibaba is one of the biggest beneficiaries.

Jack likes to say that his company’s success was an accident: “Alibaba might as well be known as ‘one thousand and one mistakes.’” In its early years, he gave three explanations as to why the company survived: “We didn’t have any money, we didn’t have any technology, and we didn’t have a plan.”

But let’s look at the three real factors that underpin Alibaba’s success today: the company’s competitive edge in e-commerce, logistics, and finance, what Jack describes as Alibaba’s “iron triangle.”

Alibaba’s e-commerce sites offer an unparalleled variety of goods to consumers. Its logistics offering ensures those goods are delivered quickly and reliably. And the company’s finance subsidiary ensures that buying on Alibaba is easy and worry free.

The E-commerce Edge

Unlike Amazon, Alibaba’s consumer websites Taobao and Tmall carry no inventory.[8] They serve as platforms for other merchants to sell their wares. Taobao consists of nine million storefronts run by small traders or individuals. Attracted by the site’s huge user base, these “micro merchants” choose to set up their stalls on Taobao in part because it costs them nothing to do so. Alibaba charges them no fees. But Taobao makes money—a lot of it—from selling advertising space, helping promote those merchants who want to stand out from the crowd.

Merchants can advertise through paid listings or display ads. Under the paid listing model, similar to Google’s AdWords, advertisers bid for keywords to give their products a more prominent placement on Taobao. They pay Alibaba based on the number of times consumers click on their ads. Merchants can also use a more traditional advertising model, paying based on the number of times their ads are displayed on Taobao.

The old joke about advertising is “I know at least half of my advertising budget works . . . I just don’t know which half.” But with “pay-for-performance” advertising—and a ready market of hundreds of millions of consumers—Taobao commands an enormous appeal to small merchants.

Keeping order amid Taobao’s virtual alleyways are Alibaba’s client service managers, the *xiaoer*.[9] Thousands of *xiaoer* mediate any disputes that arise between customers and merchants. These referees, young employees averaging twenty-seven years old, work long hours, often sending messages to vendors late at night.

The *xiaoer* have great powers of enforcement, including the ability to shut down a merchant entirely. They can also offer merchants a carrot: the ability to participate in marketing campaigns. Inevitably, some merchants have sought to corrupt the *xiaoer* by offering bribes. Alibaba periodically shuts down merchants caught in the act, and an internal disciplinary unit is constantly on the lookout to root out graft among its employees.

But Taobao’s success is not explained by the *xiaoer* alone. The site works because it succeeds in putting the customer first, bringing the vibrancy of China’s street markets to the experience of shopping online. Buying online is as interactive as in real life. Customers can use Alibaba’s chat application[10] to haggle over prices; a vendor might hold up a product to his webcam. Shoppers can also expect to score discounts and free shipping. Most packages arrive with some extra samples or cuddly toys thrown in, something I have personally grown so used to that when receiving Amazon packages in the United States I shake empty boxes in vain. The merchants on Taobao guard their reputation with customers fiercely; such is the Darwinian nature of the competition on the platform. When customers post a negative comment about a merchant or a product, they can expect to receive a message and offers of refunds or free replacements within minutes.

Alibaba’s e-commerce edge is also honed by another of its websites, Tmall.[11] If Taobao can be compared to a collection of scrappy market stalls, Tmall is a glitzy shopping mall. Large retailers and even luxury brands sell their goods on Tmall and, for those customers not yet able to afford them, build brand awareness. Unlike Taobao, which is free for buyers and sellers, merchants pay commissions to Alibaba on the products they sell on Tmall, ranging from 3 to 6 percent depending on the category.[12] Today Tmall.com is the seventh-most-visited website in China.

In Chinese, the site is called *tian mao,* or “sky cat.” Its mascot is a black cat, to distinguish it from Taobao’s alien doll. Tmall is increasingly important for Alibaba, generating $136 billion in gross merchandise volume for the company,[13] closing in on the $258 billion sold on Taobao. Alibaba earns almost $10 billion a year in revenue from these sites, nearly 80 percent of its total sales.

Tmall hosts three types of stores on its platform: flagship stores, run by a brand itself; authorized stores, set up by a merchant licensed to do so by the brand; and specialty stores, which carry the goods of more than one brand. The specialty stores account for 90 percent of Tmall vendors. More than seventy thousand brands, from China and overseas, can be found today on Tmall.

In the Singles’ Day promotion on Tmall, the most popular brands included foreign names such as Nike, Gap, Uniqlo, and L’Oréal as well as domestic players such as smartphone vendors Xiaomi and Huawei, and consumer electronics and home appliances company Haier.

Tmall is a veritable A to Z of brands, from Apple to Zara. Luxury brands also sell on the website, although they are careful[14] not to cannibalize sales in their physical stores. The presence of Burberry on the site is a sign that Alibaba is no longer just about cheap goods.

U.S. retailers like Costco and Macy's are also on Tmall, part of a drive by Alibaba to connect them along with other overseas stores to customers in China. Costco's Tmall store drew over 90 million visitors to its site in the first two months.

Even Amazon is on Tmall, selling imported food, shoes, toys, and kitchenware since 2015. Amazon has long had designs on the China market but has had to settle for just 2 percent of it.

In addition to Taobao and Tmall, Alibaba operates a Groupon-style[15] site called Juhuasuan.com.[16] Juhuasuan is the largest product-focused group-buying site in China. Buoyed by the huge volume of goods on Alibaba's other sites, it has signed up more than 200 million users, making it the largest online group-buying site in the world. Together, Taobao, Tmall, and Juhuasuan have signed up over 10 million merchants, offering more than one billion individual items for sale.

Alibaba's websites are popular in part because, as in the United States, shopping online from home can save time and money. More than 10 percent of retail purchases in China are made online, higher than the 7 percent in the States. Jack has likened e-commerce to a "dessert" in the United States, whereas in China it is the "main course." Why? Shopping in China was never a pleasurable experience. Until the arrival of multinational companies like Carrefour and Walmart, there were very few retailing chains or shopping malls. Most domestic retailers started as state-owned enterprises (SOEs). With access to a ready supply of financing, provided by local governments or state-owned banks, they tended to view shoppers as a mere inconvenience. Other retailers were set up by real estate companies more concerned with the value of the land underneath their store than with the customers within.

A key factor in the success of e-commerce in China is the burden of real estate on traditional retailers. Land is expensive in China because it is a crucial source of income for the government. Land sales account for one-quarter of the government's fiscal revenues. At the local government level they account for more than one-third. One prominent e-commerce executive summed it up for me: "Because of the way our economy is structured, the government has a lot of resources. The government decides the price of land. The government decides how resources are channeled, where money is spent. The government relies too heavily on taxes and fees associated with selling land. That almost destroyed the retail business in China, and pushed a lot of demand online. They deprived offline retailers of the opportunity to benefit from rising consumer demand—which they effectively channeled to e-commerce players." Successful brick-and-mortar retailers—from department stores to restaurants—suffer from success: If they bring in lots of customers to their store, they can expect a hefty rent hike when their lease is up for renegotiation.

As a consequence, there has been far less investment in marketing, customer service, human resources, or logistics in China's traditional retail sector than in the West. The result? China's retail market is highly fragmented and inefficient. In the United States, the top three grocery chains account for 37 percent of all sales. In China, they account for just 7 percent. The largest department stores in the United States represent 44 percent of total sales in that segment. In China? Just 6 percent.

Despite massive construction of shopping malls, supermarkets, and corner stores, China's offline retail penetration is still extremely low. For every person in China there are only six square feet of retail space, less than one-quarter the space in the United States.[17]

China will likely never close the gap. Why should it? Traditional retail is hardly a paragon of efficiency. With the burdens of inventory and rental costs, offline stores are rapidly losing sales to online players in many product categories.

In China today, some shop owners are too busy taking care of customers online to bother with those who actually wander into their store. Many vendors in China have simply dispensed with the shop entirely: Why rent an expensive space that is only open at most half of every day when your Taobao storefront is open 24/7?

Nature abhors a vacuum and in China the Internet is filling the voids created by a legacy of state ownership and state planning. That's why shopping online in China is even more popular than in the West. Jack summed it up: "In other countries, e-commerce is a way to shop; in China it is a lifestyle."

Taobao opened the door to online shopping in China, and Tmall has widened it even further. Taobao's early adopters were young, digital natives, but increasingly their parents and grandparents are buying online, too. As the mix of people buying online has broadened, so has the mix of products. The most popular items on Alibaba's sites are shoes and clothing, ranging all the way up from socks and T-shirts to dresses costing tens of thousands of dollars. The day after the country's biggest television broadcast, the Spring Festival Gala on China Central Television, the dresses worn by the celebrities—or approximations of them—are already on sale on Alibaba's sites. Many storefronts feature photos of people—including the merchants themselves—modeling a wide range of body sizes to make it easy to buy online. Customers know that if the clothes don't fit, or are defective, they can return them without charge.

Groceries are another popular category because, as Jack explained, "supermarkets in China were terrible; that's why we have come out on top." Already more than 40 percent of Chinese consumers buy their groceries online as compared to just 10 percent in the United States. In 2014, online grocery sales in China grew by half. Offline, they grew only 7 percent. Tmall offers grocery items in more than 250 cities in all but six of China's thirty-two mainland provinces, typically at cheaper prices than in a supermarket. Alibaba already offers next-day delivery of refrigerated items in more than sixty cities and also features a wide range of imported foods. Working with the Washington State Apple Commission, Alibaba secured more than eighty-four thousand individual orders for apples that were picked, packed, and freighted to customers in China within seventy-two hours, amounting to 167 metric tons and equivalent in volume to the capacity of three Boeing 747s.

Young mothers are a key customer base for Alibaba. James Chiu, a representative from the Dutch infant formula company Friso, which was showcased by Alibaba on Singles' Day 2015, said that for young mothers in China, "e-commerce is not a channel, it's a lifestyle, an ecosystem." The group sold almost $10 million worth of products on Singles' Day by 6 A.M. alone, more than their 2014 total.

Computers, communication products, and consumer electronics are popular items on Taobao, as are household goods, from hair dryers and microwave ovens to TVs and washing machines. Here the impact on offline retailers has been especially dramatic. On Singles' Day, Alibaba's sales of home appliances regularly exceed half of the annual sales of the country's largest consumer goods retailers. In August 2015, Alibaba acquired 20 percent of retailer Suning for $4.6 billion. Selling electronics and white goods as well as books and baby products, Suning operates more than sixteen hundred stores in almost three hundred cities. The deal with Alibaba, part of the growing "omni-channel" or "online to offline" ("O2O") trend, means that even if customers go to Suning merely to test out a product, the company can capture some of the revenue when they buy the item online.

Alibaba sells automobiles online, too. General Motors brands Chevrolet and Buick both operate stores on Tmall, where they also market interest-free auto loans, a critical competitive tool in a market that is already GM's largest. Automobiles are a popular category on Singles' Day, as buyers can expect to score discounts as well as beneficial payment terms. Real estate is another category. The superrich can browse lists of entire islands for sale in Canada, Fiji, or Greece.

Taobao is famous for offering all sorts of outlandish items, too. One university student gained notoriety for offering earrings that feature dead mosquitoes—like the insects, each pair is unique. Another vendor even sold bottled farts online.

Taobao isn't just about products. Customers can also buy services, too. Artists and musicians find commissions on the site. The sheer variety of services on offer provides a revealing insight into China's fast-changing social mores. Young men can hire a fake girlfriend to attend social events, or outsource a breakup with their real girlfriend to a specialist on Taobao. Wives worried about a straying husband can subscribe to a counseling service offering techniques to fend off a mistress. Busy young urbanites can hire surrogates on Taobao to visit their parents. To overcome a chronic lack of donors, Alibaba's group buying site, Juhuasuan, even teamed up with sperm banks in seven provinces to entice qualified donors with an offer of more than eight hundred dollars. This is the going rate offline, but with the power of online marketing more than twenty-two thousand men had applied within forty-eight hours.

Feel-good items such as cosmetics and jewelry are popular items on Taobao, too. Merchants are drawn to the category for commanding some of the highest margins for any product sold online. Today an estimated 42 percent of skin-care products in China are sold online, a number boosted by the wide availability of goods sold by merchants who have found a way to circumvent high import duties.

Counterfeit goods are thought to be the world's largest illicit industry, more profitable by some estimates than the drug trade. Sales by merchants of pirated goods on Taobao helped boost the early popularity of the website and continue to be a bone of contention for brand owners. China's fake goods can be so high quality that they defy detection even by legitimate manufacturers, made by "extra shift" production runs in the same plant as the real items, typically using leftover materials. As workshop to the world, China is a big part of the piracy problem. But as it becomes the world's largest consumer base, it has to be part of the solution, too.

Speaking at a fair for online merchants in Guangzhou, Jack once[18] addressed these concerns: "Are there any counterfeit products [on Taobao]? Of course there are. This is a complicated society. Taobao itself does not make fake products, but Taobao is providing some degree of convenience for those who make fake products. Taobao is a digital platform." Jack then urged the merchants who sell genuine products on Taobao to unite, enforce regulations, and kick out the merchants who sell fakes, telling them: "We keep track of all of you who make and sell fake products. You will be punished."

But Alibaba's efforts have not always convinced brand owners. In November 2011, the same month that Baidu was removed from its list, Taobao was added to the "Notorious Markets List"[19] published by the Office of the United States Trade Representative (USTR), America's chief trade negotiator. Inclusion on the notorious markets list not only threatened to damage Alibaba's reputation with merchants, but also complicated its plans for an IPO. In response, the company ramped up its efforts to weed out the largest traders of counterfeit items from Taobao, prompting a number of them to form an "Anti-Taobao Alliance" and march on Alibaba's offices in Hong Kong in protest. Alibaba also raised the bar for vendors selling on Tmall, increasing service charges and deposits, a move that triggered an angry response from thousands of merchants who accused Taobao of monopoly practices and marched on Alibaba's headquarters in Hangzhou.

To appease the USTR Alibaba also ramped up its lobbying efforts[20] and in December 2012 Taobao was removed from its list—although a number of U.S. software, clothing, and shoe manufacturers have continued since then to push for sanctions against Taobao to be reimposed.

As the perennial tensions over piracy highlight, the sheer volume of goods on sale on its platforms means Alibaba has to strike a delicate balance between serving the interests of consumers and merchants as well as protecting its own reputation. Binding Alibaba even closer to buyers and sellers is the second edge of the iron triangle: logistics.

The Logistics Edge

On Singles' Day 2015, orders placed on Alibaba's websites generated 467 million packages, requiring more than 1.7 million couriers and four hundred thousand vehicles to deliver the goods. China today has a veritable army of couriers. On foot, bicycles, electronic bikes, trucks, and trains they are the unsung heroes of the country's e-commerce revolution.

Chinese consumers spent more than $32 billion on package deliveries in 2014. The number increased by more than 40 percent in a year. But the volume is set to grow dramatically in the years ahead: On average less than one package per month is delivered for every person in China.

Without the low-cost delivery that the courier services provide, Alibaba would not be the giant it is today. To survive in a cutthroat industry, some of the courier firms have adopted clever methods to keep costs at rock bottom. In Shanghai, for instance, couriers shuttle back and forth on the subway, passing packages over the barriers to one another to avoid buying multiple tickets.

But none of these couriers are employed by Alibaba itself. Most of the packages in China are delivered by private couriers. Where for-profit delivery services have yet to be rolled out, mostly in the countryside, China Post handles the rest.

In 2005, Alibaba approached China Post, proposing to work together on e-commerce. But, chief strategy officer Zeng Ming recalled, Jack "was laughed at. They actually told him to stick to his own business. They didn't believe in express delivery." China's courier companies saw the same opportunities that prompted companies like Wells Fargo to launch their own private parcel delivery and banking services during the California Gold Rush in the mid-nineteenth century, in response to the inefficiency of what was then the United States Post Office. In China, the e-commerce gold rush has stimulated the rise of more than eight thousand private courier firms, of which twenty major companies stand out.

Alibaba's home province of Zhejiang is home also to most of China's largest courier companies. They play a critical role in delivering goods all over the country. Over half of the package delivery market in China is carried out by just four companies, known as the "Three Tongs, One Da": Shentong (STO Express), Yuantong (YTO Express), Zhongtong (ZTO Express), and Yunda. Remarkably all come from the same town, Tonglu, not far from Hangzhou. More than two-thirds of their business comes from Taobao and Tmall. Together with two other smaller delivery companies they are often referred to as the "Tonglu Gang."

The Tonglu Gang along with a company called SF Express[21] have played a major role in Taobao's success. ZTO cofounder Lai Jianfa described the relationship: "Delivery companies are a propeller. We are the strongest force driving Alibaba's fast development."

Alibaba has invested together with these companies and others in a firm called China Smart Logistics, or "Cainiao."[22] The combined hauling power of the fifteen logistics partners in Cainiao is staggering. Together they handle more than 30 million packages a day and employ more than 1.5 million people across six hundred cities.[23] Cainiao is building a propriety information platform that knits together logistics providers, warehouses, and distribution centers across the country. Alibaba owns 48 percent of Cainiao, which, with the involvement of the Tonglu Gang and other self-made billionaires from the province, gives the company a distinctively Zhejiang flavor.[24] The Zhejiang-born billionaire Shen Guojun[25] is a major investor in Cainiao, and served as its inaugural CEO. Fosun, best known overseas for its purchase of Club Med, is a 10 percent shareholder. Fosun's chairman, Guo Guangchang, is also a native of Zhejiang. In December 2015, Guo was apparently detained for questioning by the Chinese authorities before being released several days later with no explanation, causing a sharp decline in Fosun's share price.

When it was launched in 2013, Cainiao announced plans to invest more than $16 billion by 2020 to develop the "China Smart Logistics Network," comprising three networks—Peoplenet,[26] Groundnet,[27] and Skynet. Cainiao has not merged the courier companies, instead its strategy is to integrate the data that each generates—focusing on data packets, not physical packages. The idea is that by sharing orders, delivery status, and customer feedback each member company can improve efficiency and service quality, while remaining separately owned.

By investing in Cainiao, Alibaba aims to lock in vital relationships with its logistics partners while finding outside investors to fund the expansion of the networks themselves. Cainiao neither owns the physical infrastructure of the networks nor employs the personnel who make the deliveries. Those assets are contributed by the consortium's members and partners, allowing Alibaba to pursue an "asset-light" strategy.

A lot is riding on this approach. Alibaba's principal e-commerce competitor, JD.com,[28] is pursuing an "asset-heavy" strategy, investing directly in its own logistics infrastructure. JD's mascot is Joy, a gray metallic dog, chosen no doubt to give symbolic chase to Tmall's black cat. Today JD has built up the largest warehousing capacity[29] of any e-commerce company in China, offering speedy delivery services including same-day[30] delivery in forty-three cities. JD.com runs a truly end-to-end system, controlling its own procurement, inventory, distribution, and warehouse systems, with goods delivered to customers by uniformed couriers riding JD-branded vehicles.

With annual revenues topping $11 billion, JD has a growing share of the consumer e-commerce market. The company is especially strong in tier-one cities like Beijing and in product categories such as home appliances and electronics.

Alibaba's investment in the electronics retailer Suning, which it watches warily, illustrates its concern. Both Alibaba and JD are vying to ensure deliveries in as little as two to three hours in a number of cities.

Alibaba is attempting to build a whole a new competitive playing field by harnessing data technology, including Big Data—the ability to analyze and drive business decisions from the huge volumes of information generated every day on its websites. On Singles' Day, the delivery paths of most of the courier companies within the Cainiao network were analyzed and rerouted in the event of traffic jams. Alibaba justifies its investment in Cainiao by arguing that demand would otherwise have run ahead of the courier companies' ability to deliver the packages. This is borne out by feedback from merchants selling major appliances, such as refrigerators, during Singles' Day in 2015 who reported that less than 2 percent of the shipments handled by Cainiao arrived late or were damaged, compared to 15 percent of the shipments handled by other courier companies. From some 30 million packages on a typical day at present, Alibaba expects it will generate more than 100 million packages of orders a day by 2020.

An estimated 30 percent of current delivery routes are inefficient or uneconomic. Like Amazon in the United States, Cainiao member companies are experimenting with deliveries by drone aircraft—although higher population density in China, especially in coastal areas, means this is not as big a priority as in the United States. In 2015, YTO, one of the Tonglu Gang companies, ran a three-day trial involving deliveries of ginger tea by drone to a few hundred customers within one hour's flight of Alibaba's distribution centers in Beijing, Shanghai, and Guangzhou. For now drones in China remain just a gimmick. Innovations in logistics—such as shaving off delivery times or cutting costs—are likely to be more incremental than revolutionary.

Yet with Cainiao Alibaba has shored up the most important asset of all: trust. Customers and merchants know they can count on the products getting where they need to be, on time.

The Finance Edge

The final edge in the iron triangle is finance. In financial services, Alibaba's most important asset is Alipay, its answer to PayPal. By far the most popular online payment tool in China, Alipay handles more than three-quarters of a trillion dollars a year in online transactions,[31] three times the volume of PayPal and one-third of the $2.5 trillion global online payments market. In the peak early minutes of Singles' Day 2015, Alipay handled over eighty-five thousand payments per second.

As a form of escrow, Alipay diffuses trust throughout Alibaba's e-commerce empire. Consumers know that when they pay with Alipay their accounts will be debited only when they have received and are satisfied with the products they have ordered. Only then, after freezing the amount on the account, will Alipay release the funds to the merchant. Customers buying on Alibaba's consumer sites can return goods up to seven days after purchase, provided they are not damaged.

No longer owned by Alibaba,[32] Alipay is the largest asset of a company, controlled personally by Jack, which has been valued by one analyst at $45 billion. Alibaba websites account for more than one-third of its revenues, but other sites also rely heavily on Alipay to process their online payments. People use Alipay to make money transfers, top up their cell phone accounts, and make cashless purchases using bar codes at retailers and restaurants, like KFC. Twenty percent of all Alipay transactions involve paying for utilities, such as water, electricity, and gas bills. Customers can also buy train tickets, pay traffic fines, or purchase insurance using Alipay, making it the de facto currency of an increasingly digital China. Thanks to commissions on payments it handles, Alipay, which is already highly profitable, is expected to generate almost $5 billion a year in revenues[33] by 2018.

With the growth of smartphones in China, used by more than 830 million people, the value of Alipay goes far beyond that of a simple payment tool. Because consumers keep cash balances on their accounts, Alipay has become a virtual wallet for over 300 million people, the thin end of a wedge that Alibaba is driving into China's financial services market.

In the same way Alibaba has exploited the inefficiency of offline retail, offline banking has proved a ripe fruit for it to pick. Just as state-owned shops paid little interest in their customers, China's state-owned banks paid little heed to the needs of individuals and small businesses. Until recently, they had no choice but to place their cash deposits with the banks that were focused on state-owned enterprises. The political masters of the SOEs are also their own.

The "big four" state-owned banks—the Industrial and Commercial Bank of China (ICBC), Construction Bank, Bank of China, and Agricultural Bank of China—control about 70 percent of the market. The disdain of these banks for their customers has fueled popular jokes such as the one about ICBC's initials standing for, in Chinese, "*ai cun bu cun,*" translating loosely as "who cares if you save with us or not, whatever." Traditionally, these and other state-owned banks paid out very low rates of interest, at times below the rate of inflation. This "financial repression" has skewed China's economy, transferring wealth from consumers to the SOEs, which have squandered much of it in the loss-making investments of the Old China model.

The Chinese government recognizes the need for reform, and the need for more rational capital allocation. But to do so it has to take on a powerful vested interest: itself. Alibaba has already been caught in the middle. Offering much higher returns on deposits than the meager returns paid by the banks, Alibaba's Yu'e Bao online mutual fund proved so popular when it launched in 2013 that it stirred China's stagnant financial service industry into a frenzy of activity. Yu'e Bao, whose name translates in English as "savings balance treasure," sounds innocuous enough: a place to deposit your loose change. But when it launched the product Alibaba set no limits on the amount customers could deposit. Not only were the rates it offered much higher than the banks—as much as two percentage points higher—but Yu'e Bao allowed customers to make withdrawals at any time without penalty. As a result, individual customers transferred tens or hundreds of thousands of dollars into the fund. The banks became alarmed at the outflows. By February 2014, Yu'e Bao[34] had attracted over $93 billion from 80 million investors, more than the combined total accounts of all other money managers in China. The inflow was so huge that in only ten months Yu'e Bao was ranked the fourth largest money manager in the world, closing in on global industry stalwarts such as Vanguard, Fidelity, and J.P. Morgan.

Prior to the fund's launch Jack took the unusual step, for a private sector entrepreneur, of penning an opinion piece in the Communist Party journal *People's Daily* arguing, "The finance industry needs disrupters, it needs outsiders to come in and carry out a transformation." Soon after, the SOE empire struck back, denouncing the fund managers behind Yu'e Bao as "vampires sucking blood out of the banks." Starting in March 2014, the state-owned banks, holding collectively more than $100 trillion in deposits, imposed limits on the amounts their customers could transfer into third-party online payment accounts. Other government-imposed restrictions followed soon after. Pulling no punches, Jack posted a message on social media criticizing the banks by name and blaming them for failing to participate in China's market-oriented financial liberalization: "The decision of who wins and who loses in the market shouldn't be up to monopoly and authority, but up to customers." Jack deleted it soon after, but the message was reposted widely. Alibaba has continued to push the boundaries of private sector involvement in financial services, including providing microloans to the merchants and consumers trading on its platforms. Still relatively new, the lending business is expected to grow into a billion-dollar business within a few years. Offering credit also increases the "stickiness," or loyalty from customers, of Alibaba's e-commerce platforms.

Because it has access to the entire trading history of its customers, Alibaba is in a much better position to assess credit risk than the banks. A new business, Sesame Credit Management, provides credit ratings on consumers and merchants to third parties.

Other financial services offerings[35] include wealth management, peer-to-peer lending businesses, and insurance.[36] In 2015 Jack launched an Internet-only bank called MYbank, which gets rid of the need for branches entirely. MYbank plans to use smartphones to authenticate customers' identities.[37]

The iron triangle is a key factor in making Alibaba such a dominant player in China's e-commerce market. But it is the charisma of the company's founder—his "Jack Magic"—that bound together the people and capital who would build on these foundations.