Transformation of E-Commerce by Business and Law Perspectives: Case Study on “October Event” of Taobao Mall

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Abstract: We focus on the event that Taobao Mall(Tmall) changed its charging rules on October 10 in 2011 which received strongly protest of small and medium sellers, and analyze the whole event separately from business and law. From business perspective, we analyze the resistance of the E-commerce transformation, and offer a solution based on shared-value theory. From the law perspective, we discuss the legal risk and the relevant legal issues. Through the law-business dual perspectives research, it helps us to understand the business model and internet rules. Furthermore, it provides a meaningful reference of the transformation of E-commerce.

Keywords: E-commerce, business model, Law-Business Perspective, rule

1. INTRODUCTION

E-commerce is a new business model based on Internet. Sometimes e-commerce is a business model defined as “doing business electronically”[1]. It refers to firms that conduct commercial transactions with their business partners and buyers over the Internet[2]. Business model includes three design elements: content, structure and governance[3]. Governance of business model refers to who performs the activities and it is about the rule of organizations. For example, franchising represents one possible approach to activity system governance. In the e-commerce industry, sometimes it is called net-rule or internet governance.

The rule of the organization is an important research issue[4]. The rules are responsive to environmental and organizational problems. Environmental demands produce waves of rule change. Waves of new rules can also be stimulated by internal changes. The business model is an important internal factor. The business model should be fit for the product market strategy[5] and other internal resources of firms. The business model changes, the rules of the organization should change too. Otherwise, the rules can not fit for the business model.

On the other hand, organizational learning shapes the life histories of rules. The adaptive process is the relation between the exploration of new possibilities and the exploitation of old certainties[6]. Information technology enhances the exploration and exploitation in organizational learning[7]. E-commerce has direct relationships with information technology. So the learning speed of Internet business is very fast. Many e-commerce firms have the similar web portals, such as 360buy.com and dangdang.com. The trading rules of e-commerce change with the organizational learning. At the same time, environmental aspects (i.e., dynamism and competitiveness) moderate the effectiveness of exploratory and exploitative innovation[8].

Firm strategic and organization adaptations coevolve with changes in the environment[9]. El Sawy etc.(2010) defined the concept of digital ecodynamics which is the holistic confluence among environmental turbulence, dynamic capabilities, and IT systems-and their fused dynamic interactions unfolding as an ecosystem[10]. In the e-commerce industry, the rules which are called internet-laws or net rules are popular in practice. Do the rules coevolve with the business model? What is the process of the coevolution of the rules and business model?

2. FRAMEWORK AND HYPOTHESES

When the firm designs a business model, the way of earning profit is confirmed. In the next period, the firm should optimize the rules to make the business more efficient. That means the rules or laws help the firm get competitive advantage. For example, McDonald's set up the business model as the global foodservice
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retailer and designed the rules of franchising.

Because the rules which are affected by routines change slowly\(^{[11]}\), it is hard to get the fit between the rules and the business model. The rules change slowly and step by step, while the business model emerges by leaps and bounds. Information technology accelerates the innovation of the business model which often makes the rules drop behind. The lack of Internet laws is the good proof. In China, there are few e-commerce laws which lead to the fraudulent business deal on Internet.

We set up a research framework as Fig.1. The process of rules evolution is divided into two types: exploitation and exploration. The exploitation way shows that the rules evolve step by step and drive the change of Business Model 1 to Business Model 2. Most of the scholars of laws have done continuous optimization of rules. When the firm turns to Business Model 2, the next cycle of exploitation begins. The exploration way shows that the business model jumps from Business Model 1 to Business Model 3 directly. The exploration way gives the firm a new competitive path when the rules lag behind the business model. Especially, the turbulence of environment makes the firm choose the exploration way.

![Figure 1. The research framework of business model and rules](image)

We propose three hypotheses under the research framework.

**Hypothesis 1:** The fit of the rules and the business model affect the performance.

**Hypothesis 2:** In the stable environment firm is apt to choose the exploitation way and the optimization of rules can increase the business efficiency.

**Hypothesis 3:** The exploration way helps the firm keep competitive advantage.

3. DATA AND METHOD

We collect the data of Taobao and use the research methodology of case study. From April 10 in 2008 to June in 2011, Tmall has developed fast because the business model of B2C. Tmall won the first position and occupied 48.5% of the market share of B2C. The second position of B2C market is 360buy.com which occupied 18.1% market share.

In recent years, E-commerce has developed so fast in China. The market size of E-commerce has reached 7161 billion in the third quarter in 2011, which increased 17.1% on a quarter-on-quarter basis and 72.7% compared with the same period of last year. Many new E-commerce firms come forth, such as 360buy.com and VANCL.com, which increase the intensity of competition in E-commerce industry. Though Taobao.com is one of the earliest and biggest e-commerce firms, the pressure of competition still exists. To deal with the completion, Tmall.com was set up on April 10 in 2008 from Taobao.com. Tmall.com is the business model of “from Business to Customer” (B2C), which is totally different from Taobao.com of “from Customer to Customer” (C2C). The purpose of Taobao.com transformation from C2C to B2C is to increase service quality and avoid fake products. At the same time, the shops on Tmall.com should pay more to Tmall.
When Tmall.com raised the shop fee on October 10 in 2011, about fifty thousand small and medium sellers deprecated the change of shop fee and attacked some big shops on Tmall.com. This is the “October Event” of Tmall.com. Most of newspapers analyzed this event from the law perspective and criticized Tmall as monopoly. Others accused the small and medium sellers for their illegal attack. Few scholars realized the key point is not only a law issue but also a business issue. This event is about the business model and dynamic evolution of rules.

4. CASE ANALYSIS

4.1 Tmall October event review

On October 10 in 2011, TMall announced “Adjustment of 2012 Stores Renew Rules”, increases relevant fees to 5-15 times, which caused dissatisfaction of stores in medium and small size sellers (SMS).

On October 11, medium and small size sellers attacked big stores in Tmall.

On October 12, Taobao provides services to the stores who do business in a good faith and honest way to help them transfer their stores from Taobao Mall to Taobao. Taobao will keep their transaction and credit records. However, the dispute continued. In YY.com voice channel, the number of members in “Anti-Taobao Alliance” reached 50,000. More and more shops reported they had been attacked, including “Ju Hua Suan” and “Zhi Tong Che”. In the same time, off-line protest begun.

On October 13, “Ju Hua Suan” and “Zhi Tong Che” as two independent sectors of Taobao, became the main targets of attack. Taobao used emergency measures.

On October 15, Taobao who insisted on its attitude, announced “Explanation to 2012 New Rules” and announced that most stores supported the 2012 new rules. Meanwhile, Ministry of Commerce of the PRC (MOFCOM) declared that they would pay attention to the event.

On October 16, after MOFCOM’s interfering, Taobao compromised, and “Anti-Taobao Alliance” partially ceased their protest.

On October 17, Taobao announced their “1.8 Billion Supporting Plan”.

On October 21, Alipay suffered maliciously withdrawing money.

On October 31, MOFCOM said the legal administrative system should be built up to govern E-commerce, and the “E-Retail Administrative Regulations” should be set up.

4.2 Legal analysis

A) Taobao

Is Taobao a monopoly enterprise in the e-commerce market? Does Taobao abuse its dominate market position or not?

Section 17(6) of Anti-Monopoly Law of PRC stipulates: “Applying discriminatory treatments on trading prices or other trading conditions to their trading parties with equal standing without any justifiable causes.” Taobao applied discriminatory treatments to the stores by increasing annual fees and different ratio of deposit refund, therefore. As a platform service provider, Taobao intended to keep qualified big-size stores and kicked out SMSs by applying annual fees by their dominate position. Therefore, it is likely that Taobao is under suspicion of actual monopoly and abuses of dominate market position. SMSs are likely obtained legal basis to apply to authority to govern. Taobao took advantage of the condition and controlled the voice. During the negotiation with SMSs, this unequal relationship itself is unfair.

From the civil law perspective, the announcement of trading with stores from Taobao Mall is an invitation to trade. It is legal based on the principle of free will and free contract.

From the contract law perspective, to the stores who signed contracts before the commencement of the trading announcement, if Taobao Mall had not notified the parties that new rules would be adopted in 2012, then Taobao Mall committed fraud. The contracts between Taobao Mall and stores are contracts can be withdrawn;
stores could sue Taobao Mall and ask for damage to People’s Court.

B) Small and medium size sellers (SMSs)

From the perspective of civil law, buyer has right to refund purchased goods and valuate it. However, the “siege” of SMSs violated principle of “good faith and honesty”, is an abuse of right.

From the perspective of economic law, SMSs and big stores are traders in competing. Adopting the measures of “fraudulent purchase, valuation in malice”, SMSs harmed big stores’ business credibility. They not only caused economic loss to big stores, but also disturbed e-commerce order. The Administrative Department of Industry and Commerce should investigate and punish the illegals according to the law.

From the perspective of torts law, SMSs’ actions seriously damaged big stores’ business credibility. They should compensate the big stores according to the law. According to section 19 of ‘Interim Measures of network commodity trade and related services management’ that was issued by Administration for Industry and Commerce of PRC, “Internet goods trader and internet service provider shall not use internet technology or carrier to actualize unfair competing actions which damage other trader’s business credibility, business reputation and business secret.” SMSs’ organized and intended use of Taobao trading rules to attack big stores violated aforementioned rules. This is an unfair competing action and should be investigated and punished.

4.3 Business analysis

Under the traditional off-line retailing mode, because of the time and space restrictions, the sellers and consumers are located in different areas, therefore, cross-area connections between sellers and consumers are rare. Although supermarkets and department stores exist in one area, traditional sellers’ direct channel with consumers still takes important position. Every seller has his/her own resource of consumer, according to the classic business rule “20% loyal consumers bring 80% profit”, these loyal consumers are the most precious resource, and the basement supporting sellers’ long-term stable profit.

With the development of distribution, internet and E-pay, it is possible for sellers and consumers to trade online, dramatically decrease trading cost, and promote E-commerce.

E-commerce makes trading easier, but brings new problems as well. The sellers from all over the world could sell goods through internet. Opening their computers, consumers have thousands of choices. If consumers have to visit a new website once they decided to find another seller, it will be very troublesome. Therefore, consumers’ demand for “one stop shopping” and “standard transaction procedure” tends to be stronger and stronger. Taobao, as a multiple-internet trading platform like off-line shopping center, has more capacity and influence than off-line shopping center. During the promotion held in November 11, 2011, Taobao Mall gained 3.36 billion turnover. At the same time, the total Alipay turnover of Taobao and Taobao Mall was 5.2 billion, which cannot be obtained by any off-line business circle.

E-commerce consumers’ demand for platform and huge overturn force sellers, especially SMSs, to change their strategy from self-built-up website for direct sell, and resort to platform sell. Varieties of sellers enrich the goods on the platform, and increase platform’s value to consumers. On the other hand, more and more consumers get together on the platform to bring huge overturn, which in turn attracts more sellers. Both sides interact with each other, therefore, the platform, the sellers as well as the consumers been connected closer, and balanced with each other.

It is obvious that with the development of technology and economic, the change of the consuming mode modified the trading mode of traditional internet channel, which shows a tendency of one-to-one direct trade to multiple-platform trade. The loyal consumers, who had been valued as the most important consumers by sellers, gradually direct their loyalty from sellers to platform. Under this new structure, the risk and value in the trading chain has been re-located. Sellers’ profit increased due to the huge amount of turnover through platform trading. However, their trading risk is also increased due to the reliance to the platform. Most consumers gathered in the
platform, which means quitting the platform will cause the loss of loyal consumers who is the basement and guarantee of long-term profit. However, the re-location of the risk which brought by transfer of intangible property between sellers and platform had been ignored by current laws.

Assuming that the sellers quit the platform, their loss would be the sunk cost and the accumulated loyal consumers, which will bring risk for future running of the business. The huge quit cost enhances sellers’ reliance to the platform, which is the reason why sellers did not quit.

April 2008, Taobao Mall was labeled as “High class and quality” shopping platform, profits from the sellers’ store rent and relevant value-adding service providing. As return, Taobao Mall provides high-quality platform service to sellers. They try to build up “Beijing Wangfujing Street, New York Fifth Avenue, Hong Kong Harbor Town” in the internet. However, some strategies which had been adopted for occupying market position should be re-consider today. There were two strategies to be chosen. The first one is that Taobao intended to use new website and increase entry level to create a high-class shopping platform. The second one claimed that, create an independent channel in Taobao, and share the flow of C shop. However, back to that time, the B2C market was not a blue sea for many pioneers had took their positions, for instance, 360buy, Amazon, DangDang and so on. It is hard for the newly-established Taobao Mall to survive. The latter strategy obviously has remarkable advantage of business size and turnover. Following to the second strategy, to promote Taobao Mall, the search page of Taobao left the places in first group to Taobao Mall which drew extremely dissatisfaction from other stores and finally these stores forced Taobao to give up. However, without abundant turnover, it is hard for the newly-established Taobao Mall to attract sellers. Therefore, Taobao Mall lowers down the entry level which drew many sellers without any consideration to the qualifications of them. Many low-class sellers who do not meet Taobao Mall’s requirement and other high-class sellers move in together and competing with each other (as showed in below table). The conflicts affect internal stability of Taobao Mall, the original position, and would hamper its future development.

In order to remove the internal conflict, to keep the qualification of the platform, and to guarantee future development, Taobao Mall has to bear huge risk and increase annual fees. These proposals will be helpful for washing out unqualified sellers. Finally, Taobao Mall paid 1.8 billion re-investment and reputation loss. At the same time, SMSs suffered direct economic loss. Transformation like Taobao Mall cost too much.

5. TRSFORMATION OF E-COMMERCE

It is true that Taobao’s low pricing strategy face the conflicts within the system. Taobao Mall is an initial attempt of transformation of Taobao, but suffered a heavy attack. Taobao is confronting of more intense conflicts within the system because of the initial free pricing strategy is too extreme. Furthermore, Taobao is faced with the more intense issue that is the difficult to get profits. The transformation of Taobao is on the way with the two facts. However, how to get the right way of transformation ?We have to look back to the developing of Taobao, which is unusual ,besides, in-depth analysis the free model is a must, that is the original cause of conflicts within the system.

The development of free model is the challenge of Taobao transformation. The choice of free strategy is based on the time’s development when Taobao is established. Firstly, the level of development on internet in China is not as good as the United States’. At the early time of C2C’s developing, the business and customers are cautious and unfamiliar to shopping on internet. On the other hand, some leaders in E-commerce in worldwide world are given high expectation on Chinese market potential in future. Having the two factors, Taobao released free policy in the early period to keep ahead of competitors and make a larger market. Relaying on the free strategy, Taobao snatched the market from the E-bay, which was the leader in E-commerce, and be a new leader with its market’s proportion, that is expand rapidly.

Taobao has attracted many sellers speedy with the strategy, not only has improved the impact in
E-commerce, but also bring in large profits. However, it has to be seen that there are many problems with the more sellers which is caused by free strategy:

The pressures of the inner contradictions and difficult to profit which is caused by free mode make the transformation of Taobao, but the extraordinary of the way for corporate development leads it to be different from common below-the-line enterprises who make transition as traditional mode generally. On one hand, with the increase of the assigned sellers, their strength is gradually increasing. So it is difficult to transform by simple charging or raising prices. In addition, the short-term free trial in the past had been extended again and again because of the strong demand of the sellers. Finally, under the force of the increasing strength of the sellers, Taobao had to make a "permanent free" commitment. On the other hand, the Taobao mall “October Event ” also warned Taobao, as a result of the platform-dependent strengthening of the sellers, the transform mode by simply giving up part of the sellers contains a huge risk. The two factors above make a great challenge to the transformation of Taobao.

We realize that E-commerce enterprise has been a new role in today’s market; it’s hard to solve the problems faced in old ways of traditional transformation, so there is a must for exploring new model of transformation. It’s maybe a good idea to relocation the place of Taobao, taking advantage of its monopoly. Moreover, rebuild the division of pattern in E-commerce and the value chain the theory. Not only can clear the conflicts within the system, which can remove the unstable conflicts, but also form a virtual “strategy group” with other participants by the shared value. Virtual Strategy group also can make the seller’s profits come true, instead of abandoning sellers and reducing the fierce resistance, which is relied on seller’s platform. Moreover, the transformation to support behind contributes to strengthen the unique role in E-commerce and build a new pattern.

With the new mode, Taobao not only completed its own transformation, but also finding a fundamental solution to the problem which a single platform is difficult to accommodate the different needs. At the same time, Taobao sparse the contradictions by opening up the channels of industry-wide platform instead of abandoning the sellers directly regard avoiding the seller’s conflict as the premise, achieve the diversion of sellers effectively; maximize the interests of the sellers and the platform.

Under the virtual strategy group, it avoids the loss of value caused by the blind vicious competition within the industry. It creates an effective value cycle, meeting the interests of different actors within the industry by the industry-wide sharing of value.

By integrating industry-wide resources, Taobao reduced the information acquisition costs, accessed the overall industry data, and achieved the industry-wide flow of information by transaction paid. It also helped the industry grasp the dynamic development of the industry more fully and effectively, improve the industry’s ability to resist risks, laying a solid foundation for future development which is more flexible and effectively.

At the same time, the new business model of Taobao, expanding its scope of the target user. It will expand target users from a single online shopping consumers and network operators to all industry participants, it have changed competitive situation in parallel with the competitors, through different division of labor in the chain, making Taobao itself upgrade to the combination of base-supporters, industry participants and main facilitator of the flow of information industry in front of the industry chain, build the real all-round E-commerce ecosystem.

6. CONCLUSION

October Event let us think about the legal system and new business model. First, with the development of electronic commerce and the change of consumption habit and commercial model, the risk and the value have been redistributed between business participants. For the more complex economic relationship, the disadvantage of prevailing institution appear under the new economic environment. The medium and small scale sellers of October Event can’t get equal relationship with Taobao company, so it is really difficult for them to protect their
own benefit through legal solution when they suffer the interest loss. They have to choose the way of violent behavior, for which the society suffer from huge economic loss. Economic is the decisive factor of the society development and the law is the base of system guarantee for the economic development. When the system don’t meet the productivity development, we should research the new trend of economic and the direction of system reform correspondingly to guarantee that the legal can protect the benefit of each side and keep the economic regulation and promote the develop of economic while it take the function of forecasting and guiding the economic development in future.

Furthermore, when we discuss the business essential which leads to the event, we will find that the basic reason for October Event is the reform pressure. The business model of Taobao which is free to registration for seller at the early age leads to their inner contradiction and profit barrier. These two factors affect the development of Taobao. According to the result of October Event, the risk of Taobao intending to reform through the traditional way increased substantially which will cost more. With the rapid development of electronic commerce, Taobao urgently needs to exploit a new reform model to avoid fierce contradiction.

On the base of further analysis, we design the new reform model for Taobao after relocation and function resolution. Under the new model, they can go through and combine all the distribution and collect resources forming virtual association with participants. On the condition of avoiding seller collision, we should achieve the goal of seller diversion and reforming business frame to come to share the whole industry value, by which the problem of inner contradiction and profit barrier can be solved basically setting up an effective and thrive ecosphere of electronic commerce.

The model is ideal for practice, which will be influenced by many actual factors such as national policy and the information barrier by customer and the other participant and the change of environment outside. In the process of reforming, the company should pay more attention to the two points. First, the company should make full understand of their development location and achieve the goal gradually under the final target guidance. Secondly, notice the change of situation outside and it is clear that both the radical and conservation behavior will lead to the huge lose during the reforming for company. We call for enforce the relevant legislation to offer the basic insure for the economic development and the electrical commerce reforming in system and keep the economic order and expedite the development of economic. In a word, the huge model reforming can’t be finished within short time. The company should make a decision carefully under the protection of perfect legal system in the stable economic environment. Only the stable legal system and the control of strategy can achieve the final success.

The transformation of the e-commerce of Tmall.com is hard. It has universality of Chinese e-commerce firms at a certain extent. Nowadays, most of scholars and practitioners thought the lack of e-commerce law caused the e-commerce industry out-of-order. But we suggest that the rule and business model coevolve. The transformation of business model is exploration while the improvement of law is exploitation. In this paper, we analyze the “October Event” of Tmall.com carefully from both business and law perspective. This case gave use some propositions of transformation of e-commerce.

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