

Internationalization: Choosing The Right Entry Mode: Lessons From Ebay’s Strategy In China

Onyeka Uche Ofili, BSc, LL.M, MBA, DBA

International School of Management, France/New York

doi: 10.19044/esj.2016.v12n1p202 [URL:http://dx.doi.org/10.19044/esj.2016.v12n1p202](http://dx.doi.org/10.19044/esj.2016.v12n1p202)

Abstract

This paper considers the motivations for businesses to expand to other countries using the entry of eBay into China as a case study. It observed that eBay adopted the wrong entry mode by acquiring 100 percent of EachNet. The company would have performed better if it had adopted the joint venture approach with minority stake as it later did with Tom Online or if it had only retained minority stake, as was the case when it acquired 33 percent of EachNet. It was discovered that the various entry modes have their pros and cons depending on the peculiarity of the host market. This paper therefore, recommends that in entering a new market, companies should ensure to have a proper understanding of the local business dynamics before settling for any entry strategy.

Keywords: Globalization, market entry strategy, internationalization drivers

Introduction

Internationalization drivers

Various reasons motivate organizations including eBay to seek international expansion. This could entail seeking locations where the cost of production including the cost of labor is cheaper. It could be a quest to push its products and services to new markets with substantial demand. The organization may also want to be closer to raw materials. The intention could also be to minimize risk. By establishing your business in another country you spread your risk so that if one country goes into economic, social or political problems such that adversely affect business the business situated in a more stable country will serve as a hedge. Other factors may include a company’s quest to reduce seasonal fluctuations, take advantage of better technologies and reduction of the risk of losing market shares. For eBay one main reason for expanding to China was to take advantage of the growth in the number of Internet users especially online shoppers, see appendix A and B below (Lu, Tao, Chan, 2008).

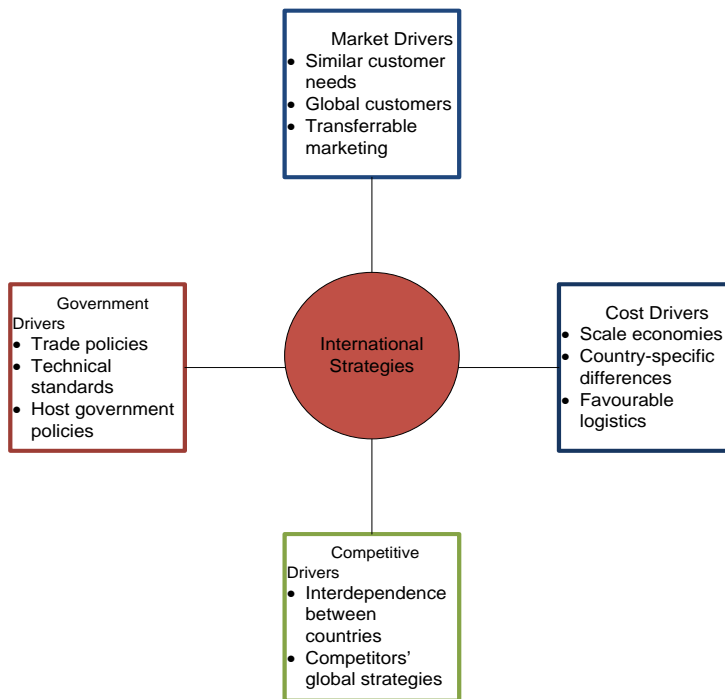
Factors that drive or cause organizations to go global are quite numerous and may vary from one industry to another and from one organization to another (Dewhurst, Harris, & Heywood, 2012). While barriers to international trade and investment and even the cost of migration are much lower for certain countries there are still some countries where the conditions may not be as desirable. Furthermore international regulation and governance have improved significantly in more countries than was the case in time past. Also, the advent of the Internet and cheaper means of travel (especially air travel) have also contributed positively to the growth and development of international business. In as much as there has been significant improvement in international business in terms of improving global business environment, some countries and industries may be exceptions to the rule. For instance there are still issues concerning migration between certain countries.

Yip (2003) identified four drivers of internationalization, see figure 1 below. The first driver identified is market driver. Companies move to other markets for the simple fact that some customers' needs are common across different markets. Also some customer needs could be global in the sense that the same customers in one market may require similar products or services in another market. Furthermore, transferrable marketing encourages globalization as companies take advantage of the fact that they can use similar advertisement and branding strategies across different markets.

The second driver is cost. Cost is a motivation for companies to go international. Companies hope to achieve scale of economics when they expand, increasing their efficiency of production with increase in the number of goods been produced. Scale of economics is very useful and beneficial in industries where the initial product development cost is high. Such companies will hope to increase their sales volume so as to reduce the time it takes to recover development cost (Johnson, Scholes & Whittington, 2008).

Government policies are identified as the third driver of internationalization. Government policies can indeed promote or inhibit internationalization. Governments with favorable policies such as adequate promotion and enforcement of intellectual property rights, transparent judicial system and minimal corruption are more likely to attract foreign direct investments. Companies will naturally want to do business in such a country. It is worthy of note that no country is completely open. Countries only open up their economies only as far as it will bring economic benefits. There will remain certain level of restrictions that may be hidden behind over regulation or under regulation (Howcroft, Ul-Haq, & Hammerton, 2010).

Figure 1: Internationalization Drivers



Source: Adapted from Yip, G. (2003)

And lastly globalization puts pressure on companies to diversify their operations from one market to another in response to competition. Companies should know not to limit their competition analysis only to their local market. They should take into consideration competition coming from businesses situated in other markets including substitute products. In order to avoid this, some companies develop robust international strategies (Hitt, Ireland, & Hoskisson, 2012).

While recognizing that there are great reasons why companies may want to go international the decision must be made with absolute care (Khan, 2005). Khan (2005) identified factors such as cultural differences, language barriers, religious beliefs, socio-political issues; peculiarity of the business environment including negotiation styles as important when making a business decision to go international. It is therefore, recommended that before going global it is advisable that companies develop international strategy framework. This framework should comprise of four main components namely international drivers, domestic and international sources of competitive advantage, market identification and selection and finally the best mode of entry into the identified market.

The rest of this paper is organized as follows: the next section (section two) is on developing international strategy. This section looks at the competitive environment analysis and making the right decision in terms of market selection. The third section looks at the various entry modes for international expansion. It considers the advantages and disadvantages of the various entry modes and the conditions under which each is more suitable. Section four is on observations and recommendations on what eBay could have done to avert its initial failure in China. The paper then reaches a conclusion in section five.

Developing international strategy

Competitive environment analysis and market selection

When a company is convinced that it should go international, the next step will be to develop a well designed, focused and robust international strategy (Kumar & Waheed, 2007). The company in deciding to enter a given market must understand critical issues such as political stability, the amount of disposable income, speed of growth of the economy, business cycles, fuel price, exchange rate and the degree of inflation in the desired country. Also the availability of skilled workers, size and spread of the demographic market segments, security and changing cultures has to be taken into consideration. Furthermore the level of contract enforcement, the degree to which intellectual property can be protected and issues such as restrictions on mergers and acquisitions have to be taken into account as well (Thomas, 2007).

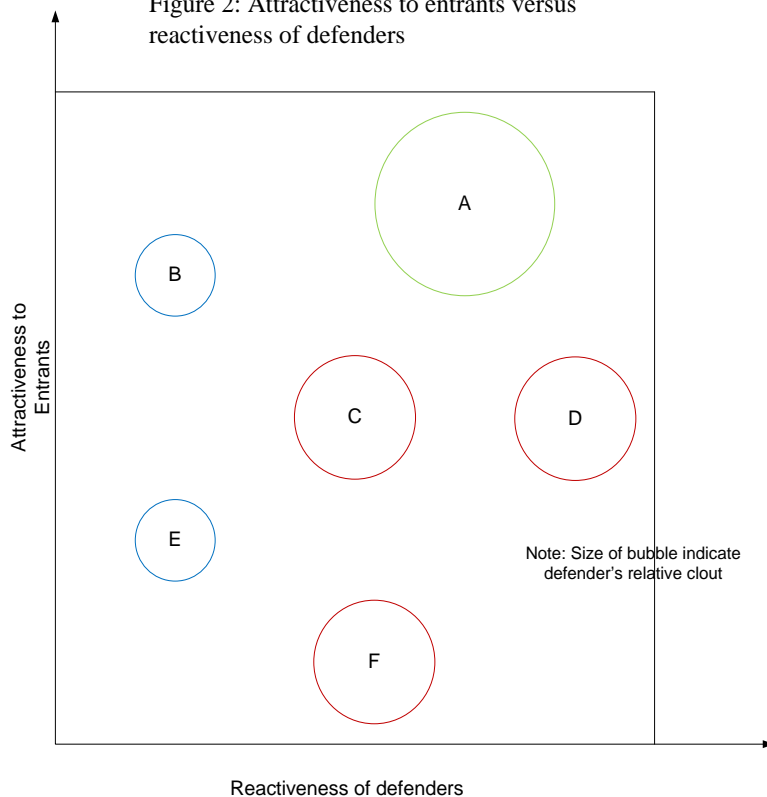
According to Ghemawat (2001) it is not enough to measure and compare the business attractiveness of different countries. He asserts that what is important is to ascertain the degree of compatibility between the country and the internationalising firm itself. A company situated in a given country may perform better in market A than market B even when market A and B share the same level of attractiveness. Take for example a South American market and say an East African market of equal attractiveness ranking. A Spanish company may likely perform better in the South American market than in the East African market. This is because the Spanish company may be more at home in the South American market due to closeness of language and culture (Johnson, Scholes & Whittington, 2008).

Ghemawat (2001) argued that distance is an issue that should be strongly considered by firms that intend to go international. He identified four types of distance. First is cultural distance, which is described as the difference in language, ethnicity, religion and social norms. The second is administrative and political distance. This refers to the level of administrative, political and judicial compatibility. The third is geographic

distance. This refers not only to the distance between the two markets but also size, sea access and the quality of communication infrastructure. The fourth is economic distance. This refers to the difference between the spending capacities of the two markets.

Having carried out both the PESTEL (political, economic, social, technology, environment and legal) and CAGE (cultural distance, administrative and political distance, geographic distance and economic distance) analysis the firm wishing to go international needs to carry out an analysis of the competitive environment of the intended market. To this end the firm may need to apply Porter’s five forces framework. This entails taking into consideration threat of potential entrants, bargaining power of buyers, bargaining power of suppliers and threat of substitute products (Porter, 1980). It is also important that the firm takes into consideration the possibility of receiving retaliation from other competitors.

Figure 2: Attractiveness to entrants versus reactivity of defenders



Source: Reprinted by permission of Harvard Business Review. Exhibit adapted from ‘Global Gamesmanship’ by Macmillan, I., van Putten, S. & McGrath, R. (2003).

So to have a robust strategic plan the firm has to take into consideration the attractiveness of the market to entrants and the degree of reactivity of defenders, see figure 2 above. The degree of reactivity of

the defenders is a function of the level of attractiveness it has towards the market and its capacity including management skill to coordinate a thorough response (Macmillan, van Putten, & McGrath, 2003). Furthermore, the market shares of the competitors have to be taken into consideration. This has to be viewed with respect to the relationship between the competitors and relevant local players including relationship with local authorities, retailers and possibly suppliers.

As can be seen from figure 2 above countries A and B are better as far as attractiveness to entrants is concern. However, countries A and D have more reactive defenders. Figure 2 above further reveals that defenders in countries A, C, D and F have more clout compared to defenders in countries B and E. In summary country B looks to be the best country for the firm to move into considering the fact that it has the least defender reactivity and clout (although it is on the same position with E as far as defender reactivity and clout are concern) but it has a higher attractiveness than E. Country A may seem the most attractive but it has both high defender reactivity and clout. Similarly, C, D and F all have higher defender reactivity and clout compared to B.

Reasons why some businesses fail in international market

A number of factors can be responsible for a business to fail in a given market. A business succeeding in one market does not mean it will automatically succeed in another using the same principles and strategies. This section will discuss the possible factors responsible for eBay's initial failure in China.

Most importantly it was identified that eBay took for granted the fact that the China business environment was very different from that of the West and indeed the United States (Lu, Tao, Chan, 2008). It was this lack of understanding that made eBay to bring in a German manager to lead its China operation and a chief technology officer from the United States. None of these two had an in-depth understanding of the dynamics of the China market and neither of them even spoke Chinese. Furthermore, this lack of in-depth understanding of the business environment made eBay spend huge amount of money advertising on the wrong medium. It spent a huge amount of resources including money and time advertising on the Internet instead of placing television adverts. In China at the time most small businesses didn't use the Internet but they rather watched television for information and entertainment. eBay also failed to understand that even though its brand was strong in the US it was not popular among Chinese. So it further failed to adapt its products and services to suit the local Chinese market (Wang, 2010).

Also while eBay EachNet's product listing was more products centric that of its core competitor, Taobao, was more customer-centric. eBay adopted its generic global platform of "buyers" and "sellers" where as Taobao adopted a listing that was more in tune with the market, which was "men", "women" etcetera (Lu, Tao, Chan, 2008). Furthermore, eBay EachNet failed to recognise that at the time many Chinese were more cell-phone savvy than Internet savvy. Taobao realized this and will send instant messaging and voice mail to mobile phones of buyers and sellers. In the overall because of Taobao deeper understanding of the market it was more responsive to customer needs than eBay EachNet (Wang, 2010)

According to Rein (2007) the fact that eBay charged listing and final selling value fees where Taobao did not was not the main reasons why consumers switched from eBay EachNet to Taobao. Rather the Chinese consumers had more faith and confidence in indigenous firms than foreign firms. Alternatively they will prefer to patronize big-named foreign brands that are well established in the China market than patronize new foreign entrants. With respect to eBay EachNet's competition Taobao, the Chinese consumers have more confidence and trust in Taobao than eBay EachNet. The reason is because Taobao was considered to be more Chinese than eBay EachNet Rein (2007). Taobao (although established in 2003) was a subsidiary of Alibaba, which was established in China since 1999, thus giving Taobao an edge over eBay, which only came into China in 2002. Note that even though EachNet was established in 1999 in China it was fully bought over by eBay and rebranded to eBay EachNet in 2003. This as far as the Chinese consumers were concerned was a new foreign company entering China in 2003.

eBay EachNet did not introduce escrow services in its payment system when it first entered China (Ireland, Hoskisson, & Hitt, 2009). The Chinese consumers were more comfortable with having a third-party company to monitor the entire transaction process and ensure that funds are only released to sellers only after the buyer has received the goods in good condition. And the sellers are in turn guaranteed that they will receive their payments as long as they keep to their side of their obligation to the buyer. On the other hand Taobao incorporated escrow payment strategy into its Alipay payment system. The Chinese consumers were more comfortable when they are able to negotiate and haggle with sellers over price to arrive at a convenient price. eBay EachNet did not initially allow direct communication between buyers and sellers until both parties confirm and close a transaction. Taobao allowed buyers and sellers to communicate directly and haggle over price face-to-face. This did not only give the buyers assurance that they are getting the best price but also helped build confidence between the parties (Rein, 2007).

Despite the fact that eBay EachNet did a better job in protecting its customers from buying counterfeit products than Taobao its customer service was considered poor (Rein, 2006). And this contributed significantly to eBay's failure in China. Lack of customer service hotline and instant messaging system discouraged consumers from patronizing eBay EachNet. Instead eBay EachNet provided links to frequently asked questions. It also provided community forum where users were expected to interact and help each other resolve issues. The consumers preferred to go to Taobao where they can report complaints directly via customer service hotlines and instant messaging system. Furthermore, eBay EachNet's response time to customers' queries was quite slow compare to Taobao.

eBay assumed that its brand and previous strategies in other markets would work fine in China just as it has done in other markets across the world (especially in the West). It failed to take into full consideration the peculiarities of the China market and adapt its strategies appropriately (Rosenlund, 2005). And also the look and feel of eBay EachNet's website did not conform to the expectations of the China market. In a nutshell eBay's failure in China was due largely to limited understanding of the local market, lack of adaptation and customization of its services to the local market, and its adoption of a centralized management strategy (Schonfed, 2005).

Choosing the right entry mode

When the firm has developed an internationalization strategy built on sound understanding of the competitive environment of the various markets of interest it will then need to work out the most suitable entry strategy. The choice of entry mode may be influenced by the amount of resources the firm intends to commit to the expansion and the extent it wishes to be operationally involved (Johnson, Scholes, & Whittington, 2008). The organisation in reaching a decision should take into consideration its level of organisational development, which has a strong bearing on the entry mode that will be appropriate (Guillan, 2003). And lastly the organisation should bear in mind that no single entry mode strategy is suitable for all markets.

There are a couple of options firms can adopt when expanding abroad, these include export, licensing, acquisition, and joint venture. Each of these modes has both advantages and disadvantages and some are more suitable for certain market conditions than others, see table 1 below. A firm can decide to use a combination of different entry modes. It can for instance start with export and as the local demand increases and as it gains better understanding of the market it can decide to shift to foreign direct investment (Pyo, 2010).

Table 1: Entry Modes

Export	
<p>Advantages Low initial investment as the firm does not need to setup operational facilities in the foreign market; It has complete control over production and it is most likely that its average cost of production per unit will decrease; With the use of modern communication technologies such as the internet firms that have little or even no experience can gain quick access to international markets; This entry method will also help the firm learn about the foreign market before adopting other entry methods.</p>	<p>Disadvantages The firm may be faced with high trade barriers such as import duties; Transportation cost may be too high thereby making the firm unable to compete in the foreign market; Lack of presence in the market may affect its ability to rapidly respond to customer queries; As the company is not on ground it may not be able to adequately gain knowledge of the foreign market and it may further not be able to take advantage of the full benefits of doing business in the foreign market.</p>
<p>In summary export entry mode should be adopted when the cost of trade barriers are very minimal and when customization of the products or services are not critical. Furthermore, firms should adopt this option when it is clear that situating operations at home has overall competitive advantage in terms of cost and other considerations.</p>	
Licensing Agreement	
<p>Advantages Low initial investment as the firm does not have to set up operation facilities in the host country. The setting up of the operation facilities is the responsibility of the licensee; The firm is not exposed to trade barriers, change in government policies and other adverse economic, social or political conditions; The firm has some level of access to local knowledge. And since the licensee is on ground it is easier for it to respond to customer needs.</p>	<p>Disadvantages It is difficult to control the operation of the licensee. And at the initial stages the firm may have challenges identifying and reaching favourable contractual terms with a potential licensee; The firm may not be privileged to understand and learn the dynamics of the host business environment; The firm may end up creating a competitor and may be exposed to imitation.</p>
<p>In summary licensing strategy should be adopted when the product or service is coded or packaged in such a way that makes copying difficult. The strategy will also thrive better where the host country has strong intellectual property rights protection regime.</p>	
Joint Venture	
<p>Advantages The risk involved in the investment is shared with the local partner; Likewise since the two firms are able to share resources and know-how, the firm is able to access its partner’s local knowledge; The firm is able to have significant input and control over the operation and management of the joint venture.</p>	<p>Disadvantages The firm may have challenges identifying the right partner and agreeing terms with the partner. And some time even when they agree they may still end up disagreeing down the road; The firm does not have full control and this may significantly hinder its ability to integrate and coordinate its activities across national boundaries; The firm may lose competitive advantage as a result of imitation.</p>
<p>In essence joint venture is appropriate when both parties involved contribute significantly to the joint venture and when it is obvious that both firms mutually need each other to survive. And lastly both parties should reach reasonable understanding in terms of respect and regard to intellectual property protection rights for the joint venture to succeed (Aguilera, 2009).</p>	
Foreign acquisition	
<p>Advantages The firm will have ready and clear access to</p>	<p>Disadvantages The firm may over pay for acquiring the foreign</p>

<p>target local knowledge; The firm can leverage on the fact that the acquired firm is already on ground in the target market. It can then take less time to kick start its own operation in the market; It will have significant control over its foreign operations and also have control over its own technology. Integration and coordination of the various organisational activities will be easier across the different markets where the firm has presence.</p>	<p>firm; There may be difficulty in absorbing and integrating some of the acquired assets; The amount of investment involved is usually high and hence the risk is higher. And the risk is even higher if the local market is underdeveloped such that corporate control becomes difficult.</p>
<p>In summary firms should undertake this strategy when the target market is developed enough to permit corporate control. The acquiring firm should also ensure there that is substantial synergy between it and the firm it intends to acquire and it possesses the capacity to effectively absorb the company it intends to acquire.</p>	
<p>Greenfield</p>	
<p style="text-align: center;">Advantages</p> <p>The firm will eliminate the risk of overpaying to acquire a local firm in the target market; The issue of integration will not arise; The firm will have full control of its operations.</p>	<p style="text-align: center;">Disadvantages</p> <p>Starting up will be much slower compared to the other options; The firm must possess substantial knowledge of the target market if it plans to survive; The level of risk and amount of commitment on the firm is significantly higher.</p>
<p>In summary a firm should pursue this strategy where there is suitable target for acquisition; it has in-house expertise of the target market, and generally possess the required resources to survive in the target market</p>	

Source: Adapted from Johnson, Scholes & Whittington (2008) and Aguilera (2009)

A classic example of a company that has recorded reasonable success in expanding its operations abroad outside its main base (in this case USA) is Wal-Mart. Wal-Mart did not carry out a one size fit all approach on its mode of entry to identified markets (Mun, 2012). Its entry modes are influenced by two major factors. The first is the level of maturity of the market. The second is the degree of cultural similarity between the target market and the US and also the degree of similarity of the spending powers of the two markets. For its entry into Canada Wal-Mart adopted the acquisition entry mode. It took this option because of the similarity between Canada and the US in terms of culture and spending capacity of customers. It did not go for the Greenfield approach as the market was quite matured a move that would have ended up intensifying an already highly competitive market. Another reason Wal-Mart pursued the acquisition mode was the availability of an attractive and willing seller in Woolco (Govindarajan & Gupta, 1999). Wal-Mart adopted a different approach in Mexico where it rather went for a 50-50 joint venture relationship with Mexico’s largest retailer, Cifra (Mun, 2012). It took this decision largely because Mexico and the US (Wal-Mart’s main base) shared different income and culture. It also adopted a joint venture approach when it entered Brazil, another Latin America company. Although this time it went for a 60-40 controlling joint venture relationship with Lojas Americana.

Having satisfied itself with the knowledge and understanding of the Latin America business environment it went into Argentina through a wholly owned subsidiary (Economist Intelligent Unit, 1998). Wal-Mart obviously did not operate a one-size fit all approach as is exemplified above from its entry modes into various markets. It strives to understand the unique characteristics of the markets it plans to enter. Based on the facts gathered it then decides on which aspect of its original business model require some change, which areas require local adaptation and finally which areas require to be wholly reinvented. Wal-Mart took all of these into consideration before entering the China market for example (Merrill Lynch, 1998 and Discount Store News, 1997). Another example is Walt Disney Co. Walt Disney Co., adopted the licensing approach when it entered Japan, it however chose a different approach for its European business. It adopted the direct investment option for Europe owning 49 percent while the remaining 51 percent was publicly held (Matusitz, 2010 and QuickMBA, 2011).

Observations and recommendations

Before entering any market in this case China eBay ought to have ensured it carried out proper analysis of the market. It needed to understand the competition, the political, social and economic dynamics of the environment. For instance Wal-Mart saw opportunity in China especially as retail sales grew at a yearly rate of 11 percent between 1990 and 1995; it however, recognised that there are challenges such as unpredictable changes in regulations and general government policies (Mun, 2012). It also recognised that the level of infrastructure including payment systems were not as developed compare to what was obtained in the US. Further more, it also discovered that the level of middle-class disposable income is much lower than is the case in the US. And lastly it recognised that most Chinese preferred to buy items in small quantities instead of in bulk (Govindarajan & Gupta, 1999). It took all of these into consideration in setting up its entry mode and overall business strategy in China.

The acquisition entry mode adopted by eBay when entering China has both advantages and disadvantages. With this mode it was able to enter the market fast enough, have quick access to the local market and so on. This option however, came with some disadvantages as already mentioned under the “choosing the right entry mode section”. eBay met challenges in adapting to the new environment. It spent more money getting around the business environment largely because the market was underdeveloped and it had a very poor understanding of the market dynamics (Einhorn, 2011). There was also the possibility that eBay may have overpaid to acquire EachNet, this is still premised on its lack of understanding of the market and poor judgment of the market expectations.

EBay should not have acquired 100 percent of EachNet that soon especially as the target market at the time was not developed enough to permit corporate control. So if it must go with the acquisition entry strategy it should have retained only a minority stake (not a controlling stake) in EachNet like it first did in 2002. This would have allowed the original managers of EachNet to carry on with the running of the company. These managers had a better understanding of the market environment.

Going with the joint venture option as was the strategy later adopted by eBay EachNet with Tom Online after it has realized that its earlier strategy was faulty may be good but also has its disadvantages. With this strategy eBay EachNet was able to share the risks involved in the business with Tom Online and also have access to Tom Online's knowledge of the local market, the strength of its brand among Chinese consumers and its technological know-how (Einhorn, 2011). And it would likely also be able to have substantial input over the operation and management of the joint venture. This strategy however, also has its demerits as parties involved in a joint venture may disagree over some issues in future. And furthermore, as none of the parties have absolute control over the operation and management of the new venture it could be a hindrance to any of the parties (in this case eBay) bringing on-board some of its proven strategies and business style.

However, the joint venture approach seems to be good especially as both parties made significant contributions towards the joint venture. And it appears that both firms needed each other to survive in the market (Einhorn, 2011). EBay EachNet has had its market shares cut down by Taobao and needed to adopt a better strategy to re-launch and stay competitive in the market. Tom Online on the other hand needed to diversify its operations as around 89 percent of its revenue was from value-added mobile phone services, which meant it over depended on mobile telecommunications providers for survival (Lu, Tao, Chan, 2008). In essence this was a much better approach compared to the EachNet approach. EBay somehow came to realize the importance of not losing touch of the local knowledge and allowing the company with in-depth understanding of the local market to be on the driving seat, which was probably the reason it allowed Tom Online to have a majority stake in the joint venture. Furthermore, in a market like China where government policies and unsolicited government interventions can have negative impact on businesses it is wise to have some relationship with the government (Einhorn, 2011). EBay EachNet was able to achieve this through the joint venture with Tom Online. Tom Online had a relatively strong political network in China. Tom Online's biggest shareholder, Li Ka-Shing, had strong relationship with high-ranking authorities in both China and Hong Kong (Einhorn, 2011).

Conclusion

Building a large and globally competitive organisation may require expanding abroad. Expanding to foreign countries enables the organisation to tap potential opportunities that may not exist within its original market. It should however, be noted that going abroad comes with huge risks and a failed international expansion can be very costly for the business. It is therefore, imperative that the firm makes the right choice in selecting the country to expand to, deciding on whether or not to modify and adjust its products and services and finally deciding on the most appropriate entry mode taking into cognisance the peculiar dynamics of the country's business environment.

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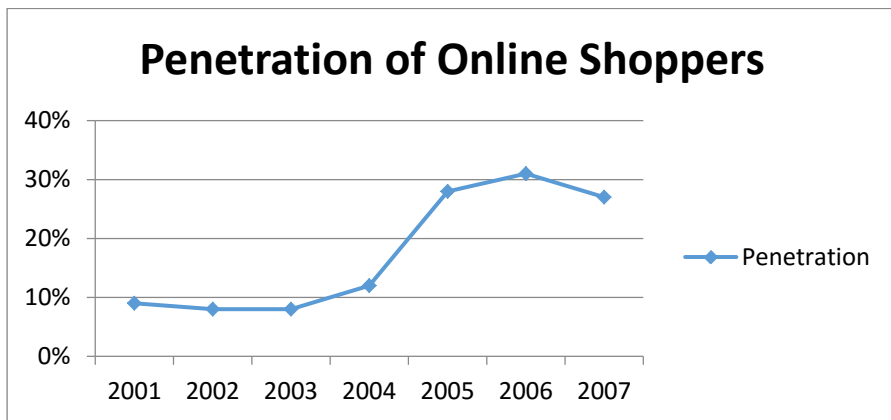
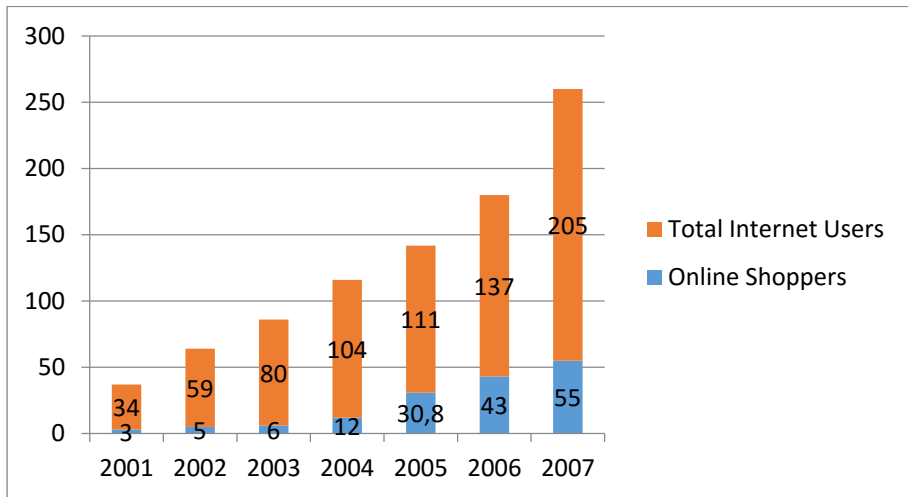
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Appendix A E-Commerce Growth in China

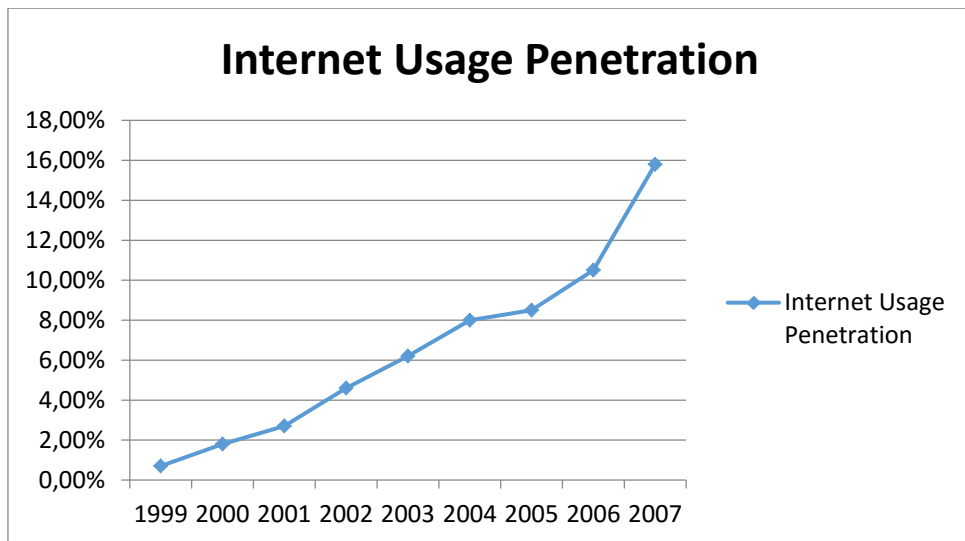
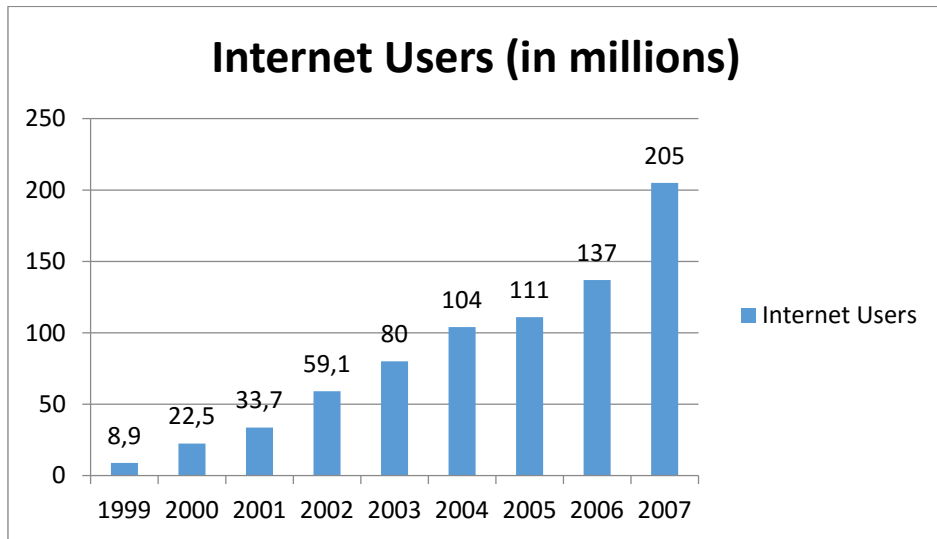


Note: 2007 figures are estimates

Source: Lin, Z. & Li, J. (2005). The online auction market in China: a comparative study between Taobao and eBay, ACM International Conference Proceeding Series: Proceedings of the 7th International Conference on Electronic Commerce, 113, pp. 123-129; Chen, F. (n.d.). China's online sales to top 51 bin yuan in 2007, China view, Retrieved from http://news.xinhuanet.com/english/2007-03/21/content_5877928.htm

Appendix B

Prevalence of Internet Usage in China



Note: 2007 figures are estimates

Source: CIA, The World Factbook: China, 2001-2007: China Internet Network Center (CNNIC); iResearch Inc.; Xinhua News Agency (1 February 2007). Internet Use in China Jumps By Almost 25 percent in 2006, Ireland, R. D., Hoskisson, R. E., and Hitt, M. A. (2009). Understanding Business Strategy, 2nd ed, Nelson Education, Ltd. (Canada)