

# Analysis of Profitability Models of Chinese Internet Enterprises——Tencent and Alibaba Group as the Examples

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## ABSTRACT

In recent years, Tencent and Alibaba have grown rapidly along with numerous Chinese internet companies, and their profit models are the ones which could suitably reflect and represent for the general image of successful profit models of the internet industry. As so, this article aims to analyse elements from Alibaba and Tencent's profit models, and find out which type/s of profit model would be more competitive in future development. The findings of this article show that the internet business company should pay more attention to the needs of the users, and utilising technological benefits wisely is a key factor for future development of the industry. However, on this basis, this research paper comprises several limitations, for example: the sample period is relatively short so is unable to represent the long-term development trend. In this case, this article is only helpful in providing theoretical research support and reference for the development of Chinese Internet companies in a short term.

**Keywords:** *profit model, Tencent, Alibaba, internet industry*

## 1. INTRODUCTION

### 1.1. Definition of Key Term

Profit model: a company's plan that layouts all aspects on what and how the company will manufacture and provide, that aims to make the business profitable.

### 1.2. Background Knowledge

Alibaba group and Tencent are two of China's largest internet companies and valuable tech companies in the world. They have successfully built dominance within the market, process hundreds of millions of users, and host millions merchants and businesses internationally.

However, there are high expectations from the strong Chinese e-commerce market and fast-growing international internet industry, as well as intensive competitions from numerous rival firms both domestically and globally. Nonetheless, Alibaba and Tencent are attempting to perform surpassingly and grow, through various attempts in updating their

profitability models and other business plans in regard to the number of new business challenges they are facing and changes within the market and industry as they develop. The following paper aims to analyze the profitability models of Tencent and Alibaba through providing business analysis and financial analysis.

## 2. INTRODUCTION OF COMPANIES

Tencent was founded in 1998, and its head office is located in Shenzhen China. Tencent spent 6 years, in 2004, on its way to be listed on the main board of the Hong Kong Stock Exchange (stock code: 00700). Shenzhen Tencent Computer System Co. Ltd. is the leading internet technology company in the internet industry over the world. Tencent's mission is to promote living quality of people in the world, by using the innovational products and services. Its communication and social services connect more than one billion people worldwide. Helping people to communicate with their relatives, and simplifying the process of payment and entertainment. Meanwhile, Tencent also provides calculation, advertisement and Fin Tech services, and the

digital transformation it brought helped promote the development of various services.

Alibaba was established by Jack Ma (a.k.a. Yun Ma) on April 4, 1999, in Hangzhou, China, and holds an aim to connect Chinese manufacturers with international buyers. [1] Alibaba is the world's largest eCommerce company and is currently the most popular destination for online shopping in the world's fast growing e-commerce market. Alibaba possesses one of the most successful business models in the world, and provides services that combine ideas from Amazon, PayPal and eBay with an even broader scope. [2] It has successfully become one of the most valuable tech companies in the world, as well as one of the most valuable Chinese public companies, ranking among some of the country's state-owned enterprises, and possesses hundreds of millions of users, and host millions of merchants and businesses internationally.

However, although Alibaba and Tencent has made glorious successes, they have become too large that internal and external coordination control and communication are becoming increasingly bureaucratic. Meanwhile, they are also facing a slew of new business challenges and intense competition against numerous rivals, due to the strong Chinese e-commerce market and high expectations worldwide.

### **3. BUSINESS ANALYSIS**

#### **3.1. Source of Profit**

In 2020, According to the Tencent Annual Report, Tencent's online game revenue was 156,101 million RMB, a year-on-year increase of 36%, and its social network revenue was 108,111 million RMB, a year-on-year increase of 27%. It can be seen that these two businesses have also become the main force of Tencent's profit growth in 2020. Interestingly, WeChat has evolved from an instant messaging program to a service that can address the digital demands of over 1.2 billion users in the last decade. Every day, over 120 million users write at any time, 360 million users read official accounts articles, and 400 million users access Mini programs.

The business model of Alibaba is different from many of its rivals, that it focuses more on trade between businesses instead of individual customer, — Alibaba focuses on being a platform for suppliers to sell products in bulk at wholesale prices to small or medium-sized businesses worldwide, who then resell them for a profit in their domestic markets. Meanwhile, Alibaba also supports other trade through e-commerce web portals. For examples: Taobao is for consumers to trade, and Tmall focuses mainly on providing branded products for middle class of China. There are many other subsidiaries through which Alibaba makes money. [1]

Internet value-added services: Tencent mainly includes three parts of Internet value-added services: member services, community services, and game entertainment services. [3] In the early years, Tencent took the first step, developing the QQ chat room, to expand the instant messaging business platform. [4] The advantage of Tencent's profit model is using free strategy to stabilize the market share, and then, Tencent through value-added services to resist competitors, such as QQ members, QQ clothing, and QQ-zone props, which are the major source of income for Tencent. [3]

Mobile and communication value-added services: The symbol application of mobile and communication value-added services is WeChat. WeChat is the social application which could send the messages, pictures, and videos freely. It was released by Tencent in January 2011. And then, WeChat monetization began as a social gaming platform, which is a form of communication that can add value. Tencent had developed some social games such as "Rhythm Master", "Daily Cool Run". And in the following years, Tencent will focus on the global game market, "Honor of Kings" was the first step of Tencent to occupy the market. 2016, Honor of Kings was the first time launched in the global, and its revenue grew almost \$2 billion in 2018, which was the highest grossing mobile game of that year. [5] The WeChat also opened one service, which could add band card to direct online pay. This online payment platform of WeChat is the competitive competitor of the Alipay. At the current stage, WeChat's profit model has built mutually, but is still exploring. [4]

Online advertising: At the current stage, WeChat's profit model has built mutually, but is still exploring. [4]

Online market services: These consist of the following:

Pay-for-performance (a.k.a. P4P) marketing services, where sellers bid for keywords that match their product or service listings appearing in search, resulting a cost-per-click (CPC) basis at the prices established by Alibaba online auction system.

Display marketing services, where sellers bid for display positions on the relevant marketplaces at fixed prices or prices established by their real-time bidding system on a cost-per-thousand impression (CPM) basis.

Taobao program, where sellers on Taobao marketplace and Tmall pay commissions to Alibaba based on a percentage of GMV for transactions settled through Alipay from users sourced from third-party marketing affiliates.

Placement services, where sellers pay placement fees to purchase promotional lots on the Juhuasuan marketplace for a specified period of time.

Commission on transactions: Alibaba generates revenues from commissions on transactions over

AliExpress, where sellers on Tmall and Juhuasuan pay a commission based on a percentage of gross merchandise value (GMV) for transactions settled through Alipay in the respective marketplaces.

### *3.1.1. 1688.com*

Revenue from 1688.com is primarily generated from the sale of China TrustPass memberships, which allow wholesalers to host premium storefronts with access to basic data analytic applications and upgraded storefront management tools. Alibaba also offers them value-added services, such as premium data analytics.

### *3.1.2. Alibaba.com*

Revenue from Alibaba.com is primarily generated from the sale of gold supplier memberships on Alibaba.com, which allow wholesalers to host premium storefronts. Alibaba also offers them value-added services such as product showcase, custom clearance, value-added tax, or VAT, refund and other import/export business solutions.[6]

## **3.2. Customer Value**

Customer value focuses on ways to provide more personality services or good quality products, to satisfy customers' mental demands, leading to improvements on customers' loyalty of the business's services and/or products. As the competitive internet company, the customer value is the key factor of the profit value. Only realize the importance of the customer value and make it play its part, Tencent could build up one high-quality profit model.

Tencent as the typical internet enterprise, its major profits depend on its multiple ages' user group. However, there are more than half of the Tencent's users younger than 26. And the main users' age of Tencent is among 18 to 35, which accounts for about 86.2%. [3] All in all, Tencent should concern the factor-customer value, to focus on developing and researching products in the future, so that increasing customer loyalty and dependence.

## **3.3. Business activities**

### *3.3.1 User-oriented*

#### *3.3.1.1. Communication and socializing*

From the connection with people each other perspective, Tencent research, develop and provide the instant messaging platform with various functions. To enrich people's lifestyle, Tencent developed and researched the applications, like Wechat and QQ, this innovation method makes the communication and sharing become more personalized and convenient.

#### *3.3.1.2. Digital content*

Tencent keeps developing the diversification applications (combined communication and entertainment) which are more suitable to the future trend. Based on the high-quality content, technology drives the engine, through crossing the screen, multi-platform, multiform method, providing diversified and multi-dimensional contents, so that satisfying users' diversity entertainment experience. At the same time, Tencent realizes the importance of IP's meaning for development of innovation industry. Tencent keep exploring potential IP, helping it develop. So far, Tencent's major digital products including game, video, live, news, music, and literature.

#### *3.3.1.3. Financial Technology service*

Based on WeChat payment and QQ purse platforms, Tencent devotes to connect people and finance, building up financial ecology, with partners provide mobile payment, wealth management, credit services, securities investment, and other innovative financial services to users in the world.

#### *3.3.1.4. Tools*

Tencent provides various tool software, helping users could fast directly solve internet safe management, quick browsing, positioning travel, applications management, e-mail and so on specific demands.

### *3.3.2. Business-oriented*

#### *3.3.2.1. Tencent advertising*

Based on massive amounts of commercial data, marketing technology and professional service ability, providing integrated marketing project. Tencent advertising devotes to high efficiency solution, building up the good connection between brand and users.

#### *3.3.2.2. The cloud of Tencent*

Tencent combined the advanced technology, such as, cloud computing, big data, artificial intelligence, internet of thing, with business activities. The Cloud of Tencent face many industries, for instance, finance, education, energy, transport, medical treatment, retail.

#### *3.3.2.3. Wisdom industry*

Tencent helps customers save cost, improve the efficiency, find new business model, and profit growth points. Tencent takes advantage of AI, payment, mini program and LBS, to create the wisdom industry project. At present, Tencent has already developed in finance, retail, travelling, medical treatment and education industry.

Innovation Technology: Tencent devotes to more active nature environment ecology, to solve the key world problem, such as grain issue, issues of water resource management. At present, Tencent has cooperated with the Wageningen University, to work out the problem of grain shortage, with the help of AI to improve the farm produce.

### *3.3.3. Innovation Technology*

Tencent devotes to more active nature environment ecology, to solve the key world problem, such as grain issue, issues of water resource management. At present, Tencent has cooperated with the Wageningen University, to work out the problem of grain shortage, with the help of AI to improve the farm produce.

### *3.3.4. China Commerce*

Which consists of two subsegments: China Retail Marketplaces and China Wholesale Marketplaces.

#### *3.3.4.1. China Retail Marketplaces*

Where Chinese consumers purchase in these marketplaces, namely: Taobao Marketplace, Tmall, and Juhuasuan.

#### *3.3.4.2. China Wholesale Marketplaces*

Where retail merchants are supplied by Chinese wholesalers and manufacturers, solely on 1688.com.

#### *3.3.4.3. International Retail Marketplaces*

Where Chinese wholesalers and manufacturers supply directly to global consumers on AliExpress.

#### *3.3.4.4. International Wholesale Marketplaces*

Where Chinese wholesalers and manufacturers supply for and purchase from global wholesale buyers on Alibaba.com.

Cloud Computing and Internet Infrastructure: Alibaba offers various cloud computing services, including elastic computing, database services and storage, and large-scale computing services, to sellers on its marketplaces and other third-party customers, for instances: start-ups in mobile gaming and Internet applications. These services are also offered to established corporations in digital entertainment, consumer electronics, financial services, mobile communications, healthcare, and education industries. Moreover, Alibaba also provides Internet infrastructure services like web hosting and domain name registration.

### *3.3.5. Others*

Primarily consists of their SME loan business, where

micro loans are provided to the sellers on Alibaba retail and wholesale marketplaces through lending vehicles licensed by the local government.

## **4. FINANCIAL ANALYSIS**

During the process of analysing the financial situation of a company, calculating some financial ratios to find out and infer about the trend of the company is a very common and widely-used method. This article picked out several specific ratios from Tencent and Alibaba's profitability ratio, liquidity ratio and solvency ratio to compare and contrast the differences and similarities between their profit models, in order to find out which pattern would more likely to become a more competitive model for the future.

### *4.1. Profit Margin*

The typical ratio to know about the profitability of one company is the profit margin, which could measure the net income and net sales of the company.

The net income of Tencent in 2020 is 160,125 million RMB, and the net sales in 2020 is 482,064 million RMB (Tencent Annual Report P164). According to the figures from Tencent Annual report could work out the ratio-Profit margin, as shown in TABLE I, which is 33.21%. By the same method, the profit margin of Tencent in 2019 is 25.42%. There is a slight increasing of profit margin. From the annual report, the net income, and net sales both experienced steady increase from 2019 to 2020. From Tencent's Annual Report 2020: "During the year ended 31 December 2020, majority of the Group's revenue from value-added services was contributed from online games and was predominately derived from the sales of virtual items". And then the net income also increased. Overall, Tencent's profit showed a clear trend of growth.

The net income of Alibaba in 2019 and 2020 was 650,570.86 million RMB and 1,064,422.57 million RMB respectively, and the net sales of 2019 and 2020 was 2,798,680.74 million RMB and 3,634,837.52 million RMB respectively. According to these data, as shown in TABLE I, Alibaba's profit margin ratio was worked out to be 29.28% for 2019, and 20.95% for 2020. This shows that Alibaba had managed to make profit successfully, as the ratio for both years is positive. However, the ratio for 2020 has decreased to 20.95% compared to 29.28% in the previous year. This indicates that although Alibaba is still making income, but the ability of Alibaba to generate income has worsen during the time period, which may not display a good prospect for growth and future development.

**Table 1.** Profit Margin of Tencent and Alibaba from 2019 to 2020

Company name	Years	
	2019	2020
Tencent	25.42%	33.21%
Alibaba	29.28%	20.95%

**4.2. Current Ratio**

Current ratio is used to measure the ability of an enterprise's current assets to be converted into cash to repay its liabilities before the maturity of short-term debts.

In 2020, Tencent's current assets were 317,647 million RMB and current liabilities were 269,079 million RMB (Tencent Annual Report P167), after calculation, as shown in TABLE II, the current ratio was 1.18:1. In the same way, the current ratio of Tencent in 2019 was 1.06:1, which increased slightly. By comparison, it was found that the current assets increased by 25.1%, higher than the 12% increase in current liabilities. According to the Tencent Annual Report 2020, the increase in current assets was mainly due to the large income brought by online games. Although it shows an upward trend, it is still lower than the normal ratio of 2:1, and the Tencent's ability to repay short-term debt is still weak.

Alibaba's current assets in 2019 and 2020 was 255,964.80 million RMB and 415,529.67 million RMB respectively, and its current liability within the same time period was 337,625.41 million RMB and 397,142.06 million RMB, respectively. According to these data, as shown in TABLE II, Alibaba's current ratio is calculated to be 1.3:1 for 2019 and 1.76:1 for 2020. This increase in its current ratio indicates that Alibaba's capability of paying its obligation has improved, since it has a larger proportion of short-term asset value relative to the value of its short-term liabilities in 2020 than 2019. This also shows that Alibaba is using its current assets efficiently and properly managing its working capital throughout the time period.

**Table 2.** Current Ratio of Tencent and Alibaba from 2019 to 2020

Company name	Years	
	2019	2020
Tencent	25.42%	33.21%
Alibaba	29.28%	20.95%

**4.3. Debt to Assets Ratio**

The debt to assets ratio is an index to measure the ability of enterprises to use the funds provided by creditors for business activities, and to reflect the security of creditors' loans.

According to Tencent's statement, the total liabilities in 2020 were 555,383 million RMB and the total assets were 1333,425 million RMB (Tencent Annual Report P166). Therefore, the calculation results are shown in TABLE III, the debt to assets ratio is 41.7%, which can also be obtained from the data in 2019, the debt to assets ratio in 2019 is 48.8%. It can be seen that this ratio has decreased. According to Tencent's 2020 annual report, it is due to the sharp increase of total assets, which has increased by 39.8% in 2020 compared with 2019, while the increase of total assets is mainly due to the increase of fair value in non-current assets, with a year-on-year increase of 80%. The decline in the ratio of liabilities to assets also means that Tencent has sufficient funds, good operation and low investment risk, but its debt raising ability has decreased compared with Tencent.

The total liabilities of Alibaba in 2019 and 2020 was 337,625.41 million RMB and 397,142.06 million RMB respectively, and its total assets in the same time period was 913,984.78 million RMB and 1,178,568.18 million RMB, respectively. According to these data, as shown in TABLE III, Alibaba's debt to assets ratio is calculated to be 36.9% for 2019 and 33.7% for 2020. This decrease in Alibaba's debt to assets ratio within the time period from 2019 to 2020, shows that Alibaba has more assets than debt in 2020 than 2019, which is showing a positive trend. However, the ratio has only decreased by approximately 3%, which indicates that not much improvements have made in degree of leverage (DoL) and financial flexibility of Alibaba.

**Table 3.** Debt to Assets Ratio of Tencent and Alibaba from 2019 to 2020

Company name	Years	
	2019	2020
Tencent	48.8%	41.7%
Alibaba	36.9%	33.7%

**5. CONCLUSION**

This paper analyzes the profitability models of Tencent and Alibaba respectively through business analysis and financial analysis. It can be seen that Tencent's profitability model focuses more on the revenue from online networks, such as the huge profits brought by online games and various social programs, and pays more attention to the company's customer value and digital technology. Whereas, Alibaba pays more attention in selling goods and trading to obtain profits, which is not as diversified as Tencent. As so, it can be seen from Alibaba's financial analysis that the profit margin has decreased significantly. However, this paper contains some limitations as it only comprises studies of profit models of two companies. Therefore, this paper may lack extensive representativeness of the whole internet industry. Meanwhile, since the financial

analyses only reflected on data within the last two years, meaning that the results may be unrepresentative to the long-term trend. As so, in future research, the sample number of enterprises can be expanded, and incorporating enterprises with different development stages and different positions can be considered in order to improve the reference of the article and the research results.

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