

Growing-by-Unleashing Grassroots Entrepreneurship and Alibaba Innovations

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Abstract Inspired by Phelps' book (*Mass flourishing: how grassroots innovation created jobs, challenge, and change*. Princeton University Press, Princeton, 2013) and drawing upon Alibaba's experience, this paper discusses a small-business-based and digital-technology-driven new growth model—growing by unleashing grassroots entrepreneurship. Small business is an important expression of individuals' will, capacity, and aspiration to innovate. In the digital age, technology-driven platform can assist small business to thrive. From Alibaba's experience, building credibility and trust, providing open, transparent, efficient, and accountable finance services and establishing rules of games are crucial in the digital age for unleashing grassroots entrepreneurship and innovation that can bring sustainable mass flourishing.

1 Introduction

This paper was inspired by Professor Phelps' 2013 new book, *Mass Flourishing: How Grassroots Innovation Created Jobs, Challenge, and Change*. Phelps focuses on dynamism, innovation, and personal growth as well as economic growth. Innovation is “a new method or new product that becomes a new practice somewhere in the world.” Dynamism is about people's participation in economic activities and “the will and the capacity and aspiration to innovate” (Phelps 2013, p. 19). According to Phelps, one way to measure dynamism is the inputs producing dynamism. Businesses that entrepreneurs start and operate embody such inputs. The pervasiveness of business is the base for generating dynamism and producing mass flourishing. A nation to have a high degree of dynamism must be full of small

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businesses providing the backbone of the economy. These owners of young therefore small business, with hope and expectation of growing larger, are major contributors to the dynamism of innovation.

The paper presents a new economic growth model—“Growing-by-Unleashing Grassroots Entrepreneurship” using Alibaba as a case study. Information technology has reshaped the world and people have had to change their ways of thinking and doing business. Confusingly, when the world was suffering from “too big to fail,” beautiful “small” is “the new big.” Free enterprise and free competition have become evermore important; and the prevalence of small business ownership and mass innovation have become ever more crucial to economic growth and people’s economic wellbeing.

Alibaba started by 18 founders with an investment of 50,000 RMB in 1999 and grew into a 25,000-workforce giant valued at 936 billion RMB (\$150 billion) in 2014. The reason for Alibaba’s unusual growth was not mainly injections of large amount of capital or an exploitation of natural resources such as oil or coal. Alibaba has built a platform for innovation and created a market ecosystem that brings together over 10 million e-commerce vendor businesses, and that in 2013 alone created over 11 million jobs. This paper characterizes Alibaba’s growth experience as “growing by unleashing grassroots entrepreneurship.” Those unleashed entrepreneurs on Alibaba’s platform have been putting goods and services on the market, servicing hundreds of millions consumers and improving people’s lives.

The paper proceeds as follows. Section 2 reviews the importance of prevalence of small businesses. Section 3 provides a theoretical background for understanding the role of small businesses and technology in unleashing grassroots entrepreneurship. Section 4 examines how Alibaba created a mass of businesses and jobs. Sections 5 and 6 draw on Alibaba’s experience and analyze the importance of credibility, trust and finance as well as market rules in unleashing grassroots entrepreneurship. Section 7 discusses issues appeared from Alibaba journey of growing by unleashing entrepreneurship. Finally, Sect. 8 concludes the paper.

2 From “Small Is Beautiful” to “Small Is the New Big”

Since later 1950s, when large-scale industrialization achieved unprecedented success, western economists—led by John Kenneth Galbraith—concluded that the United States had entered the era of big industry and that the traditional small business community no longer on Main Street. Further, by merely relying on government and the cheap products supplied by big industries, the American people would be able to enjoy their lives in an “Affluent Society.”¹ Many scholars had opposed Galbraith’s ideas and policy proposals, as well as his endorsement for the

¹Galbraith (1958, 1967, 1973).

behaviors and stands of big business. In addition to the criticism from Nobel laureates such as Paul Krugman,² many scholars who believe in market and grassroots innovation and entrepreneurship proved Galbraith's ideas were factually incorrect.

Phillips (1958) in *Little Business in the American Economy* emphasized two important value of small businesses: (1) small business is "the backbone of the American system of free enterprise"; it "serves as a providing ground for new technologies and new, vigorous entrepreneurial talent." (2) The preservation of small business "is essential to the maintenance of the middle class" (p. 113–114).

Bunzel (1962) in *The American Small Businessman* pointed out that small business is as American heritage; the small businessman "appears to have few enemies and is, in fact, something of a national hero" (p. 13). He further noticed that "living in a country that places heavy emphasis on material success and pecuniary rewards, the small businessman had managed to be a symbol of success even in times when he has not ... been financially successful" (p. 85–86).

In his world-awakening book in the midst of the Oil Crisis, *Small is Beautiful: Economics as if People Mattered*, Schumacher (1973) firmly believed in the "small" as basis to freedom, efficiency, creativity, joy, and enduring. He called for a "restructure [of] large-scale industrial ownership without revolution, expropriation, centralisation, or the substitution of bureaucratic ponderousness for private flexibility." In his view, "All the indications are that the present structure of large-scale industrial enterprise, in spite of heavy taxation and an endless proliferation of legislation, is not conducive to the public welfare" (p. 275).

Solomon (1986) in *Small Business USA: The Role of Small Companies in Sparking America's Economic Transformation*, claimed that "by injecting aggressive, free-market forces into a modern economy, small businesses permits the 'invisible hand' to play an important part in selecting those innovations upon which America will compete in the new global marketplace" (p. 140).

Blackford (1991) in *A History of Small Business in America* claimed that "From the time of Thomas Jefferson to the present, many Americans have seen the owners of small businesses as epitomizing all that is best about the American way of life." He noticed, "Small businesses have often received special treatment in state and national legislation" (p. 4).

Case (1992) in *From the Ground Up: The Resurgence of American Entrepreneurship* clearly saw "The economic stability that Americans once took for granted was gone. We could no longer count on big companies for what they used to provide." He envisioned that we "will need a highly dynamic business world, once characterized by high levels of innovation, technical progress, and entrepreneurship" (p. 224).

In the wake of the financial crises, the United States and European countries regained a sense of urgency to recognize the importance of small business. China shares this same sense of urgency. Under the unique circumstances after 1949,

²For example, Krugman (1994).

through the power of the state, China rapidly integrated its very limited resources, utilized large-scale industries, and rebuilt homes on its brutally trampled land. The heavy industry, large industrial and state-owned enterprises all have made undeniable contributions to the development of new China. However, due to the state economy's biggest setback—the lack of efficiency, let alone dynamism—China's economy was on the verge of collapse in the late 1970s. Thanks to the market mechanism, which unleashed long absent entrepreneurship, tens of millions of businesses created a very dynamic Chinese economy via market competition. Business number increased drastically from 348,000 in 1978, 7957,800 in 1990, to 60,623,800 in 2013.³

“Small is the new big” (Godin 2006). Big boxes, such as Wal-Mart and Home Depot once drove mom-and-pop stores out of main streets, are facing severe competitions from special niche markets and efficient e-commerce businesses. In nowadays, the successful big businesses are no longer the ones that are strongly associated with the Wall Street and the well-established supply chains internationally. Instead, those establishing platform and running two-sided markets, such as Google, Amazon, eBay and Alibaba, are the successful ones. The secrets of success in the platform economy are two folds: bringing together the most innovative grassroots entrepreneurs and creating a business territory by providing the best quality services. The small and micro enterprises that have the flexibility and vitality to face a constantly changing environment can either prosper or disappear in a drastic manner. Business as an expression of the willingness and capacity to innovate might either succeed or fail. However, the dynamism and innovation generated by a mass of entrepreneurs would agglomerate, proliferate, and spillover—thus creating the positive energy field for building a prosperous and strong society.

Small is beautiful because people matter. The U.S. Small Business Act states simply why “small is beautiful”: “Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed.”⁴

“Small is the new big because small gives you the flexibility to change your business model when your competition changes theirs. ... Small means you can tell the truth on your blog. ... Small means that you will outsource the boring, low-impact stuff like manufacturing and shipping and billing and packing to others while you keep all the power because you invent something that's remarkable and tell your story to people who want to hear it. ... A small law firm or accounting firm or ad agency is succeeding because they're good, not because they're big. So smart, small companies are happy to hire them. ... A small restaurant has an owner who

³The 2013 business number is from <http://www.chinanews.com/gn/2014/01-14/5734631.shtml>.

⁴From *Small Business Act* as amended (1/13/13), http://www.sba.gov/sites/default/files/Small%20Business%20Act_0.pdf.

greet you by name. ... A small venture fund doesn't have to fund big, bad ideas in order to put their capital to work. They can make small investments in tiny companies with good ideas. ... Small is the new big *only* when the person running the small thinks big" (Godin 2006, p. 217–218).

3 A New Growth Model: Growing-by-Unleashing Grassroots Entrepreneurship

Economic theory defines economic growth and provides several economic growth models. Economic growth is the increase in the market value of goods and services produced by an economy over time. The conventional measurement is the percent rate of increase in real gross domestic product, or real GDP.

The classical (Ricardian) growth model describes production and growth in the agricultural era. Holding other variables constant and with no technological change, the theories of production and growth claim that increasing either of the factors of production (labor, capital, or land), will increase output, but at a diminishing rate that eventually will approach zero.

The neoclassical growth model is a product of the industrial revolution. In this model, labor-time, capital goods, output, and investment are all important; the law of diminishing returns to scale applies, but the role of technological change became crucial, even more important than the accumulation of capital. In this models, the long-run rate of growth is exogenously determined by either the savings rate (the Harrod–Domar model) or the rate of technical progress (Solow model). However, the savings rate and rate of technological progress remain unexplained.

Endogenous growth models strive to overthrow the “diminishing return to scale” and “steady state” dogma and incorporates “human capital”—the skills and knowledge that make workers productive. This model can explain the long lasting economic growth in many western nations. The model assumes human capital to have increasing rates of return. Overall, there are constant returns to capital, and economies can never reach a steady state. Growth does not slow down as capital accumulates. The research focus is on the determinacies that increase human capital (e.g. education and training) or technological change (e.g. innovation).

Phelps (2013) firmly believes that only sustained grassroots innovation can bring prosperity to the country.⁵ Phelps does not believe in the explanatory power of either classical models that focus on the resources, or neoclassical models that emphasize on human capital or technological changes to the long lasting economic growth. He believes instead in the importance of economic dynamism, e.g. people's will, capacity and aspiration to innovate. Phelps quoted McKinsey's finding: from 10,000 business ideas, 1000 firms are founded, 100 receive venture capital, 20 go

⁵Professor Phelps defines “Dynamism” as “the will and the capacity and aspiration to innovate,” Phelps (2013, p. 19).

on to raise capital in an IPO, and two become market leaders.⁶ Massive participation in innovation is the key to nurture such market leaders for economic growth.

Lowrey (2003, 2005, 2006, and 2011) verified Phelps' idea about the role of dynamism to foster economic growth. Lowrey (2003) attempts to introduce the entrepreneur as the "economic man" into a neoclassical framework. The paper assumes the entrepreneur to behave as if he maximizes utility including his valuation of success and his desire to succeed, subject to an income constraint determined by his physical effort in subsistent production and entrepreneurial production. The paper also defines entrepreneurship as an "economic system" that consists of three components: (1) entrepreneurs who desire to achieve their goals of economic survival and advancement; (2) a societal framework that grants the entrepreneur's right of free enterprise; and (3) a government that has the ability to adjust the institutional framework that can protect each individual entrepreneur.

Lowrey (2006) further develops the 2003 idea about the entrepreneur. Focusing on entrepreneurial work, the paper challenges the neoclassical doctrine of the representative agent's utility maximization and borrows from the classical theory of the entrepreneur in the tradition of Max Weber and Joseph Schumpeter. From this classical tradition and evidences from data, the paper finds entrepreneurial work to be the intrinsic character of the entrepreneur. This paper divides the human work into "subsistence" production for standard products such as bread and butter, and entrepreneurial products and services such as iPhone, Google Map and Amazon.com. When assuming the representative entrepreneur to take pleasure in entrepreneurial work, the utility maximization requires a higher productivity of subsistence production than that of entrepreneurial production. The paper also develops a two-period and two-goods dynamic model that allows the inclusion of an initial capital to this representative entrepreneur's utility maximization problem. The model predicts that an additional unit of initial capital generates a substitution effect in the first period, but a complement effect that is positively associated with initial capital.

Lowrey (2005) asserts that people's economic well-being relies upon the strength of the economy and that behind a robust and balanced economy must be a vibrant market system, in which private business ownership is pervasive, small, and local. Using business/firm data and macroeconomic data from all 50 US states, this paper introduces a new concept—business density defined by the business number per unit of population. A spatial economic model and statistical testing demonstrate a significant correlation between business density and economic well-being at the state level. The paper estimates that increasing business density by one percent would respectively increase household income by 1.0957 %, personal income by 1.0178 %, and gross state product 1.2444 %. The estimated results also indicate that a higher business density is associated with lower poverty and disparity between the rich and the poor.

Lowrey (2011) distinguishes two kinds of jobs in the process of business creation. One is the "employment job" offered by an employer to an employee through

⁶p. 24 in Phelps (2013). U.S. Small Business Administration, Office of Advocacy released a report (2010) is a good example of such dynamism in the US.

a contractual (paid) relationship. The other is the “entrepreneurial job” created by active business owners for themselves. Only a small proportion of salaried entrepreneurial jobs are included in official employment statistics. To estimate the scale of entrepreneurial jobs, this paper examines mainly three databases: the Panel Study of Entrepreneurial Dynamics (PSED), the Kauffman Firm Survey (KFS), and the 2002 Survey of Business Owners (SBO). All three provide information in detail of both employment and business owners. In 2002, an average of 5.8 jobs (4.4 employment jobs and 1.4 entrepreneurial jobs) created by a startup employer firm and an average of 1.2 entrepreneurial jobs by a startup nonemployer firm. Each entrepreneurial job taker contributed an average of 33.1 labor hours per week to their startup firms. It estimates that at least 2.5 million people created their own entrepreneurial jobs every year between 1997 and 2008, in addition to creating more than one million paid employment jobs. The paper concludes that, to encourage job creation, policymakers need to recognize that startup business owners are creators of jobs for others, but most importantly, for themselves.⁷

Determined to become “China’s greatest, most unique, 102-year-old company that exists across three centuries,”⁸ Alibaba realized the need for ceaseless “routinized innovation” “in order to survive.”⁹ The “customer first” value does not need to be based on “altruism.” Rather, it can be ecological characteristics of the e-commerce “platform economy” in the digital age.¹⁰ From a subjective point of view, the philosophy of “customer first” guided the design a platform to bring together millions entrepreneurs for online business. Modern hardware and software enable Alibaba to use technological innovations and the economy of scale for developing a huge special customer-vendor base. This base consists of millions self-reliance, active, innovative, and dynamic businesses. Alibaba empowers a large number of grassroots entrepreneurs. The 7 million active vendors on Alibaba’s platform not only created and developed their own businesses, but also fueled Alibaba’s growth. In this process of empowerment and innovation spillover, Alibaba and millions of small and micro enterprises entered an interdependent and complementary relationship. Alibaba is a good example of growing by unleashing grassroots entrepreneurship.

4 Alibaba’s Creation of Businesses and Jobs

Alibaba’s creation of 25,000 jobs is not the whole story. Its retail e-commerce platform (Taobao.com and Tmall.com) alone brought together about 50,000 third-party e-commerce service-providing businesses for over 10 million registered

⁷An employer firm is a business with employees while nonemployer firm without.

⁸p. 14 Jin (2012).

⁹Please see Chap. “Trade Margins and Exchange Rate Regimes: New Evidence from a Panel VarX Model” in Baumol (2002) for the idea of “routinized innovation.”

¹⁰Parker and Van Alstyne (2013). This is a good paper on the platform ecology system.

on-line retail sellers, of which, only 10 % paid a usage charge, the rest were free users on the platform.¹¹ These e-commerce and its service-providing businesses on Alibaba platform had created 11.76 million jobs.¹² In addition, Alibaba Group includes many other components such as the company's English language international marketplace for importers and exporters from more than 240 countries and regions.

Besides Taobao.com and Tmall.com that serve on-line retail businesses, Alibaba Group also consists of many internet and mobile related subsidiary business groups. For example, 1688.com is for B2B services; Alipay.com is for transactional payment and clearance; Aliloan.com is for micro lending services; Aliyun.com is for cloud computing service and data management; Alibaba.com is as leading global wholesale platform for small businesses; and Aliexpress.com is as popular E-marketplace for international consumers.

There are key similarities and differences between Alibaba and its three American counterparties, i.e., Google.com, Amazon.com and eBay.com. Like them Alibaba uses the latest technologies, such as internet, big data, cloud computing and mobile communications, to serve its customers. However, Alibaba is not a reseller but rather provides a virtual marketplace for real economic activities. One might say that Alibaba provides a fishing platform and fishing poles to all who want to start fishing.

Alibaba became a household name in China not only because of the growing reliance on online retail and services, but more importantly because of Alibaba's unique small business vision—"to use the open nature of the Internet to level the playing field so small businesses could compete more effectively in national and global markets."¹³ Following this vision, while enjoying remarkable growth, Alibaba enables people to develop online business as an expression of their creativity and unleashes grassroots entrepreneurship. In this digital age, a country can also enjoy long-term economic development via generating such dynamism nationwide.

Noting stagnant economies since the mid-1970s in the Western world, Professor Phelps inquires how to restart the economic system of "desire and dreams" that arose "the world's first modern economies." He boldly concludes that neither mercantilism nor the discoveries in science and the inventions that followed were reasons for "the take-off economies of Western Europe and North America" in the 19th century. Rather, these nations' "economic dynamism" and the resulting "indigenous innovation" made them "the marvel of the modern era" (Phelps 2013, p. 14).

¹¹<http://www.aliresearch.com/?m-cms-q-view-id-74973.html>.

¹²Alibaba Research Institute 2013.

¹³<http://news.alibaba.com/specials/aboutalibaba/aligroup/index.html>.

Table 1 Alibaba e-commerce retail job creation by category, 2013

Category	Explanation	Number of employment (million)	Total (million)
Direct employment	Taobao.com platform vendors	9.27	9.72
	Tmall.com platform vendors	0.45	
Indirect employment	Alibaba online exchange service	0.01	2.04
	Supporting services (logistics, express delivery, payment and finance)	0.94	
	Other e-commerce services	1.09	
Total job creation			11.76

Source Alibaba E-commerce Retail Employment Research Report, November 2013, see Alibaba Research Institute, 2013.

While the world is still impacted by the aftershock of the 2007 financial crisis, Alibaba experience shows that, “economic dynamism” has been the reason for the marvel of China’s economic growth since the end of 1970s.

Why Alibaba? Alibaba was created at the right time and in the right place. Alibaba was created at a time when entrepreneurship was a new concept in China; when it could apply rapidly evolving technologies to reach out to grassroots people at unprecedentedly low cost; when China was still backward enough that an industrial corporatism with special interests had not yet strongly and widely formed; and when China was open and flexible enough to combine eastern and western cultures. However, the reason why Alibaba had achieved so much is its deep belief in entrepreneurship with its core mission on “championing small businesses to help them achieve their dreams.” Alibaba strives to “operate an ecosystem where all participants—consumers, merchants, third-party service providers—have an opportunity to prosper. Our success and rapid growth is built on the spirit of entrepreneurship, innovation, and an unwavering focus on meeting the needs of our customers.”¹⁴

According to Alibaba most recent study using big data from the Taobao.com platform, Alibaba created 9.72 million direct employment in 2013, including 4.96 million employment jobs and 4.76 million self-employed jobs (Table 1). In fact, millions vendors on Alibaba platform business chose to “start and run their own businesses” already became a necessity, as well as a fashion. Alibaba platform provides the major or sole income for 42 % of Alibaba e-commerce vendors. Among all vendors, about 60 % of them had an associate or higher academic degree, near 90 % of them were below 35-year old, and more than 60 % of them were moonlighters who took e-commerce business as a second job (Table 2).

In 2011 Alibaba Research Center published the book *Light House for a New Path—The Alibaba’s 100 Global E-commerce Business Vendors of 2011*, recording 100 entrepreneurial success stories (Alibaba Research Institute 2012). These cases show that Alibaba not only provided personal and household employment and livelihood, but also was associated with tremendous innovation and positive energy for society.

¹⁴http://news.alibaba.com/specials/aboutalibaba/aligroup/culture_values.html.

Table 2 Demographic information of Taobao.com e-commerce platform vendors, 2013

Education background		E-commerce business income nature	
College associate and above	59.7%	Sole income source	26%
High school (include associate)	30.9%	Major income source	16%
Middle school or below	9.4%	Not major income	58%
Multiple job?		Vendor's age group	
E-commerce business only	37.3 %	22-year old or below	7.2 %
Government employment	5.8 %	23–25	24.7 %
At school as student	3.4 %	26–30	35.7 %
Self-owned other business	22.4 %	31–35	20.8 %
Other's business employment	27.7 %	36–40	6.6 %
Farming	1.5 %	40–60	4.96 %
N.A.	1.9 %	Above 60	0.1 %

Source Alibaba E-commerce Retail Employment Research Dataset, 2013

Many college graduates or migrant workers returned to their villages and brought their knowledge, ingenuity, and curiosity to try new things, and experience in modern manufacturing and urban lifestyles. They led their fellow villagers to start e-commerce businesses, create a local economy, and establish a “Taobao village.” Alibaba defines a Taobao village as a village where more than 10 % of local economic activity derives from e-commerce. So far, more than 20 Taobao Villages have been found nationwide.¹⁵ These villages have become clusters using e-commerce as a driver for boosting the regional economy. A list of Taobao County are emerging; focusing on regional characteristics of Chinese organic food and other local products, China.taobao.com becomes especially popular.

5 Credibility, Trust and the Missing Microfinance Market

Credibility and trust are crucial to maintaining a functional economy with money, banking, virtual transactions, and extremely segmented productions and services providing. An efficient finance market can play an important role in assisting startup and operation activities of numerous small and micro businesses. However, in the era of financial capitalism, microfinance market was missing or imperfect, so were credibility and trust.

Using the concept of “invisible hand,” Adam Smith’s 1776 book *The Wealth of Nations* laid out a solid theoretical ground for today’s mainstream economics. Focusing on moral code or credibility, Smith’s 1759 book *The Theory of Moral*

¹⁵Calum MacLeod, “Alibaba works magic for China’s Taobao ‘treasure hunters,’” April 25, 2014 USA Today <http://www.usatoday.com/story/news/world/2014/04/24/alibaba-china/8102033/>.

Sentiments set norms for human behavior and the wellbeing of human life. The book should have been the ethical, philosophical, psychological, and methodological underpinnings of mainstream economics. Nevertheless, mainstream economics had ironically overlooked these important underpinnings.

“Greed is good” became a dangerous idea for 300-year, *The Fable of the Bees* by Bernard Mandeville in 1705 was some classroom relish; such a largely reviled story, later passed around in academia and Wall Street.¹⁶ Smith expressed his strongly distained opinion in his 1759 book and in its later revisions of such a fable.¹⁷ Unfortunately, this fable is still in lectures and winning applause in MBA and EMBA classes in China.¹⁸

There has been much written about human greed particularly in the financial sector. A financial “insider,” former U.S. Treasury Secretary Timothy Geithner acknowledged this fact: “Most financial crises are caused by a mix of stupidity and greed and recklessness and risk-taking and hope”, reported by Reuters on April 25, 2012.

Through reviewing annual reports and financial ratios longitudinally between 2004 and 2009, Alison Lui (2014) describes and compares the effects of the financial crisis 2007 on five UK banks.¹⁹ The author examines two hypotheses: (1) banks moved from a customer-driven culture to a sales-driven one; (2) the banking culture during the 2004–2009 period was one of greed, recklessness, and dishonesty. The case study shows that there is evidence that both hypotheses are correct to a certain extent.²⁰

The financial sector is important to economic development and growth, as pointed out by Shiller in his 2013 book, *Finance and the Good Society*. However,

¹⁶“‘I think greed is healthy,’ an apparent acolyte told the graduating class at Berkeley’s business school in 1986. ‘You can be greedy and still feel good about yourself.’ The speaker was Ivan Boesky, who shortly thereafter would be fined \$100 million, and later go to prison, for insider trading. His address was adapted by Oliver Stone as the basis for Gordon Gekko’s ‘greed is good’ speech in Wall Street. An exhortation to shareholders of a sagging company, it reads like a corporate raider’s war cry, with Gekko the grinning avatar of Agency Theory.” See John Paul Rollert, “Greed is Good: A 300-Year History of a Dangerous Idea,” *Atlantic*, April 7, 2014, <http://www.theatlantic.com/business/archive/2014/04/greed-is-good-a-300-year-history-of-a-dangerous-idea/360265/>.

¹⁷“Such is the system of Dr. Mandeville, which once made so much noise in the world, and which, though, perhaps, it never gave occasion to more vice than what would have been without it, at least taught that vice, which arose from other causes, to appear with more effrontery, and to avow the corruption of its motives with a profligate audaciousness which had never been heard of before.” Paragraph 13, Chap. “*Rebalancing and the Euro*” in Adam Smith, *The Moral of Sentiments*, Sixth Edition (1790).

¹⁸p. 9 in Chinese version of *The Theory of Moral Sentiments*, SONG Deli translate, Yilin Publishing House, 2011.

¹⁹The five banks are Northern Rock, the Royal Bank of Scotland, Barclays, Lloyds Banking Group and HSBC.

²⁰Lui (2014), <http://www.palgrave-journals.com/jbr/journal/vaop/ncurrent/full/jbr20141a.html>.

the “financial capitalism” that made the financial sector “too big to fail,”²¹ also brought “the anger and resentment over executive compensation account for much of the public hostility toward financial capitalism in general.”²² These anger and resentment accumulated very negative sentiment in the society. For example, Americans are losing trust in all institutions, especially banks in the U.S. where the 2007 financial crisis started.²³ A Gallup poll in 2011 shows that more than 3 quarter of people in the poll did not believe in banks; but in the midst of financial crisis, about two third of them believed in small business. This poll reflected the international mood about the financial sector and small business.

Despite the popularity of small business ownership, microfinance has long been a missing market due to lack of collateral, credit record, and financial insurance of small business owners. These are two key ideas from Shiller (2012): (1) the finance sector ought to be about financing economic activities; (2) the financial sector is too concentrated so it must be democratized. Alibaba’s Microfinance Service Group is a result of financial democratization.

Alibaba’s financial innovations give hope to regaining people’s confidence in modern finance. Aiming at unleashing grassroots entrepreneurship and financing economic activities, Alibaba microfinance services include: (1) establishing a payment system to build people’s trust in e-commerce; (2) creating easy access to capital using a credibility based micro lending system; and (3) facilitating the public’s wealth management based on individual preference and convenience.

Launched in 2003, Alipay strives to serve grassroots business and hundreds of millions online or offline consumers. Without charging transaction fees, Alipay provides online and mobile third party payment escrow service for more than 550 million registered users, about 8.5 million transactions daily. Alipay collaborates with more than 65 financial institutions including Visa, MasterCard and all national banks in China. Alipay also facilitates offline value-added services through strategic partnerships with China Post, which has coverage of rural areas and university campuses, and 24-hour convenience stores.²⁴ Alipay does not run credit card service, and operates in a manner similar to PayPal. The difference is that Alipay does not release payment until after the buyer actually receives the item.²⁵ In this way, consumer trust in the online purchase is created. China has not yet established a credit card system like that in the U.S. Alipay has successfully filled the gap between the backward credit system and advanced online retail system.

²¹Financial capitalism is “an economic system that is increasingly guided by financial institutions and that, in the wake of the severe financial crisis that began in 2007, appears to many to be broken.” p. 67 in Shiller (2012).

²²p. 21 in Shiller (2012), in which, Shiller mentioned the term “resentment(s)” 20 times.

²³Ron Fournier and Sophie Quinton, “In Nothing We Trust: Americans are losing faith in the institutions that made this country great.” <http://www.nationaljournal.com/features/restoration-calls/in-nothing-we-trust-20120419>.

²⁴<http://market.alipay.com/ospay/home.html>.

²⁵<http://www.forbes.com/2010/01/18/china-internet-commerce-markets-equities-alibaba.html>.

Traditional lending required borrowers to provide at least one of the following three: (1) solid collateral, (2) good credit record, or (3) sound insurance. Using the transaction records from Alibaba platforms such as 1688.com, taobao.com, and alipay.com, Alibaba's credit management team uses the big data processing and credit assessment techniques to classify credit lines for 300 million online business owners and other real-name registered online users; and creates an efficient credibility based financial system. The operational cost for processing an outstanding loan by traditional bank is about 2000 RMB; only 2.3 RMB by Aliloan.com. At the end of 2013, Aliloan.com provided micro loans to 642,000 borrowers, the accumulated outstanding loan had reached at 172.2 billion RMB (US\$27.5 billion). The key characteristics of Aliloan.com service are three: small-amount, short-term, and flexible-maturity-date (<http://www.aliloan.com/>). Aliloan.com provides needed lending service to startups and online e-commerce small business entrepreneurs. Loans average about 13,000 RMB (US\$2077) and 36,000 RMB (US\$5751) per borrower.²⁶

As a wealth management platform, Yu'eobao (in Chinese that means "leftover treasure") is another core innovation of Alibaba Microfinance Service Group. Established in June of 2013, Yu'eobao has become an attractive alternative to banks because it offers around 6 % in annualized return. In contrast, banks' demand deposits offer a paltry 0.36 %.²⁷ Up to January 31, 2014, Yu'eobao has accumulated around 350 billion RMB (US\$56 billion) from over 58.95 million users.²⁸ Money market and fund management are not new to Chinese; the Alibaba innovation is nevertheless significant. Yu'eobao serves grassroots investors that the traditional financial sector has ignored. The characteristics of Yu'eobao are three folds: (1) simple procedure, (2) easy access, and (3) high liquidity. The cost of money market fund management is low due to highly adapted information and digital technology; ordinary, especially poor people can enjoy making their own choice between consumption and investment and gaining "return" from their savings. Many young people take their saving decision and the return to saving seriously. They would manage their fund and move any leftover cash into Yu'eobao as a last chore before getting to bed; they would check on their over-night return from computer or cell phone as first daily routine in the morning after getting up. Some even happily enjoy a nice breakfast because of the gain from Yu'eobao and view that as a free breakfast. Economic professors would never have imagined how the time preference theory and utility maximization theory could be so prevalent among ordinary people in China.

Alibaba's financial innovation apparently filled a market need in the prevailing financial capitalism world. Many great leaders, such as Mohammad Yunus, had made lifetime endeavor for establishing this market. However, this market can be

²⁶Alibaba Microfinance Service Group Social Value Report (2014), p. 28–29.

²⁷<http://www.reuters.com/article/2014/03/20/china-banks-idUSL2N0MG0BV20140320>.

²⁸P. 6, Alibaba Microfinance Service Group Social Value Report (2014), "Internet Based Inclusive Finance Practice."

facilitated only when new technologies available for eliminating the prevailing asymmetric information problem, and when transforming the monopolized financial sector. Alibaba's microfinance service innovation has had a profound impact on China's financial market, which is strongly controlled by the government. The negative spillover effect of financial crisis brought by Americans and the western nations on China is emerging. Slow growth, high unemployment, and declining export forced the government to implement limited financial democratization.

In addition to the third party guarantee system of Alipay and grassroots investment and wealth management, the most important contribution of Alibaba's financial innovation is the creation of a new format of human capital in the digital age—credibility. Relying upon a good record of credibility, one can obtain financial capital on Alibaba Microfinance Service platform for business startups and operations. Thus, modern technology can facilitate the microfinance market; and credibility can become an invisible moral standard guiding people's market conduct. Relying on the principles of openness, transparency, efficiency and accountability, finance sector will regain people's trust and become effective tool for unleashing grassroots entrepreneurship, supporting business operations, and encouraging mass innovation.

6 The Importance of Rules of Games

Baumol (1990) points out that entrepreneurship in a society could be productive, non-productive, or even destructive. The attribute of innovation in a nation depends on the political system and the incentive structure shaped by the society. Shiller (2012) addressed "Financial Capitalism" can be classified at least as "unproductive entrepreneurship." After the dot com bubble burst in the U.S., rather than studying high techs, or learning mathematics or sciences, a great number of world "best of the best" youth flooded into business schools and majored in finance. This is still the case in today's China. It reflects that there is an unusually high payoff structure for the financial sector.²⁹ There are two premises for unleashing grassroots entrepreneurship and promoting mass innovation: (1) it must change the unfair payoff structure; and (2) it must establish a set of rules that effectively build trust and credibility in the society.

Trust and credibility in a market economy were subject terms but now can be facilitated by digital technology recording people's conducts including transactions. Investing in most updated technologies, Alibaba has endeavored in setting up rules for promoting the efficiency of its platform, and the incentive structure for fostering a culture of productive innovations.

Alipay.com's third party guarantee in linking buyers and sellers has generated trust for the platform. The buyers can easily get on this two-sided platform and

²⁹<http://businessforecastblog.com/is-the-us-financial-sector-too-big/#.UkxKPcmS19A>. .

make their evaluation on the services from sellers. The powerful computing system fully records the transactions of both sides, and can easily pinpoint to individuals who have broken rules, or cheated. This in turn places people to an invisible norm where being a player on the platform must follow rules and be credible. This invisible norm can greatly help to unleash productive entrepreneurship.

Aliloan.com employs the best workforce that can apply sophisticated mathematical models and computing algorithms, relying on its platform big data for screening-in those who are honest and credible, and screening-out those who cannot be trusted. Rather than maximizing profit, Aliloan.com makes tough decisions on using finance as effective tools to serve the grassroots entrepreneurs.³⁰ Lately, all Alibaba affiliated financial functions have merged in Alibaba Microfinance Service Group that clearly defines its serving customs and strives to assist small businesses.

In the present age based on modern technology, destructive internet and mobile businesses emerge constantly. In recent years, China's e-commerce big players such as Jingdong, Taobao, Dangdang, and Suning have been fighting in malicious blackmail incidents. These incidents included ill-intentioned orders, professional blackmailers, invoice complaints, and many other illicit online shopping activities. The evaluation system for online credit was designed to protecting the rights of the buyer, the seller, and the platform. When designing this evaluation system, the focus was only on the "expected" effects but not on the "unanticipated consequences." As a result, "the destructive innovation" seriously harm the reputation of sellers and badly hurt innocent parties. Although the e-commerce platform can adopt appropriate measures to prevent and combat illegal activities, it is still very important for the government to influence the direction of innovation by setting legal boundaries. Although e-commerce platforms are not law enforcement agencies, they can use the modern technology and big data to develop sounder incentive mechanisms for promoting good and eliminating or punishing bad behaviors.

To build a platform that can effectively govern the two-sided market as a third party, Alibaba has established its internal management and incentive systems to unleash the productive entrepreneurship and promote innovation amongst its employees. From recruitment principles, the Paten Wall (for posting names of people who applies patens), to the free-messaging board on restroom doors facing toilets, Alibaba's human resource department actively and carefully conducts initiatives to accumulate positive energy. At the same time, Alibaba resolutely cracks down on activities that are harmful to its ecosystem, corporate culture, and business principles. After verifying the fraudulent activities of a few thousand "China suppliers," Alibaba concluded that some of its B2B direct sales team employees had intentionally or negligently allowed the fraudulent companies to participate in Alibaba's platform. As a result, nearly a hundred sales personnel were held legally

³⁰At a meeting with Jack Ma, the Chairman of Alibaba Group Holding Ltd., former general manager of Aliloan.com was very excited about the success of online lending. He suggested raising the ceiling of loan amount from one million to 5 million. Jack Ma responded, "If you dare to increase the ceiling, I will fire you right away!" The former general manager told this story in many occasions.

responsible. In accordance with company rules, penalties such as dismissal were imposed on these employees. Alibaba also decisively held its senior executives responsible. Both its internet network's CEO David Wei and COO Xuhui Li resigned.³¹ In addition, to prevent rent-seeking activities which can be textbook case of unproductive entrepreneurship, Alibaba set up rules similar to that of the U. S. government, which regulates and prohibits government employees from receiving payments of illegal gifts or bribes.

7 Alibaba's Next 10 Years

Chris Anderson, the author of *Makers: The New Industrial Revolution*, predicted: "Here's the history of two decades of innovation in two sentences: The past ten years have been about discovering new ways to create, invent, and work together on the Web. The next ten years will be about applying those lessons to the real world" (Anderson 2012, p. 17). In the new age, "a maker movement" creates new challenges and opportunities to entrepreneurs: they can bring artisan's professional work ethic and innovation together, offer products with high-tech but low cost, with abilities to maintain a small scale but global production. "Killer app" and "3D Printing" are good examples of starting small and growing big (Anderson 2012, p. 16). Because of the nature of platform service, Alibaba can be such a "killer app." Tens of millions of "makers" connect to the platform. Taobao.com, Alipay.com, Aliloan.com and Yu'eobao all started small but got big. Despite all these successes, Alibaba has not been and should not be satisfied with what it has achieved so far.

Overall, U.S. e-commerce is the international front-runner. In 2011, U.S. e-commerce amounted to 49.3 % of sales in the manufacturing industry; 24.3 % in wholesale trade; but only 4.7 % in retail and 3.0 % in the service sector.³² In contrast, China's e-commerce is extremely competitive in retail and service sectors. The former CEO of Alibaba's B2B platform David Wei recently said to CNN, "Unlike in the U.S., many small Chinese cities have not yet been penetrated by large retailers or brand products, which provides an opportunity for e-commerce in these cities to eventually become the mainstream retail mode."³³ While China is realizing goals of "new-four initiatives," one can foresee the irresistible force of e-commerce in other sectors.³⁴

³¹See Chinese report: 《阿里巴巴CEO卫哲引咎辞职事件》, http://baike.baidu.com/link?url=hcgKNOiJpX31VjtfYhHmcOIGvEBVDK_HoNgHWTRahVR7GRId2R97SUX8DKICthGEae_z2bcgFgYytiI2HdgQo_.

³²Source U.S. Census Bureau, 2011 Annual Survey of E-commerce.

³³David Wei, "E-commerce bigger in China than United States," September 19, 2013, CNN, http://edition.cnn.com/2013/09/19/business/on-china-alibaba-e-commerce/index.html?iid=article_sidebar.

³⁴The new-four initiatives are the nation's industrialization, informatization, urbanization, and modernization.

Alibaba benefited from China's "late development advantage" in certain industrial sectors. China's undeveloped retail industry has not yet been occupied by countless middle-men. This provides a great opportunity for online retail businesses. Aliresearch.com reports that the e-commerce density (online-retail seller business number per thousand population) of the Top 100 E-commerce Counties was 7.1 times that of the national level. These top counties are all in locations where the real economy are strong.³⁵ At the same time, e-commerce has become the new engine for real economic growth. Many villages and counties became clusters because of e-commerce development.³⁶ Therefore, the success of any e-commerce platform depends on how to attract to grassroots e-commerce sellers who can naturally link to real production. David Wei pointed out that "Behind these millions of merchants are hundreds of thousands of factories in China. This is why such phenomenon does not exist in the United States where you can hardly find any manufacturers."

China's retail business was less developed and marginalized. Alibaba can easily adapt the "growing by unleashing model" in this sector and become the e-commerce giant. How Alibaba is going to run its microfinance service platform remains to be seen. Two strong forces are affecting Alibaba's financial business strategies. The first is central government's strong control of China's financial sector; the second is the "financial capitalism" from the west. As a de facto traditional financial system beneficiary, the government does not want to have a strong private-owned business in financial sector. The second influence coming from the West could entice Alibaba to take the advantage of its powerful platform and grow into another Goldman Sachs. This will be trillion dollar bet: can Alibaba resist the pressure from current stakeholders of Chinese financial sector and continue its endeavor for establishing a strong microfinance market? Can Alibaba resist the temptation from financial capitalism and continue to explore a new model and provide services for a two-sided microfinance market? What would Google do (Jarvis 2009)?

How to facilitate many upcoming new "killer apps" in all different sectors? How to bring vibrant idea-producers, ingenious manufacturers, and market-know-how entrepreneurs all together and effectively assist China's industrial upgrading and product improvement? How to encourage various professional service providers, such as physicians, lawyers, teachers, accountant, and architectures, to create their businesses online so that people can enjoy a wider range of two-sided markets for modern products and services? Finally yet most importantly, how should Alibaba act as the world new business leader and establish benchmarks for running financial services where openness, transparency, efficiency, and accountability replace the "asymmetric information" of "financial capitalism"? Without doubt, the grassroots entrepreneurs on Alibaba's platform can create an unprecedented

³⁵See 《县长必读：“电商百佳县哪些方面‘牛’？”》 <http://www.aliresearch.com/?m-cms-q-view-id-75924.html>.

³⁶“Alibaba works magic for China's Taobao ‘treasure hunters’,” this tells one of great stories in China. <http://www.usatoday.com/story/news/world/2014/04/24/alibaba-china/8102033/>.

demand through their novel products and services. With Alicloud in broad application and development, Internet of Things and Internet of Services would further unleash China's entrepreneurship, and become powerful engines for economic growth.

Yet, Alibaba still has a long way to go. Microsoft has entered its “middle age.” Because of “big company syndrome,” this once vibrant and super innovative “youth” started losing the vitality to innovate.³⁷ Alibaba is only 15 years old. As Alibaba has grown into a world giant, will it still be keen on entrepreneurial Lilliputians? An increasing number of platform companies have started to imitate Alibaba's business model and tried to attract online sellers. What would Alibaba's profit model be when facing with competitors? During the end of last year, 11,000 online small sellers waged a siege event toward large sellers such as Uniqlo.³⁸ Alibaba is constantly struggling in balancing the needs of large vs. small sellers: serving small is in Alibaba's mission statement; but serving large can be more profitable.

Alibaba recently updated its report on “Corporate Social Responsibility (CSR).” Its CSR embodies the company's free-enterprise conviction, small business passion, and the routinized innovations. Improving its ecosystem and promoting mass flourishing are important parts of Alibaba's social responsibility. Because of the internet revolution, the founders' wisdom, and employees' innovations, Alibaba has made invaluable contributions to China by “creating jobs, challenge, and change” and has become China's “David and Goliath” story. Countless new “Davids” surround Alibaba as a modern “Goliath”. It is Alibaba's social responsibility and wisdom to continuously attract and serve mass entrepreneurs to innovate.

8 Concluding Remarks

Inspired by Phelps' 2013 book and drawing on Alibaba's experience, this paper discussed a small business based, digital technology driven new growth model—growing by unleashing grassroots entrepreneurship. Small business is an important expression of individuals' “will, capacity, and aspiration to innovate.” Modern technologies can help create an open, transparent, efficient, and accountable microfinance market that can assist small business to thrive. Establishing and reinforcing a set of rules and regulations for an ecosystem can help the entrepreneurship of a society to be productive. Alibaba's experiences show that a nation can enjoy sustainable economic development and improved economic wellbeing by creating dynamism through unleashing grassroots entrepreneurship.

³⁷ Joe Wilcox, “Why former employees say Microsoft can't innovate?” <http://betanews.com/2010/02/09/why-former-employees-say-microsoft-can-t-innovate/>.

³⁸ <http://www.chinaz.com/news/2013/1206/330151.shtml>.

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