**Hitt 13e Case Teaching Notes**

**Case 2: Baidu’s Business Model and Its Evolution**

**Case Synopsis**

After a little more than a decade of exponential growth and increasing revenues, China’s Internet search giant Baidu suddenly found itself struggling in 2016. Co-founded by Robin Li Yanhong, chairman and CEO, and his friend Eric Xu in 2000, Baidu was China’s first home-grown search engine. Much like Google in the United States—one of its early rivals until Google exited the Chinese market in 2005—it was created with the mission of providing the best way for people to find information. More than using technology efficiently, however, Baidu aimed to serve China better than competitors by focusing on Chinese culture and the Chinese language, while simultaneously adhering to strict governmental regulations on content.

Within China, Baidu rapidly expanded through diversification, creating and/or acquiring stakes in numerous online services, such as several types of advertising, mobile search, video streaming, and more. As increasing numbers of people began to shift away from personal computer use to smartphone use, CEO Li recognized a need to reduce Baidu’s dependence on the desktop search business by moving into O2O (online-to-offline) services. These included online and mobile payment services, personal cloud computing, mapping, and food delivery.

Driven by its success in meeting the unique needs of the Chinese market, Baidu also began to expand internationally and to continue to localize its services for the people of such countries as Brazil, India, Egypt, Thailand, Vietnam, and Indonesia. Through a partnership with France Telecom, it entered the African market. Baidu’s Li has even suggested long-term plans to enter the U.S. and European markets.

In 2016, Baidu faced several significant setbacks. The first came in the form of new government regulations on healthcare-related advertising that were implemented in response to the death of a 21-year-old Chinese student who blamed Baidu for selling him on an experimental drug. Complying with the new regulations resulted in a 34.1% slump in profits for the April–June 2016 period. Fierce competition from new entrants in the market, as well as heavy investments in new O2O services, also negatively impacted Baidu’s profits, which caused concern among investors and analysts.

With slowing growth in its core business of online search, Baidu announced a significant shift in its business model in May 2016: a new focus on artificial intelligence (AI) and augmented reality in addition to its work with O2O services. The company is working on developing products involving voice search, automatic translation, and driverless vehicles. Baidu’s mission changed

from one of connecting people to information to one of connecting people to services, and Li promises solid long-term growth with the two segments supporting this goal.

**Learning Objectives**

* Discuss the relationship between customers and business-level strategies in terms of *who, what,* and *how*. (Chapter 4)
* Describe business models and explain their relationship with business-level strategies. (Chapter 4)
* Explain the differences among five types of business-level strategies. (Chapter 4)
* Use the five forces of competition model to explain how firms can earn above-average returns when using each business-level strategy. (Chapter 4)
* Describe different levels of diversification achieved using different corporate-level strategies. (Chapter 6)
* Explain three primary reasons firms diversify. (Chapter 6)
* Identify three basic benefits firms gain by successfully implementing an international strategy. (Chapter 8)
* Explore the determinants of national advantage as the basis for international business-level strategies. (Chapter 8)
* Describe the three international corporate-level strategies. (Chapter 8)
* Discuss environmental trends affecting the choice of international strategies, particularly international corporate-level strategies. (Chapter 8)
* Understand why firms use cross-border strategic alliances as an international cooperative strategy. (Chapter 9)
* Define entrepreneurship and entrepreneurial opportunities and explain their importance. (Chapter 13)
* Define invention, innovation, and imitation, and describe the relationship among them. (Chapter 13)
* Describe entrepreneurs and the entrepreneurial mind-set. (Chapter 13)

**Strategic Issues and Suggested Discussion Questions & Answers**

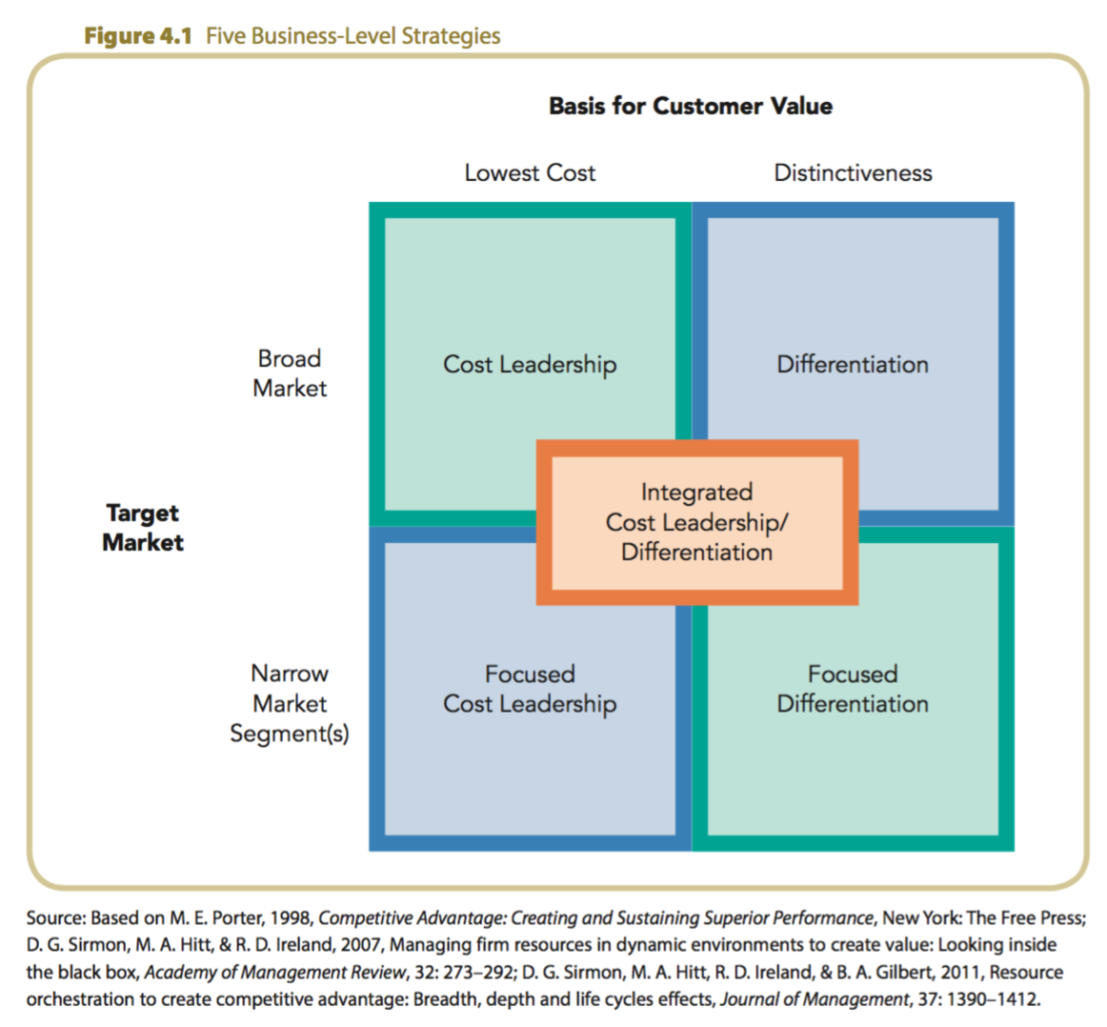
1. ***How and why have Baidu’s business model and customers changed over time?***

When Robin Li Yanhong and Eric Xu co-founded Baidu in 2000, their intention was to create China’s first home-grown search engine as a means of providing the best way for people to find information. The firm was intent on localizing its search engine to serve the Chinese people better than competitors by factoring in Chinese culture and the Chinese language. At the same time, it was very cognizant of adhering to China’s strict governmental regulations on content.

However, many factors have influenced Baidu’s business model over time, and in the process, have expanded its competitive scope and customer base. Specifically, as people have moved away from desktop and mobile search, Baidu has had to look elsewhere for revenue. The solution has been to emphasize connecting people with services. Baidu now has two main segments that support this mission—O2O services and artificial intelligence—and these businesses are operating in locations around the globe. The search engine and other services are aimed at emerging economies, like Brazil and India, where growth potential in smartphone usage for search and services is strong, while artificial intelligence and augmented reality products will most likely be geared toward developed economies.

***2. Which business-level strategy is Baidu using? Provide at least two examples of how Porter’s five forces are affecting the firm and its strategy.***

With an emphasis on providing products and services that are different and create value for customers for which they are willing to pay a premium, it is clear that Baidu is pursuing a differentiation strategy. While the firm’s initial focus on China may have categorized it as focused differentiation in the beginning, today’s Baidu is broad enough to be categorized as simply differentiation (Figure 4.1).

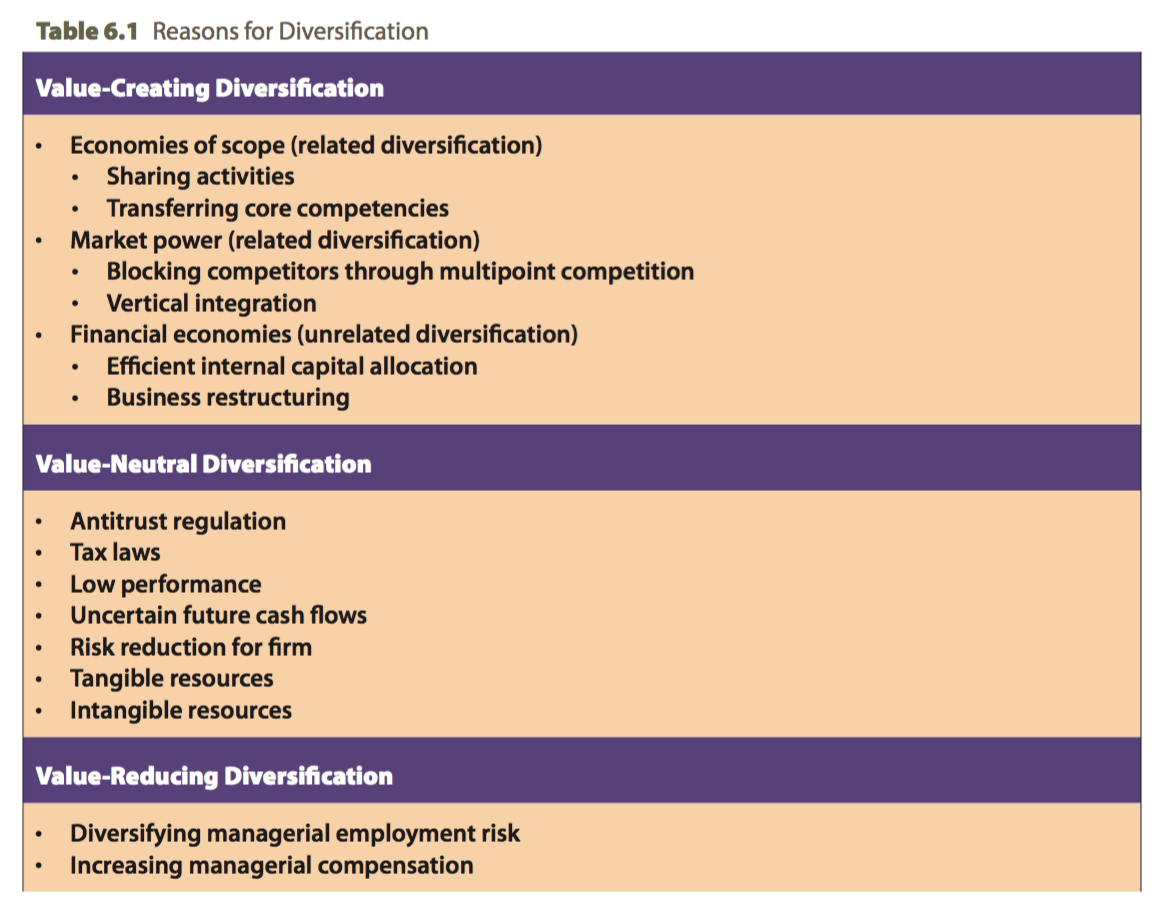


The case describes several examples of Porter’s five forces at work. Numerous rivals exist for many of Baidu’s businesses, some of which are offering product substitutes. Perhaps chief among them is international leader Google/Alphabet Inc., which not only runs a search engine and online advertising business, but is also developing other online services and technology-based products, including a self-driving car. Within China, Baidu’s mobile search business faces competition from new entrants like Qihoo 360 and Sohu, and from established firms like Alibaba and Tencent, which try to attract customers through smartphones. Baidu has been forced to adapt its technology to retain its competitive advantage.

Perhaps the biggest threat to Baidu’s search engine business is that its perceived value is gradually diminishing. More and more people are turning to other sources, particularly social media, for information, so search, in general, is not as attractive and valuable as it once was. This explains why Baidu has moved away from search as its core business and turned its attention toward O2O services and AI. Although its business model has changed, its differentiation strategy remains the same.

***3. Baidu has diversified through both the creation and acquisition of new businesses. Choose three examples from the case, and identify the value-creating, value-neutral, or value-reducing reason behind the creation or acquisition of each of the examples.***

The reasons for diversification fall into three general categories (Table 6.1), and Baidu has diversified (Exhibit III) for all of these reasons.



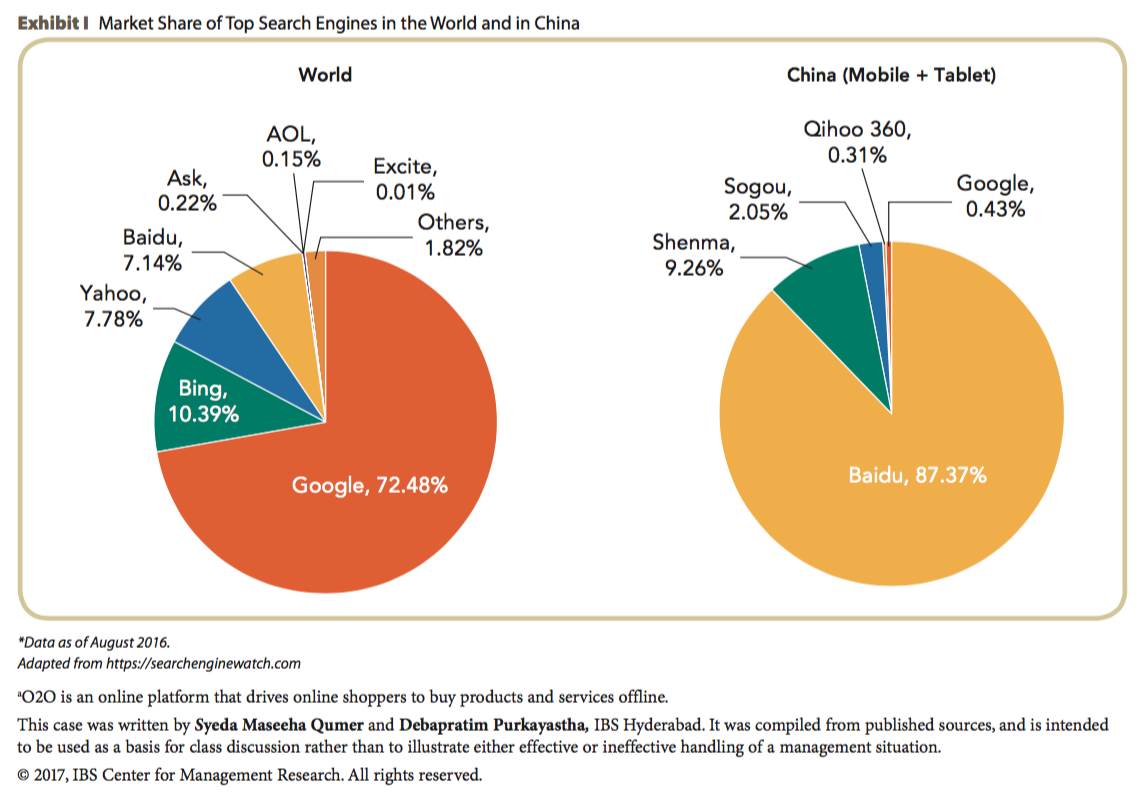
In terms of value-creating diversification, many new businesses are related to its initial search engine business, thus capitalizing on economies of scope. These include online advertising, mobile search, and video streaming. O2O services, such as online and mobile payment services, ticketing and booking assistance, personal cloud computing, mapping, and food delivery, make use of Baidu’s original core competencies while expanding its market power.

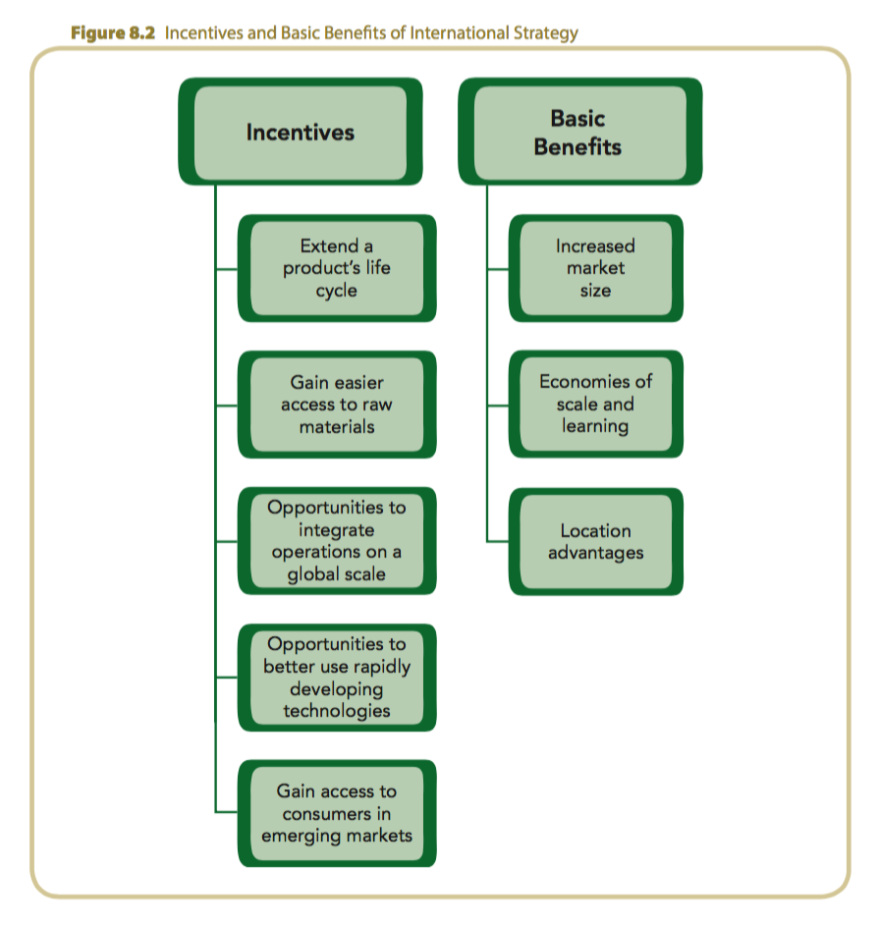
In terms of value-neutral diversification, decreasing performance, risk reduction, and fallout from new regulations also motivated Baidu’s expansion and heavy investments in O2O services. Thus, certain diversification tactics actually provided multiple benefits.

And finally, increasing managerial compensation, which is a value-reducing reason for diversification, may have been the driver behind some of Baidu’s other lucrative acquisitions and partnerships with firms doing research in AI and other forward-thinking technologies, such as self-driving vehicles.

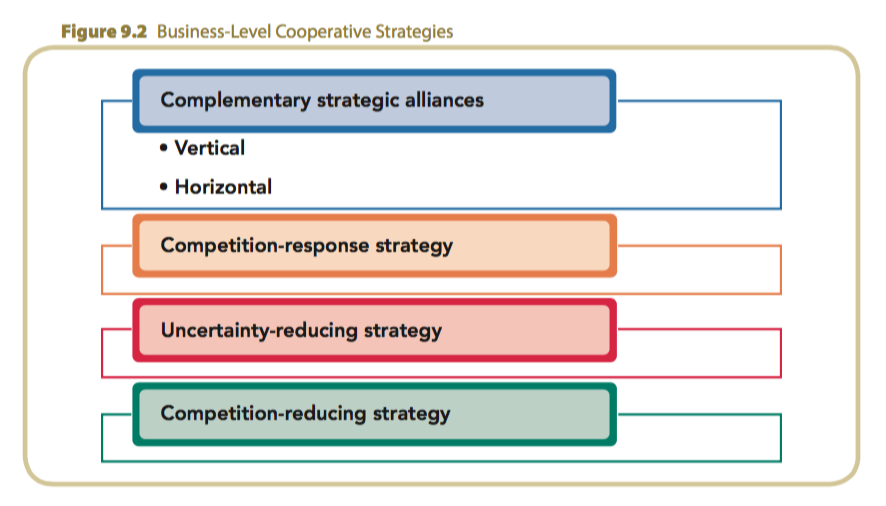
***4. What has been the most powerful incentive for Baidu’s international expansion, and what benefits is the firm enjoying from its global growth?***

In a fairly short amount of time, Baidu’s top leadership recognized that it was getting close to saturating the Chinese market (Exhibit I). Furthermore, the firm recognized that people in developed economies were moving away from search, even mobile search. In order to continue growing, Baidu’s highest priority was to gain access to consumers in emerging markets who still wanted to utilize mobile search on their smartphones. In a sense, the firm’s focus on the South American, Southeast Asian, and African markets is also extending mobile search’s life cycle (Figure 8.2).





Thanks to Baidu’s international expansion efforts into some of the largest known markets (India, Brazil, Southeast Asia), the firm has definitely increased its market size. In some ways, Baidu could also be enjoying economies of scale as it applies its core competencies in online search and services to developing products and services for new markets. However, because Baidu has chosen to localize its products and services for each new market, it has not realized any location advantages. In fact, in this respect, the growth has increased R&D and other costs (Figure 9.2).



***5. Choose one of the examples of Baidu’s cross-border strategic alliances described in the case, and explain which type of business-level cooperative strategy it exemplifies.***

On its own home turf, Baidu has made a cross-border strategic alliance with U.S.-based Uber by investing an undisclosed amount of money. This move leverages Baidu’s strengths in mobile search, mapping, and app distribution, and it integrates the Uber app with several of Baidu’s services. Since Uber would be considered part of Baidu’s value chain, this alliance is an example of a vertical complementary strategic alliance.

Similarly, Baidu’s deal with France Telecom is another vertical complementary strategic alliance because the mobile phone manufacturer is part of Baidu’s value chain. In this case, Baidu made a deal to have its browser pre-installed on low-end smartphones that France Telecom was manufacturing for the African and Middle Eastern markets.

The self-driving vehicle industry, however, is a very new industry filled with uncertainty and having few players. Thus, Baidu’s decision to partner with microprocessor maker Nvidia Corporation can be seen as an uncertainty-reducing strategy. Nvidia will share some of the weight of the R&D costs with Baidu in developing a computer platform for self-driving cars in the Chinese market.

***6. Would you characterize Robin Li Yanhong, chairman and CEO of Baidu, as an entrepreneur? Explain your answer.***

Baidu’s CEO and co-founder Robin Li Yanhong exhibits many of the qualities that characterize an entrepreneur. Based on his experience with other search engines, as well as his personal background as a Chinese national, he recognized an entrepreneurial opportunity to create a search engine for China that was more closely aligned with Chinese language and culture. Clearly confident in his abilities and passionate about the value of his innovative idea, he founded the company and was able to secure key investments from venture capitalists that allowed Baidu to grow in its early years. Several of his comments in the text suggest that he is optimistic, even in the face of uncertainty.

**Additional Resources**

Reuters’s company profile gives in-depth background on Baidu’s current financials, leadership, valuation, news, and more:

<https://www.reuters.com/finance/stocks/overview/BIDU.OQ>

Yahoo! Finance’s company profile offers additional background on Baidu’s current financials, leadership, valuation, news, and more:

<https://finance.yahoo.com/quote/BIDU/>

CoinTelegraph houses a series of links to the latest Baidu news:

<https://cointelegraph.com/tags/baidu>

Seeking Alpha’s April 2019 article explored how Baidu, Alibaba, and Tencent joined forces against other rivals:

<https://seekingalpha.com/article/4254699-baidu-alibaba-tencent-strange-bedfellows-united-common-foes>

From September 2018, CNBC created this video profile:

<https://www.youtube.com/watch?v=cxOdFGg3Sgs>

In September 2018, CNBC published this insider’s look at the Baidu high-tech campus:

<https://www.youtube.com/watch?v=sTsi4-UvCOU>

Hugh Sergeant, head of UK Equities at River & Mercantile, offered his perspective on Baidu in April 2019:

<https://www.youtube.com/watch?v=13xklUaxkhs>