



CHINA'S



MOBILE



ECONOMY



OPPORTUNITIES IN THE LARGEST AND FASTEST



INFORMATION CONSUMPTION BOOM



WINSTON MA

FOREWORD BY DOMINIC BARTON, INTRODUCTION BY DR. XIAODONG LEE



WILEY

China's Mobile Economy

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INFORMATION CONSUMPTION BOOM**

Winston Ma

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"Every company – and every country – must succeed at digitization to compete successfully in the 21st century. Winston Ma delivers a rare book that is both an outstanding survey of a fast-changing and vitally important economic landscape and a delightful 'field guide' that will enrich your understanding of what's really happening on the ground."

—**Dominic Barton**, Global Managing Partner,
McKinsey and Company

"Winston has written a first of its kind – a timely, insightful and eminently readable analysis of the world's fastest growing mobile economy. A must-read for anyone interested in China, the mobile economy, or technology, more broadly. Eye-opening and thoroughly enjoyable."

—**Reuben Jeffery III**, President and CEO,
Rockefeller & Co., Inc.

"China is determined to make innovation an engine for the next stage of the country's development, and no sector has been more creative or dynamic than the mobile economy, which in some areas has surpassed even the United States. Winston Ma's deep dive into this fiercely competitive, constantly evolving industry dissects the companies, personalities and forces that are transforming China and that will inevitably influence commerce far beyond its shores."

—**John L. Thornton**, Co-Chairman, Brookings Institution

"As the world moves to mobile technologies, and with China now the world's largest market of Internet users, all stakeholders have to think about China's economy, market, and society from a completely new perspective. This is an indispensable book for understanding the emerging shape and scale of opportunities in the Middle Kingdom and beyond."

—**Rod Beckstrom**, Co-Author of *The Starfish and the Spider*;
Former President and CEO, ICANN

"Chinese society is experiencing a rapid transformation, becoming increasingly industrialized and digital-based. The Chinese internet population has officially entered into the age of mobile internet. This extraordinary book explains how the internet has been the engine that catapults commercial activities from offline to online and towards ubiquity."

—**Xiaodong Lee**, President & CEO, China Internet Network
Information Center (CNNIC)

China's Mobile Economy

To Angela – I love you dearly

Foreword

Some authors are good at spotting and analyzing trends. Others go in deep and provide detailed explanations of how an industry ecosystem or specialized sector is evolving. But in *China's Mobile Economy*, Winston Ma delivers the rare book that is both an outstanding survey of a fast-changing and vitally important economic landscape and a delightful “field guide” that will enrich your understanding of what’s really happening on the ground.

Start with the headline: even those generally aware of the scale of the country’s ongoing digital transformation may have missed this news – 2014–15, Ma insists, marks “the most important inflection point in the history of the internet” in China. Almost overnight, the world’s largest digitally-connected middle class went both mobile and multi-screen (smartphone, tablets, laptops and more), with huge implications for how consumers behave and what companies need to do to successfully compete.

How have China’s Big Three, the group known as “BAT” (Baidu, Alibaba, and Tencent) responded so effectively to the shift to a mobile platform and how are their business models converging as the lines between e-commerce, social media, and entertainment blur? What does the swift rise of more than 600 million mobile consumers and the rapid merging of online-to-offline shopping (O2O) mean for Western multinationals in traditional industries such as autos and beverages, as well as for digital stalwarts like Apple and aspiring newcomers such as Uber? (Quick quiz: guess which three cities are now Uber’s most popular in the world, measured by rides per day? Answer: Guangzhou, Hangzhou and Chengdu.) What role has government policy played in helping drive China’s digitization and

how will future regulation shape the fates of fast-growing sectors such as online banking?

Ma offers rich insight into all these macroeconomic and industry questions, making a convincing case that, as next-generation mobile devices and services take off, China's strength in this arena will transform it from a global "trend follower" to a "trend setter." At the same time, in a delightful array of boxes and sidebars, he supplements his analysis with a depth of cultural reporting and definitions of popular terms that would make a social anthropologist proud. Are Chinese consumers "shai"-ing your products in social media, as they have express-delivered fresh Canadian blackberries purchased online? Well, good for you. But be careful that they truly view your goods and services as "gao-da-shang" versus dismissing them as "tu-hao-jin." Understanding these phrases and the behaviors behind them, Ma rightly suggests, is no less critical than understanding what your next round of Big Data market research may be telling you.

As befits a successful investor, deeply grounded in both Western capital markets and in local equities, through his distinguished career at the China Investment Corporation (CIC), Ma strikes the right balance between enthusiasm for the opportunities that China's mobile marketplace offers and a clear-eyed assessment of potential challenges ahead. At McKinsey and Company, we too believe every company – and every country – must succeed at digitization to compete successfully in the 21st century. In many of our recent reports we have cast a bright light on some of the themes explored here, from China's growing capacity to innovate to the role the internet can play in its next wave of productivity-driven growth.

As Ma concludes, "The development of China's mobile economy is one of the most important trends that will reshape the future of business, technology and society both in China and the world." We couldn't agree more. From our work with leading global private and public sector clients across many industries and regions, we know just how keenly they are following the next phase of China's economic evolution. This

independent, richly reported and highly readable book is a welcome addition to our understanding of this exciting, continuously unfolding story.

Dominic Barton
Global Managing Partner, McKinsey and Company

Preface

For China, the years 2014 to 2015 were the most important inflection point in the history of the internet, as the Chinese internet population officially entered the mobile internet and multi-screen age (with smartphones, tablets, personal computers and more). During this incredible period of change, the mobile internet in China gave rise to a dynamic tech sector, thriving social networks and the world's largest digitally connected middle income class. The development of China's mobile economy is one of the most important trends that will reshape the future of business, technology and society, both in China and the world.

Of course, the mobile transformation of China's economy has also had profound implications for global stakeholders dealing with the Chinese market. During China's digital boom, foreign investors are richly rewarded, and consumer goods companies see an emerging market filled with opportunities from an expanding middle class. Overseas users are cautiously adopting smartphones and mobile apps created in China, but Silicon Valley tech giants are taking notice of new competition arising from Asia. This book intends to provide a cutting-edge overview of this digital transformation in China as well as its global impact.

Chapter 1 will provide an overview of China's macro economy and the important government policy drivers behind the digital economy growth, such as urbanization, information consumption, smart cities, as well as internet plus, which is essentially the sum of it all.

This opening chapter will also introduce the big three "BAT" companies, Baidu, Alibaba and Tencent. These companies have respectively dominated the three strategic areas of

the mobile market, namely the online search, e-commerce, and social network and messaging service in China. At this time of market inflection, these three key players are becoming more open-minded and proactive in moving into new areas through expansion, acquisition and strategic cooperation. Their impact can also be felt overseas by foreign investors, consumers, products users, start-ups and industry companies across the globe.

While the BAT companies strive to maintain their dominance over the digital high ground, many other Chinese firms are becoming strong players in the mobile market as well. Some of them have reached a significant size, and they come to the battlefield with unique strengths from different origins, such as Xiaomi (smartphone/hardware), LeTV (media content), Lenovo (PC/smartphone), Huawei (network/smartphone) and ZTE (telecom/smartphone). In addition, there are countless start-ups being formed every day by entrepreneurs eager to become the next Robin Li, Jack Ma or Pony Ma (the three founders of BAT, respectively).

The partnership, competition and cross-investments among these players of different traditional strengths, corporate scales and market focuses have made the mobile market extremely active and dynamic. As illustrated by the online shopping extravaganza and digital retailing revolution, the successful business models in the mobile era aim to integrate the four “Cs” seamlessly: Context, Community, Content, and Connection (see Figure P.1). As a result, the mobile internet and social networks are making a profound impact on productivity and growth in many parts of the economy. This chapter will briefly list some examples in the entertainment and media, retail and finance sectors, which will be discussed in detail in later chapters relating to corresponding business areas.

Chapter 2 will cover the various global stakeholders and the new opportunities and challenges they are experiencing. In particular, the “going mobile” and “internet plus” trends are critical for the foreign companies heading to China in search of their slice of the digital economy pie. In this fast-changing market, even for multinational corporations that have done

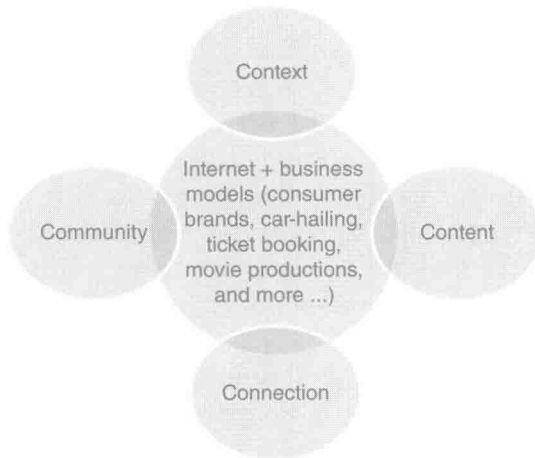


Figure P.1 The Four “Cs” in the Mobile Economy

business in China for many decades, a comprehensive rethink of their strategies in China may be necessary. Meanwhile, the mobile infrastructure opens up new opportunities to foreign merchants who do not have or need to have, a physical presence in China. To a large extent, mastering mobile internet strategy will separate the winners from the rest of the pack in their competition for Chinese customers.

Chapter 3 is centered on Xiaomi, the highest valued start-up in China. Focusing on a niche passed up on by premium brands like Apple and Samsung, the Chinese brands like Xiaomi, Huawei and Lenovo have mainly offered low price, high performance devices, which have played well into the general Chinese population’s desire to own a smartphone and to access the internet for the first time. As China’s smartphone market started showing early signs of saturation in 2015, Xiaomi (and its competitors) is striving to innovate its business model and product offerings to become a true “internet company” instead of a pure “smartphone company”.

Chapter 4 starts the “internet plus” discussion with digital retailing. The online retailers have expanded so rapidly that the shopping malls, also a recent development in China,

have already had their business disrupted by the new technology. The traditional retailers need to move away from the perception that e-commerce is merely another sales channel for their products, as it is critical for customers to get the same products, services and shopping experience in every channel where they choose to make purchases. As illustrated by the Alibaba/Suning alliance and the JD/Yonghui investment, the mobile era retailers have to integrate their online and offline channels, instead of having separate systems to sell products online and offline.

Chapter 5 carries the digital retailing discussion into mobile e-commerce territory and the broader online-to-offline (O2O) service consumption. The growth in “experience” consumption, such as movie-going, dining out, taxi-hailing and so on, is at the core of the O2O trends in China. The future e-commerce model – if the term e-commerce still applies here – is likely to be a seamless platform that links customers across multiple screens of mobile devices, providing standardized products as well as specialized goods and experience offerings, and connecting online content with offline activities.

Chapter 6 explores the mobile entertainment sector, which is of strategic importance for the internet giants’ digital empires. This is because entertainment content and services are not only an important revenue source by themselves, but also a distinguishing factor that draws users to any specific e-commerce ecosystem and keeps them hooked. For a large part of their time online, young netizens play online games, watch videos of TV programs and movies, assume online personas in the virtual world and form online communities to have fun together. As smartphones are becoming the top channel for internet access in China, they enjoy themselves whenever and wherever they are during their “fragmented time” throughout the day (i.e. the time they spend online while outside of their homes).

It is important to note that “fragmented time” creates a different and additional demand for entertainment content. For

example, online novels can be read on mobile devices anywhere and anytime, which not only leads to a disruption of the physical book market, but also creates a different experience from traditional book reading (hence new readers). As such, the mobile internet provides a new avenue for marketing, advertising and brand building, with the biggest growth potential from people in smaller cities, who may not have PCs but are now engaging with online entertainment content using their smart devices.

Chapter 7 discusses the application of the O2O model in the movie business, which has added an online DNA to the traditional film industry. To meet the quest for high quality content, the tech giants are not only betting on set-top boxes (devices that provide contents over the internet and bypass traditional distribution) to convert TV and theater viewers to online viewing, but also creating their own blockbuster movies for the big screen at offline cinemas. The mobile internet has empowered young movie fans to get intimately involved with a movie, from the beginning to the end of a movie's life cycle. While traditional production companies face new competition, the industry has experienced soaring movie box office receipts thanks to the new social network, crowdfunding and big data. The so-called So-Lo-Mo trends ("Social-Local-Mobile") are bringing new challenges and opportunities for both Hollywood and Chinese movie studios in the digital age.

As one would expect, the internet giants have quickly evolved into media companies. The same has also happened in dining services, car-hailing and other sectors. Because every major firm's goal is to create a "closed loop" of its own, the companies are increasingly in competition with one another. As many players race to offer services at below cost to compete for users, the market is starting to have doubts about the sustainability of such businesses. In fact, internet firms are taking huge bets by spending heavily on subsidies because the repeat customers may not stay when the subsidies end. The cases addressed in this book will examine whether a profitable model will eventually arise in those markets.

Chapter 8 will examine the huge impact “internet plus” has on the traditional finance sector, most notably in commercial banking and asset management. The rising integration of internet and finance is closely linked to the two imperfections of the existing financial system and the potential solutions from the internet. One is the difficult access to credit by small and new businesses, because banks focus their attention on bigger and more established companies for their perceived lower credit risk. The other is the lack of investment channels for individuals, as the public stock market and real estate require large sums of investment capital and high levels of risk tolerance.

For instance, internet firms have offered short-term deposit products online that provide more convenience and liquidity, essentially making the financial system more efficient. Similar innovative products include crowdfunding for movie productions, where young people with limited disposable income can nevertheless make an investment and enjoy the experience of being a mini financier for film productions. In the P2P (peer-to-peer) lending area, China has surpassed the level in the US (where the model was first developed) to become the world’s largest market. The internet giants Alibaba and Tencent have set up internet-only banks, which can potentially provide microloans to individuals and small businesses more effectively than traditional banks due to their big data capabilities.

Chapter 9 will discuss the broad trend of major internet and tech companies in China moving beyond the saturated domestic market to compete on the global stage. Their presence has been felt abroad as they send their products and services overseas. For example, China’s smartphone brand ZTE has obtained a sizable market share and has a top three Android phone-maker ranking in the US market, only behind Samsung and LG. They also actively partner with or directly invest in foreign companies to accelerate their expanding reach. However, as will be seen in the examples in this chapter, it is not an easy task for a Chinese company to break into the US and other markets that are external to China.

Chapter 10 examines the opportunities and challenges that foreign firms are facing in the Chinese market, which they have to tackle in order to win the battle for global domination. For example, the San Francisco-based car-sharing app company Uber has been an undeniable hit in China, and its rapid growth in China so far may be the best performance by a US tech company in years. Going forward, the Chinese market is poised to be a trendsetter, rather than a trend-follower, in next-generation mobile devices and services. The story of China is rapidly transforming from the old “Made in China” to the new “Innovated in China”.

Acknowledgments

Compared to my previous book *Investing in China*, published in 2006, this book on China's internet-based "mobile economy" was a much more challenging project. For one thing, China's economic model had transformed from decades-long double-digit growth into a more sustainable growth model based on innovation and consumption. For another, the explosive growth of smartphone users, e-commerce and online content consumption and creation led to a digital revolution in almost all industries and business sectors.

A book on such a complex and fast-moving topic would not have been possible if I had not been blessed to be able to work with and learn from an amazing group of mentors in business, law and investments.

My deepest thanks go to Dr. Rita Hauser and Dr. Gus Hauser and the New York University (NYU) School of Law. My private equity investing, investment banking and practicing attorney experiences all started with the generous Hauser Scholarship in 1997. At the Hauser Global Law School program, I encountered a broad range of perspectives and viewpoints, which was the basis for my future career as a global professional working in the cross-border business world.

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