



# China: Internet Development

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## Summary

China's internet development and online service industries are experiencing incredible growth. By the end of June 2008, the number of netizens in China had reached 253 million, surpassing that in the United States to be first place in the world. Among them, the number of broadband users has reach 214 million, which also tops the world. The number of CN domain names was 12.18 million, becoming the largest country code Top-Level Domain names in the world. These three major breakthroughs show a big Internet power is taking shape.

Along with exponential growth in general demand, both accessibility (in terms of lower costs and increasing availability) and connection speed are growing dramatically, improving prospects for a broad range of internet-based products and services including telecommunications, online advertising, e-commerce, online gaming, information searching, and mobile internet services.

## Market Demand

Internet service hot spots in China have been broadly described by one executive as progressing from comprehensive portals, to highly interactive telecommunications and entertainment, to search and e-commerce. In fact, the government recognizes this trend as well, and has included e-commerce development in its 11<sup>th</sup> Five-Year Plan of 2007. But while top-down investment and accommodation will contribute to future growth, advantage in the Chinese internet industry will derive from players who are capable of adapting to local market preferences among several service-based industries.

The composition of existing and potential demand falls within three broad categories of services, online entertainment, media, and e-commerce. Online entertainment and media has dominated the internet with conventional user habits, emphasizing discursive information searching, various telecommunications services, video watching and online gaming. Online advertising and gaming, especially, have been the thrust of most successful internet businesses, currently accounting for more than 80% of the internet industry's revenue, according to one internet company executive in China. On the other hand, significant development remains to be seen in e-commerce. Demand is only increasing for the infrastructure that not only supports e-commerce but also encourages its expansion, such as payment systems, user technological literacy, and transport logistics.

## Market Data

The Chinese government-run China Internet Network Information Center (CNNIC) released the most recent [Statistical Survey Report on the Internet Development in China](#). It is the most reliable and comprehensive source of statistical information on China's internet development.

The following chart is drawn from CNNIC's most recent survey about internet application and users' scale in China.

### Internet Application and Users' Scale

Internet Application		Percentage	Number of Users (million)
Internet Basic Application	Search Engine	69.2%	175.08
	E-mail	62.6%	158.38
	Instant Message	77.2%	195.36

<b>Network Media</b>	Network News	81.5%	206.20
	Blogs	42.3%	107.06
	Updated blogs	28.0%	70.92
<b>Digital Entertainment</b>	Network Gaming	58.3%	147.46
	Network Music	84.5%	213.66
	Network Video	71.0%	179.63
<b>E-commerce</b>	Online Shopping	25.0%	63.29
	Online Payment	22.5%	56.97
<b>Network Society</b>	BBS visits	38.8%	98.22
	BBS posts	23.4%	59.31
<b>Others</b>	Online Banking	23.4%	59.31
	Online Stock/fund Transaction	16.9%	42.88
	Online Job Seeking	14.9%	37.75
	Online Education	18.5%	46.69

The top three online services in China are online music, online news and instant messaging through online chat programs. In the first half of the year, 84.5 percent, 81.5 percent and 77.2 percent of Chinese Internet users used such services, respectively.

### Best Prospects

China has had 253 million netizens, ranking first in the world. Even so, China's Internet user base will continue growing due to its huge population and the rapid pace of economic growth. China's Internet users currently account for just one-fifth of its population, so there is much potential for growth. It also means potential for overseas companies hoping to get involved in China's Internet industry.

Basic services like search engines will still be popular in the next few years. The industry could gain users who are unfamiliar with more advanced services. Other opportunities for American companies exist in several service sectors of the internet industry including online advertising, search and e-commerce, mobile internet services, and online gaming.

### ONLINE ADVERTISING

According to the CNNIC survey, China's online advertising market grew from less than US\$20 million in 2000 to US\$900 million in 2006 and is expected to approach US\$1.5 billion this year, an increase of 66% since 2006. About 60% online advertise revenue was generated from picture advertisements, 20% from authorized agents like Baidu, and 5% from flash. Internet companies normally do not advertise on TV due to price.

Although Internet users only account for 19% of China's total population at present, up to 40% of residents in affluent cities access the internet, suggesting a wide section of the market that is consumer-oriented. Yet, according to one analyst, China's advertising revenue is far disproportionate to the attention given by internet users. Revenue from online advertising amounts to less than 5% of China's advertising market at present. As search functions becomes more popular, online advertising will most likely grow in pace.

### E-COMMERCE AND SEARCH

E-commerce applications in the Chinese internet market have yet to mature. China's retail e-commerce sales for 2007 totaled about US\$626 million, according to Analysys International. The recent CNNIC survey states that only about one-fourth of Chinese internet users have shopped online, and most of such transactions are consumer-to-consumer (C2C) driven.

The C2C market in China has been effectively monopolized by Taobao.com, an Alibaba.com Corporation subsidiary that has many services similar to eBay. Alibaba, moreover, is responsible for the majority of buyer-to-

buyer (B2B) internet transactions. Alibaba Group aims to make Taobao.com the world's biggest retailer and has planned to invest RMB 2 billion (USD 291.64 million) in the Web site over the next five years. Jack Ma, founder of Alibaba Group, said he hopes Taobao will surpass eBay and Amazon in global revenue within five years, and surpass Wal-Mart within 10 years.

According to the CEO of Baidu, Robin Li, e-commerce will see further growth in tandem with search engine use. iResearch data, which tracks visitor counts of search engines in China, during the first three months of this year puts Baidu at capturing 66.7% of the market share, followed by Google and Yahoo who together account for 24% of market share. Baidu, like its American equivalents, does not have specific focus upon e-commerce and is seen more as a facilitator of e-commerce.

## MOBILE

Similar to the internet's sheer volume, China has the world's largest mobile phone market with over half a billion subscribers. The mobile phone internet services market has great potential for further growth. Although third generation (3G) technology has yet to be fully implemented for convenient mobile phone access to the internet, current connection speed limitations have not stopped a steady growth in mobile phone internet surfing. Out of an approximate 400 million mobile phone subscribers in China, 50.4 million netizens have used mobile phones to access the internet, amounting to 12.6% of mobile phone subscribers.

Equally promising as general market expansion, mobile payments (m-payments) seek to bridge the wide gap between conventional consumer payment habits and e-commerce business models. This payment method is especially attractive to e-commerce business in light of the lack of a developed credit market. Online payment systems and solutions capable of circumventing the need for credit - or cash, for that matter - have great potential.

## GAMING

Online gaming is more developed in China than in the United States and European countries. The number of online gamers in China rose 23% to 40.17 million in 2007, according to a recent industry survey. Regular subscribers comprised 22.36 million of the total, up 30% from 2006. Moreover, sales of online games in China topped 10.57 billion RMB (about US\$1.45 billion) last year, up 61.5%. Industry analysts estimate that China's online gaming population will hit 84.56 million by 2012, with regular subscribers totaling 50 million and sales of 26.23 billion RMB. As such, the potential for online gaming products is undeniable.

In addition to relatively matured markets in urban areas, internet growth in the rural area would be another trend to be watched. The Chinese government has launched a campaign to equip all rural areas with internet access. At present, Guangdong province has taken the lead in this regard. In Guangdong province the hardware equipment has been put into place. Foreign companies with experience in running agriculture-related websites are encouraged to help improve management of Chinese rural websites.

## Key Suppliers

Major comprehensive portals:

- [www.qq.com](http://www.qq.com) (Tencent Inc.)
- [www.sina.com](http://www.sina.com) (Stone Rich Sight Information Technology Co., Ltd.)
- [www.sohu.com](http://www.sohu.com)
- [www.163.com](http://www.163.com) (Netease.com Inc.)

Major search engine websites:

- [www.baidu.com](http://www.baidu.com)
- [www.google.com](http://www.google.com)

Top online shopping websites:

- [www.alibaba.com](http://www.alibaba.com) (China's largest online business-to-business service operator)
- [www.taobao.com](http://www.taobao.com) (China's largest online customer-to-customer service operator, affiliated to Alibab.com Corporation)
- [www.joyo.com](http://www.joyo.com) (American online shopping giant Amazon's Chinese e-commerce website)
- [www.dangdang.com](http://www.dangdang.com)

Major online game operators:

- Shanda [www.snda.com](http://www.snda.com)
- Giant Interactive Group (being listed at New York Stock Exchange on Nov. 1, 2007)
- Netease.com Inc. [www.163.com](http://www.163.com)
- Tencent Inc. [www.qq.com](http://www.qq.com)

Major recruitment websites:

- [www.51job.com](http://www.51job.com) (Nasdaq-listed)
- [www.zhaopin.com](http://www.zhaopin.com)

## Prospective Buyers

Young people are the main users of the Internet in China. Among all internet users in China, 68.6% of them are below the age of 30. It has presented huge opportunities for online entertainment and online shopping. According to CNNIC's recent survey, online shopping in the first half of 2008 reached RMB 16.2 billion in 15 major cities in China. About 25 percent of Internet users in China engaged in online shopping during the January to June period. The percentage is significantly lower than other countries that have a high number of Internet users, such as the United States.

Alibaba Group founder Jack Ma anticipates that China's Internet users would be over 600 million in the near future, and he hoped by then there would be 100 million to 200 million shoppers on Taobao.com.

It is estimated that the growth of e-commerce would be phenomenal, given that the infrastructure will be in place, a better understanding of technology, improved logistics, ease of online payments, and improved trust between buyers and sellers.

Besides the C2C market, the B2B market is also undergoing a new change. Alibaba.com, China's largest B2B service operator, has also started a new service designed to help foreign enterprises sell products in China. The service, called Export-to-China, aims to help foreign enterprises, especially small- and medium-size enterprises, reach Chinese buyers.

## Market Entry Strategies

Like other industries, entering the Chinese internet market and its service industries requires, first and foremost, a Chinese partner. This is necessary not only for legal reasons pertaining to the presence of foreign enterprises in

China, but also for practical considerations regarding relations with governmental authorities. Foreign internet companies are advised to find a local partner to not only explore the market, but also go through procedures for market entry such as domain name registration, internet permit license, and company registration.

For example, Northgate Technologies, an Indian e-commerce and online advertisement solutions provider, has formed partnerships with several leading Chinese search and advertising companies. In their agreement, a wholly-owned subsidiary of Northgate Technologies has formed partnerships with Chinese advertising giants Baidu, Alimama and Allyes, according to a recent press release. Such companies will provide advertising platforms for Northgate's products at several of its subsidiary websites. Partnerships of this sort will be essential to American companies seeking to strengthen their profiles in China.

Service support is another concern to be addressed. Foreign internet companies sometimes fail to address the issue of response efficiency. There have been examples of foreign internet companies that chose to place servers in their home country, resulting in unsatisfactory market penetration due to slow response to China market demand.

### **Market Access Issues & Obstacles**

To cope with the rapid development of the internet industry, the Chinese government has started to issue new regulations to oversee the Internet market.

#### **Online video license:**

On Dec. 29, 2007, the State Administration of Radio, Film and Television (SARFT) and the former Ministry of Information Industry jointly issued regulations for online video content. The regulations state that Web sites must obtain a license from SARFT in order to provide online video services. After Jan. 1, 2008, only Web sites that are at least partially state-owned can apply for such licenses. In June 2008, three privately owned web sites have received such licenses to operate video services. They are UUSee.com, Ku6.com and 6.cn. At present, there are about 10 such licenses issued in China.

#### **Business licenses for Online Stores**

On July 3, 2008, the Beijing Administration for Industry and Commerce (Beijing AIC) announced that online stores operated by individuals in Beijing must hold business licenses from August 1 of this year. The regulation stipulates that e-commerce service providers, such as e-commerce trading platforms and online shopping centers, will be held responsible for checking sellers' license details, archiving trading records for at least 2 years, and employing adequate staff to handle consumer complaints. In addition to Beijing, other regions in China also plan to issue similar regulation. The Minister of the State Administration for Industry and Commerce said recently that provincial bureaus should prepare for the implantation of regulations that require online stores operated by individuals to hold a business license.

### **Trade Events**

China International Software& Information Service Fair  
June 18-22, 2008  
Dalian  
<http://www.cisis.com.cn>

China Hi-tech Fair  
October 12-17, 2008  
Shenzhen  
<http://www.chtf.com/english/>

Chinajoy

July 17-19, 2008  
Shanghai  
<http://www.chinajoy.net/>

## References & Key Contacts

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<http://www.cnnic.net.cn>

Ministry of Industry and Information Technology (MII)  
13 West Changan Avenue, Beijing 100804, China  
Tel: (86-10) 6820-8212  
Website: <http://www.mii.gov.cn>

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Website: <http://www.sarft.gov.cn/>

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