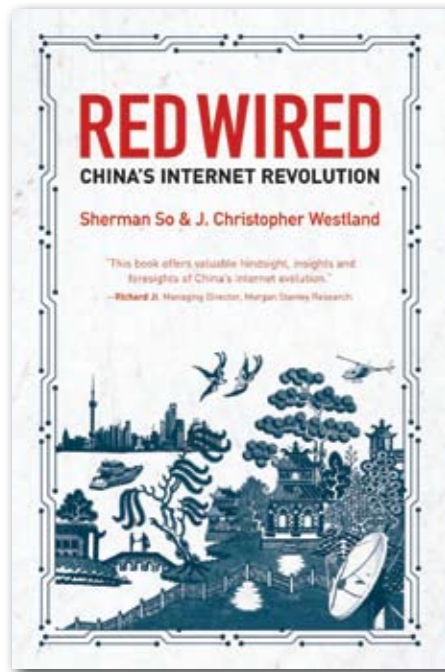


Internet development: China's conundrum

Hong Kong journo co-author's first-hand account of China's cyberscape



Editor's note: This article is adapted from the book, "Red Wired: China's Internet Revolution" (www.redwiredrevolution.com). The book, written by Sherman So and J. Christopher Westland, and published by Marshall Cavendish, is the first to comprehensively survey the nature of China's Internet from first-hand interviews with the entrepreneurs and visionaries who forged China's Internet markets

In October 2009, the market value of the largest Chinese Internet company—Tencent, at US\$31 billion—had surpassed that of Yahoo (\$24 billion) and was rapidly approaching that of eBay (\$32 billion). Many Chinese Internet entrepreneurs have expanded from their niche markets to become major players in the industry. But how did this rag-tag band of entrepreneurs grow so successful?

Surprisingly, because the Chinese government—long characterized as an overbearing, doctrinaire monolith—actually took a step back when the Internet took off in 1995. Of course, it expressed concerns about politically sensitive news and discourse, which at times led to blatant censorship. But when it comes to commercially important issues, the government knows when to get out of the way.

Selective regulation

"While regulating the Internet is important, government's role is also to provide a healthy environment for the industry to grow," said Kou Xiaowei, a deputy director of the General Administration of Press and Publication (GAPP). Compared to other industrial sectors in China, the Internet is handled with kid gloves. In telecoms and heavy industry, government entities are both regulators and players through state-owned enter-

prises—China's Internet sector has more freedom, is more dynamic and successful.

All the major Internet players in China are private companies, many of which are listed on foreign stock exchanges. Major companies such as Sina, Ctrip, Baidu, Shanda, Alibaba, Tencent received their original investment through venture capitalists, ultimately going public on either the NASDAQ or Hong Kong stock exchanges.

"There were no incumbent state-owned enterprises in the Internet industry," said Kou. "Besides, the nature of Internet business is risky, [making it] less suitable for state-owned enterprises to operate. Private companies, together with venture capital investment, are perhaps more suitable."

Deng's timely reforms

Deng Xiaoping completed his "Southern Tour" of China's most successful cities in 1992, kicking off the country's economic boom. Deng's apocryphal phrase, "To get rich is glorious," took the public's fancy and kicked off a wave of entrepreneurship. Most impressive, though, is the awareness and understanding of America's Internet innovations that many of these Chinese entrepreneurs demonstrated.

During the 1990s, the government felt that the Internet was too small to be a

threat—according to researcher CNNIC, less than one percent of China's population was online in 1999—and took a hands-off approach that the tightly controlled media sector envied. Government bureaucrats saw the Internet more as a technological innovation.

The government body most involved at that time was the Ministry of Information Industry (MII), which oversaw the development of the country's telecoms infrastructure. MII saw the Internet as another way of increasing China's telecoms usage, and thus its own revenues.

Imported skills, unfettered ambition

With no state-owned enterprises as competitors, little direct government control, and relatively low barriers to entry, Chinese Internet entrepreneurs flourished. They had access to Silicon Valley's capital and know-how, as many of the entrepreneurs were returnees from overseas.

People like Baidu's Robin Li, Sohu's Charles Zhang, and Ctrip's James Liang had been valuable members of the American engineering community before they returned to China. It was a new, Darwinian world where only the fittest survived. The result was a burgeoning Chinese Internet market with a bevy of competing services.

The strongest players, with the most creative ideas and best overall performance, eventually dominated their individual sectors—Baidu for search engines, Taobao for online auction, Tencent for online chat, and Sina for online portals. In fact, today these companies are so strong that they have beaten their Western rivals—Google, eBay, Yahoo, and so on—in the battle for Chinese online consumer loyalty.

China's Internet is no longer a niche market. Over 25 percent of the population is online, according to CNNIC, and

the numbers are increasing faster than anywhere else in the world. This is a mixed blessing, as the Internet has now "come to the attention of the authorities." China's government has recognized the Internet as a powerful media force, and something to be controlled. Regulation is no longer solely the domain of the business and technology friendly MII, which recently changed its name to the Ministry of Industry and Information Technology (MIIT). New, hard-line regulators are entering the fray, including the State Administration of Radio, Film, and Television (SARFT). SARFT traditionally regulated China's TV stations and cares more about policy and political agenda than promoting Internet use.

Video effect

The change was most apparent in the licensing of video-sharing sites in 2008. SARFT initially required all video-sharing sites to be government owned. Though strong protests from the industry forced it to cancel this strict requirement, a frustrating litany of requirements needed to be met before licenses were issued. SARFT even made an example of one of the major players, to show that it meant business. 56.com, the third most popular video-sharing site at the time, was suspended for a month in June 2008 before eventually getting its license. The effects were devastating—56.com lost its popularity and ceased to be a major player.

Kou, however, does not think that the government's role in the Internet business has changed fundamentally. "As Internet services develop and mature, the government can implement more detailed rules to regulate different Internet businesses," he said. That's what happened: for example, the government launched regulations for online news, for online publications, and in 2008 came SARFT's new rules on video-sharing sites."

Rules and regs

Kou believes more regulation will emerge in the next two to three years. "The Internet is like a double-edged sword. There is no doubt its development will benefit society and the people. But, without proper control, it can also have a negative impact."

The current regulatory environment reflects China's consternation over exactly how much control is healthy in an industry. Over-controlling it would kill the creativity that has generated so much wealth, employment, and innovation. Under-controlling it allows media and technology to be used in acts that are harmful to society and to the government. The challenge facing the government is how far it can balance its urge to control the Web, while keeping entrepreneurial spirits flourishing.

"Ultimately, the government does not want to kill the Internet industry," said Kou. "We just try to rule out what is deemed improper."

Author bio



Sherman So is a journalist and was previously the lead China technology reporter for the *South China Morning Post*. Her work allowed her

to witness the rise of China's Internet sector first-hand and to talk to many of the entrepreneurs and industry experts. She graduated at the University of Hong Kong before earning a MBA at Hong Kong University of Science and Technology.

J. Christopher Westland is a professor at the University of Illinois, with extensive professional experience as an information technology, innovation and financial consultant in the US, Europe, Latin America and Asia.