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The Internet in China – cutting through the hype

The expansion of the Internet and the evolution of e-business are progressing at a rapid pace in the U.S. In Asia, some countries like Japan, Singapore and Hong Kong although left at the starting gate during the initial days are now moving quickly to catch up. Figures about internet growth in Asia are often deceiving to the uninitiated because they lump all the Asian countries together and don't point out the different rates of growth in different countries and the widely varying distribution of computers and internet access across each country as a whole. Nowhere is this more true than in China where oftentimes totally unsubstantiated figures about computer sales and internet access are served up with what boils down to a lot of hype about the whole move to widespread internet access and e-business.

The first question one needs to ask in looking at Internet access in China is first how many people have access to the Internet and is this access growing and how rapidly. A study recently published by the China Internet Information Center (CIIC) which was based on a survey of China based websites conducted over a 15 day period and which contains a relatively high number of responses that would seem to bolster its credibility, gives the following figures on China's internet usage:

Total responses 66,283
Total valid responses 52,549

Analysis:

Total usage of the Internet in China: 1.46 million computers of those:
0.25m dedicated-line computers
1.21m dial-in line computers
Internet usage in China – four million
0.76m dedicated-line users
2.56m dial in users
0.86m that use both
Total number of “com.cn”-28,0456
Total number of Websites in China –9,906
Total International Bandwidth 241 MB

User Breakdown:

Most common user:
Male – 85%
21-30 yrs – 67%

Unmarried – 63%

College or higher education 75%

Average Income – Yuan 500-2,000 (exchange rate \$1 =8.27 Yuan) per month

Internet access categories:

1. News 84%
2. Computer related product information (next highest category)

Most visited websites in China:

1. New Wave
2. Soho
3. Capital Online

The estimate as to total internet usage of four million is confirmed by four other estimates of 1999 Internet users in China by IDC Asia Pacific, the China Internet Network Information Center, Goldman Sachs, and BDA China which estimated internet-users at 3.8, 4, 3.8 and 6.7 million respectively. The one caveat on all these numbers, however, is that all of the pollsters would point out, if you could talk with them, that there are many caveats on these statistics and caution is warranted. They note, China is such a big market and poll methodology used by the various companies generally only relies on polls taken in the larger cities and then extrapolated for the country. This means that the figures are not as precise as they first appear. Further they point out the fact that at least at the current time, China to a large extent represents a series of markets, not one giant well integrated structure.

The figures from the China Internet Information Center, however, of the typical internet user in China being young, generally unmarried, college educated and predominantly at least at the present time male, does seem to be substantiated from what little survey data exists on demographics at this point.

Thus we are looking at an Internet population of about four million in a country of 1.25 billion people. On a percentage basis usage therefore remains much less than in the west and figures the reader may have heard of a vast Internet are largely hype. Growth though is rapid. IDC Asia-Pacific again estimates that total computer sales in China will exceed 4.5 million units in 1999 and over six million units in 2000. Low-priced PCs, particularly those made in China by companies such as China's Great Wall Computer company that sell for just under \$600 are expected to top 800,000 of the total computers sold this year. This figure is up 80% from a year earlier during a period when total computer sales increased what would be an impressive 30% if it were not compared to the torrid growth in the low priced models. These units which are being marketed as aids to help Chinese students improve their studies could well increase even more rapidly given Chinese extended family pampering of the more limited offspring brought about by China's one child family planning policies.

Even with these growth figures, however, future projections for growth of the Internet in China seem too optimistic. The Yankee Group, a U.S. information technology research firm, has stated in a recent report that China is expected to surpass the United States in its Internet users by 2005 to become the largest Internet market in the world. The Yankee Group report goes on to say that China will be the largest nation in terms of Internet users in the Asia-Pacific region by the year 2001 with about 40 million users. As can be seen from the previous numbers, this projection seems off the mark and widely higher than what other sources report. It is representative of the often overly optimistic figures that are often touted and that can be critical stumbling blocks for

the unwary.

Despite the fact that the Internet in China is not as large as some of the hype might suggest and despite the fact that it probably won't exceed the size of the Internet in the U.S. anytime soon, it is clear that it is developing rapidly and will soon be a very large market. Servicing this market is currently what Embassy and other knowledgeable sources claim are about 3,000 Internet Services Providers (ISPs) mostly based in large cities such as Beijing, Shanghai, Guangzhou, Tianjin, Xiamen, etc. China Telecom (the State Telecom Company) is the largest Internet provider, followed by China United Telecommunications Corporation (China Unicom – essentially the designated number two) which says it will be providing Internet service in 100 cities by year's end. 263.net and gznet.com, both of which are run by Guangzhou Favour Telecom Co. and Shanghai Online which is run by the Shanghai city government all control large shares of the ISP market in China. Currently it appears that the major Internet companies are with central governments blessing trying to reduce their service price to drive the smaller firms out of the market. Minister Wu Jichuan, Minister of Information Industry, has said that China only needs a dozen or so ISPs and that the government favors a shakeout of the smaller players. Reducing the number of ISPs down to only a dozen is definitely not what China needs in order to spread the internet but this shows some of the forces in the government that still make internet growth more of a challenge than it might be in other Asian nations.

China does not only have a fairly significant number of internet providers, it also has an increasing number of small Chinese grown entrepreneurs who are trying to do for the internet in China what companies such as e-bay, travelocity, etc. have done in the U.S. These often-foreign educated young risk-takers are developing a host of new sites and using them to entice local and foreign investors to help build their vision. Examples of Hong Kong based startups are China.com Corp. which operates bilingual websites focused on China, Taiwan and Hong Kong, which on July 12 raised \$84 million through a public offering on the Nasdaq. Another less well capitalized but rapidly growing Hong Kong based Internet Content Provider (ICP) is China Infobank. Examples of Beijing based entrepreneurs trying to do the same are Chales Zhang, head of ITC, a MIT educated entrepreneur who has secured Intel, IDC and other funds to back his Sogu site and Edward Zeng (no relation) whose company sparkice.com was recently reported in the International Herald Tribune to be considering an initial public offering on the Neuer Markt, the German exchange for high-growth companies created in early 1997.

All of these companies were flying high a month ago but all are keeping a lower profile after Minister of Information Industry Wu Jichuan, announced that companies involved in the Internet in China are off-limits to foreign investors, even though many already accepted foreign capital. This statement some have seen as a bargaining ploy in the talks with the U.S. over a WTO agreement but others are more skeptical that this is more a move by Wu to get out front on this issue to set central government policy. Whatever the motive, it has had a cooling effect on Internet investment in China. The Wall Street Journal reports that following the announcement Eachnet.com, a Shanghai company which holds electronic auctions and had received over \$1 million in venture capital to this time and was hoping for more had to withdraw its request. The article goes on to report that major internet venture capital firms specializing in Asia were taking a wait and see attitude on future investments and that this was likely to retard growth at many websites in China that were looking for foreign investment.

A further look at the pitfalls Chinese Internet companies must navigate is that all Chinese companies are required to have a government issued business license that authorizes them to engage in a specific business. There is currently no listing for Internet Content Provider, so no

Chinese company has a valid license for this. Sparkice.com has a license to operate a chain of Internet cafes (They currently have 15) but currently not one to serve as an ISP or ICP. No company in China has a valid license to advertise on the Internet although several are in fact advertising. Examples of situations such as this where the law and the government are lagging the development in business and society are common in China. Many of these risk takers may in fact be big winners if they have the right contacts are can get their license changed at a later date when the new category is recognized. The danger, however, is that less well connected companies or those who become too visible often are punished by closure or other penalties which can make investment capital disappear without little warning or recourse. The old saying – buyer beware – therefore has particular relevance in these cases.

As hopefully I have conveyed above, the Internet in China is in a state of flux. It is small by some western standards in terms of the percentage of the total countries population on-line but growing rapidly in total numbers. It is going through many of the changes with Internet Service Providers (ISPs) and with cost that are happening in the west and throughout the rest of Asia. It is an entrepreneurial environment just like that found in other countries both in Asia and the West. It is an environment that takes nerves and offers big returns but also possible catastrophic losses. In any case, however, it is a market that cannot and should not be ignored because the opportunities are large for both sides.

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Until April of 1999, Mr. Runckel was Minister-Counselor of the US Embassy in Beijing, China. Mr. Runckel lived and worked in Thailand for over six years. He was the first permanently assigned U.S. diplomat to return to Vietnam after the Vietnam War. In 1997, he was awarded the U.S. Department of States highest award for service, the Distinguished Honor Award, for his contribution to improving U.S.-Vietnam relations. Mr. Runckel is one of only two non-Ambassadors to receive this award in the 200-year history of the U.S. diplomatic service.

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