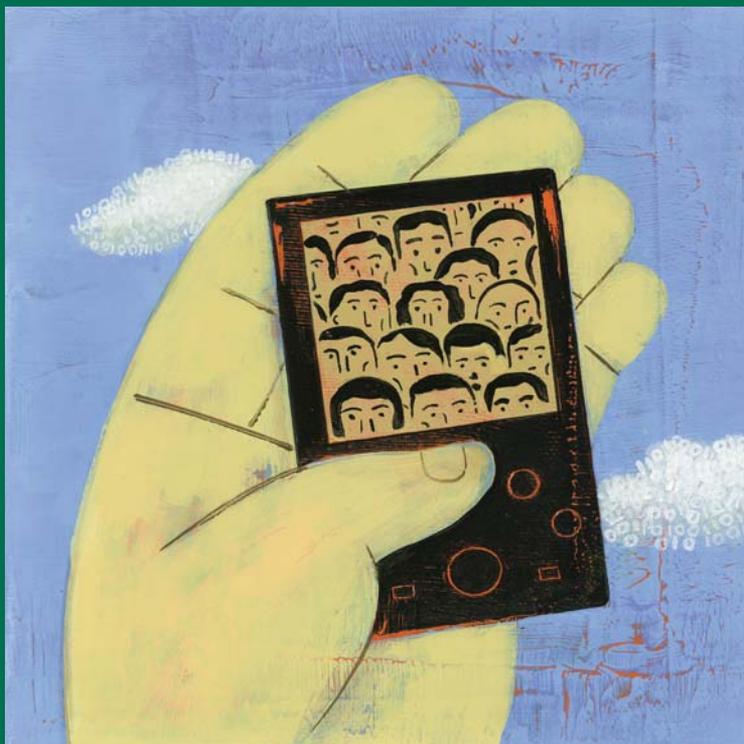


REPORT

China's Digital Generations 2.0

Digital Media and Commerce Go Mainstream



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Digital Media and Commerce Go Mainstream

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May 2010

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Executive Summary

Digital technology has fundamentally changed the way Chinese people live—how they read news, shop, travel, play games, watch movies, express themselves, and relate to others. As this trend gains momentum, understanding the online impulses of these digital consumers has become a crucial—and increasingly urgent—prerequisite for engaging them. A comparison of Chinese Internet consumption to that in other economies, notably Brazil, Russia, India, and Indonesia but also the United States and Japan, reveals that Chinese people use the Internet for entertainment and communication to a much greater degree. They are also shifting a large share of their commercial activity online, including shopping, product research, ad viewing, and the purchase of value-added services such as customizing a personal blog.

But China's Internet growth story is increasingly a tale of two markets. For example, Feng, 26, lives in Beijing and is typical of the generation of young professionals populating China's urban centers. He earns about \$9,000 annually, enough to rent his own apartment, and has an impressive digital inventory: a Western-brand laptop PC, a digital camera, a mobile phone, and an MP3 player. Along with his PC at work, these devices keep Feng online for nearly every minute of his day. There are already tens of millions of people like Feng in China, and we can expect there to be hundreds of millions more in the coming years.

Still, the next wave of Internet users will come from China's hundreds of millions of rural residents. We are already seeing sophisticated Internet habits from younger rural users—like Chao, an 18-year-old only child in his last year of high school in the province that borders Siberia, whose family has an annual household income of just \$4,000. Chao finds ways to stay connected, even though his parents are too poor to buy a PC and his mobile phone is hardly top-of-the-line. Chao uses his

mobile phone to send instant messages to friends online, and heads to the local Internet café in his spare time. He spends half of his \$40 monthly allowance on digital communication and entertainment.

By and large, the same companies meet both Feng's and Chao's online needs. The last three years have seen leaders in digital-services sectors emerge—and dominate. Chinese companies like Tencent and Alibaba.com have pulled away from the pack, transforming themselves from microcaps to billion-dollar companies in the process. The success stories of China's digital giants add a crucial dimension to the key trends in online consumer behavior, including the rise of e-commerce, social-networking sites, online advertising, and mobile-Internet use.

Companies that aim to engage Chinese consumers will need to understand Feng and Chao—and everyone in between. By delving into the digital lives of a sample of Chinese consumers, we hope to allow their personalities, habits, needs, and aspirations tell the story of this dynamic and complex market—and encourage companies to serve it.

In the last three years, China's digital generations have undergone a dramatic transformation, with rapid adoption of digital devices and the Internet across different city tiers and in rural areas. Yet there is still significant room for growth as the Internet penetrates further into China's less-developed regions.

- ◇ China's Internet user base reached 384 million in 2009, more than in the U.S. and Japan combined. That number is expected to be more than 650 million by 2015.
- ◇ Internet penetration is forecast to increase from its current 29 percent to nearly 50 percent by 2015—and

to reach almost 40 percent of China's vast rural population.

- ◇ The market in China for online content and aggregation will grow from \$14 billion in 2008 to \$40 billion in 2012, at which point it will represent 20 percent of China's \$200 billion digital market overall (which includes online content and aggregation, Internet distribution, and devices).

Not only are more Chinese people using the Internet but they also use the Internet more than do consumers in the major emerging markets of Brazil, Russia, India, and Indonesia—which, together with China, form what we call the BRICI countries. A forthcoming BCG report will explore Internet trends across all of the BRICI markets.

- ◇ Digital devices and the Internet are moving to center stage in the lives of China's digital consumers, with total time spent online averaging 2.7 hours a day in 2009.
- ◇ This usage rate is the highest among all the BRICI countries and averages 0.4 hours a day more than the average rate in the United States.
- ◇ As a country, China spent more than 1 billion hours online per day in 2009—double the daily total in the United States. This number will grow to well over 2 billion hours per day by 2015.

Social, historical, and economic factors have shaped a unique set of needs and behaviors among Chinese digital consumers compared with the other BRICI economies.

- ◇ The most prominent themes are that far more Chinese people use the Internet to communicate and seek entertainment than in the other BRICI markets.
- ◇ For instance, more than 80 percent of Chinese digital consumers use instant messaging (IM), read news online, and stream or download music via the Internet. Three-quarters stream video content, and more than 50 percent use search engines and play games online.

The majority of China's digital consumption comes from those aged 35 and under, who make up 73 per-

cent of China's total online population and account for more than 80 percent of China's online hours. Different user segments demonstrate different online behaviors and needs.

- ◇ Young professionals, who represent 6 percent of all Internet users, have a remarkable 99 percent penetration. They also have the heaviest Internet use, averaging 4.0 hours a day online.
- ◇ Young gamers, who make up 21 percent of all Internet users, average 3.2 hours a day online, mainly on IM and playing online games.

One of the most significant changes in online behavior in China since 2007 is the embrace of e-commerce, best exemplified by the growth of Taobao, a consumer-to-consumer site owned by Alibaba Group.

- ◇ Some 8 percent of the Chinese population shopped online in 2009, compared with just 3 percent in 2006. E-commerce adoption is estimated to jump to 19 percent of the Chinese population by 2012.
- ◇ An additional 8 percent of Chinese Internet users conduct product research on e-commerce sites, even though they are still unwilling to actually purchase online—suggesting that besides hosting transactions, e-commerce platforms have emerged as important clearinghouses for product information and prices.
- ◇ In the past, concerns about a lack of both buyer-seller trust and reliable payment mechanisms generated skepticism about China's e-commerce potential. The current pace of growth shows how outdated these notions are becoming.
- ◇ The value of business-to-consumer and consumer-to-consumer online transactions was \$37 billion in 2009 and is projected to surpass \$100 billion in 2012.

In 2008, social-networking sites boomed in China among university students and young professionals, and by 2009 Chinese Internet users of all backgrounds and age groups were active in their use.

- ◇ The total number of Chinese users of social-networking sites reached 130 million in 2009.

- ◇ In 2009, “Happy Farm” platforms caused a nationwide sensation, introducing social-networking sites to digital consumers outside of the young professional and university student populations, which had been the predominant users in the past.

As consumption of online news and other portal-based information continues to climb, so too has the growth potential of China’s online advertising market.

- ◇ Online advertising is taking share from magazines, newspapers, and TV, and will hit a projected 20 percent of total advertising in 2012, up from 8 percent in 2008.
- ◇ The online ad market in China is expected to reach \$8.6 billion in 2012.

The rise of the digital giants—which have transformed themselves from startups to multibillion-dollar companies—helps explain how monetizing Chinese consumer behavior can work.

- ◇ The most successful local companies outperformed multinationals in every category of the Internet industry in China, driven by a deep understanding of Chinese consumers and by innovative approaches to meeting their needs.
- ◇ Important examples are Tencent (with a market capitalization of \$38 billion), Baidu (\$24 billion), Alibaba.com (\$10 billion), Ctrip.com International (\$5 billion), and Sina (\$2 billion), among others.

Any company committed to engaging Chinese consumers will need to grasp the trends and implications of the country’s Internet-usage patterns.

- ◇ Understanding the underlying needs and tastes of the different segments of Chinese digital consumers is vital to crafting an effective approach to communicating with them.
- ◇ However well established they may currently be, consumption trends such as e-commerce, online advertising, and social-networking sites are far from realizing their potential.
- ◇ Many consumer-oriented multinationals in China are operating under outdated assumptions regarding Chinese consumers’ media and shopping behaviors. These companies are at grave risk of losing touch with one of the world’s most important growth markets.
- ◇ It is imperative to act fast, because the shift toward digital media and commerce has already become mainstream—and is gaining momentum at a tremendous rate.

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China's Digital Landscape

China currently has 384 million Internet users—more than the United States and Japan combined. This number, however, represents only 29 percent of the population, indicating how much room there is for growth. The main pathway to the Internet at present is through PC connections—and although only an estimated 20 percent of the population own PCs, many tens of millions more are able to access the Internet at Internet cafés, in workplaces, or through PCs that are shared by a household. Meanwhile, 769 million people, or 57 percent of the population, own mobile phones, although mobile-broadband Internet use is only now beginning to see large-scale adoption.

A look at the activities of China's many types of digital consumers shows the range of conveniences introduced by PC ownership and an Internet connection. Shopping for the best bargain, streaming NBA games at any hour, downloading a newly released movie, checking homework with friends—all of these activities have become mainstream online behaviors as China's PC-based Internet platforms and technology have developed. But the implications extend beyond PC ownership alone—digital consumers who rely on Internet cafés for a connection also use the platforms made popular by the more casually active PC owners. And as mobile-broadband Internet develops, early adopters will transfer PC-based Internet-usage habits to their mobile devices.

For many Chinese digital consumers, then, Internet use is now a fixture in their daily lives. Chinese Internet users, defined as those who go online at least once a month, spend an average of 2.7 hours a day online, up from 2.4 hours a day in 2006—and 0.4 hours a day more than U.S. users. (See Exhibit 1.) This means that China has the

most-active digital users of what we call the BRICI countries (Brazil, Russia, India, China, and Indonesia). As a country, China spent more than 1 billion hours online per day in 2009—double the amount in the United States. This number will grow to well over 2 billion by 2015.

Rural Markets: The Next Wave of Growth

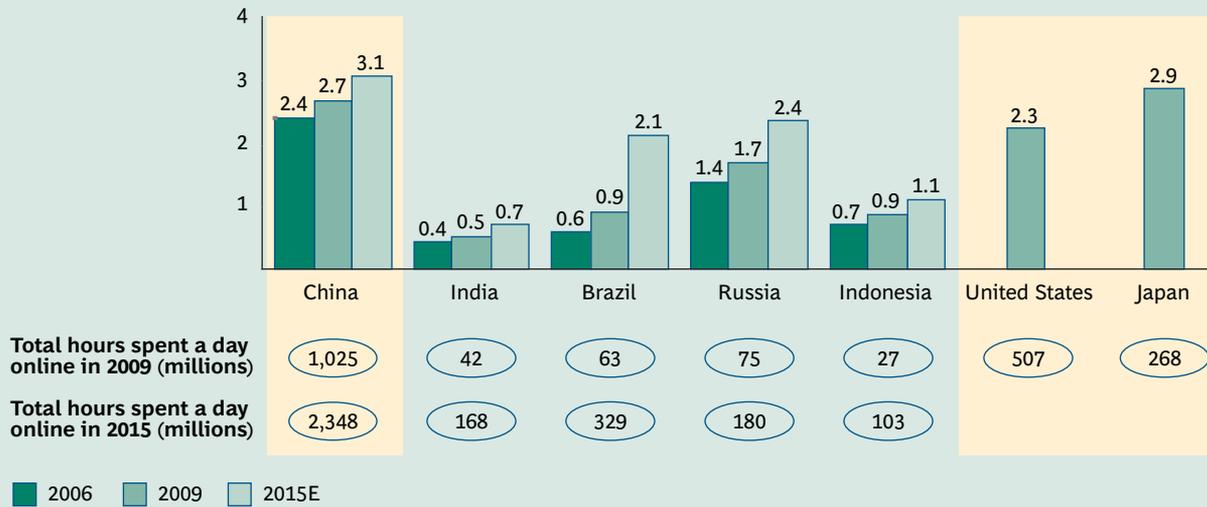
Internet penetration in China is expected to nearly double by 2015 to more than 650 million users—but this will still be less than 50 percent of the total population. Much of the remaining growth will come from rural China. The government has been stepping up its efforts to connect rural areas as a means of stimulating consumption and promoting economic development. Network coverage is remarkably widespread, although rural broadband penetration remains low.

Yet despite the uneven reach of broadband in rural China, most of the country's new Internet users come from rural areas—many of them young people visiting Internet cafés for the first time. In addition, young Internet users in rural areas are already the most active online segment in those regions. The under-30 population makes up 77 percent of rural Internet users, and nearly half of rural Internet users are under 20 years old. (See Exhibit 2.)

Aside from the Chinese government's interest in broadband infrastructure, another major driver of rural Internet penetration will be the rise in disposable income. Annual income in rural areas increased from \$407 per capita in 2005 to \$758 in 2009, a 17 percent compound annual growth rate (CAGR). And while only 34 percent of the rural population had disposable income of more than \$882 a year in 2009, that proportion will be 54 percent by 2015.

Exhibit 1. Chinese Internet Users Spend 2.7 Hours a Day Online

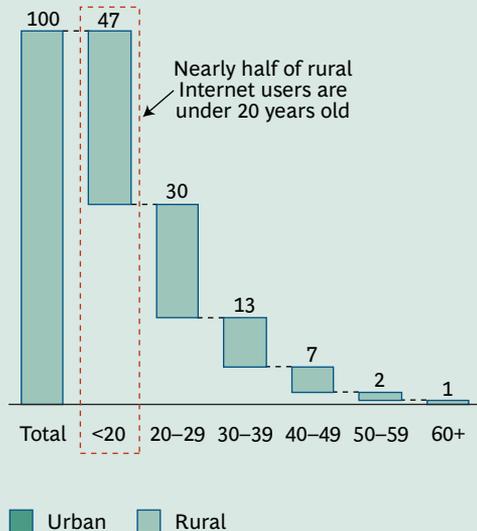
Hours per day spent online per Internet user



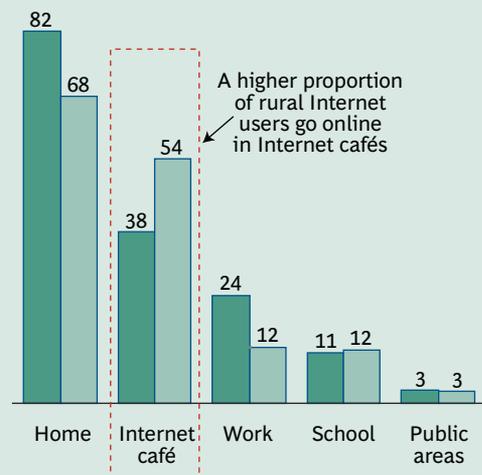
Sources: China Internet Network Information Center (CNNIC); The Nielsen Company; International Telecommunication Union (ITU); comScore, Inc.; BCG analysis.

Exhibit 2. Nearly 80 Percent of China's Rural Internet Users Are Under 30 Years Old

Percentage of rural Internet users by age



Percentage of Internet users by point of access



Sources: China Internet Network Information Center (CNNIC); BCG analysis.

Not surprisingly, PC ownership is much rarer in rural areas, as well—only 16 percent of rural residents have access to household PCs, compared with 70 percent of residents in tier 1 cities such as Beijing and Shanghai. More than half of rural Internet users head to Internet cafés to go online, compared with 38 percent of urban users. (For example, see the vignette “Rural Teenager: Chao Connects with Friends via Internet Cafés and His Mobile Phone” on page 16.) However, PC prices are falling steadily, and PC firms are increasingly looking to the evolving habits of the rural consumer as a source of growth.

Entertainment and Communication

Chinese Internet users exhibit distinctive online-behavior patterns compared with digital consumers in other BRICI markets. Specifically, they use their Internet connections to entertain themselves and communicate with others to a much greater extent and in many more ways.

One of the most distinctive online habits among Chinese consumers is the tendency to prefer instant messaging

(IM) over e-mail. For instance, 87 percent of Chinese digital consumers use the Internet for IM, compared with only 53 percent for e-mail. (See Exhibit 3.) By comparison, e-mail usage rates in India, Brazil, Russia, the United States, and Japan all range between 77 percent and 95 percent. After China, India has the next-highest rate of IM activity at only 62 percent.

China also has the highest usage rates for online music, video, and gaming, and the second-highest rate for news reading (after Japan). Availability is a major factor in online entertainment activity—the wealth of media available online, due in large part to China’s loosely enforced intellectual-property laws, has made video-streaming and music sites key entertainment destinations, although many of these platforms now license content as well.

A major reason that digital consumers prefer viewing content online is that they can do so at their convenience. For instance, even though the TV drama *Wo Ju* ran on Chinese network television, two of the women we interviewed opted to stream the series during their free moments, watching it on the online video site Youku.com, which licensed the program. Yet online platforms also al-

Exhibit 3. China’s Digital Consumers Favor Instant Messaging over E-Mail

Online activities by percentage of users, 2009

	China	India	Brazil	Russia	Indonesia	United States	Japan
Instant messaging	87	62	61	56	58	38	23
Online music	83	60	49	47	34	34	25
Reading news	80	61	47	65	47	70	90
Online video	76	53	49	41	16	68	49
Search engine	69	50	83	81	56	89	92
Online gaming	55	54	44	31	35	35	16
E-mail	53	95	77	78	59	91	88
Blogging	38	NA	17	33	33	11	32
Social networking	33	23	69	15	58	35	32
E-commerce ¹	28	17	17	21	5	71	46
Online banking	26	NA	NA	11	5	55	NA
Bulletin board/forum	21	NA	18	NA	33	22	13
Job hunting	19	73	NA	NA	20	51	8
Others	NA	57	NA	67	NA	NA	NA

■ Above average²

Sources: BCG Digital Generations consumer research, 2009; *Business Insider*; BCG analysis.

¹E-commerce includes online travel booking, e-payments, and e-shopping.

²Above-average categories have usage rates that are at least 10 percent higher than the average of the BRICI countries, the United States, and Japan.

low digital consumers to catch important events in real time. For instance, Chinese NBA fans often prefer to watch games live at work online rather than catching them on CCTV that evening. Quick access is another plus—Chinese Internet users upload new content to file-sharing sites much more quickly than traditional media channels can disseminate it. And access to the content is free of charge, as well.

Online gaming in China is another increasingly prevalent form of entertainment. Games like Tencent's *Dungeon & Fighter* and NetEase's *World of Warcraft* are exceedingly popular in our surveys, and nearly all the male respondents in the vignettes on pages 14 through 16 play online games at some point during their day. "I love to play online games, especially *World of Warcraft*," explains Chaojun, a 29-year-old worker in Guilin who—not atypically for a young single person—lives with his parents. For Chaojun and many others, online gaming can also be a form of community building. "It makes my life after work more colorful. It's really a very good experience playing with your friends together online," he said.

Factors That Shape Today's Digital Reality

What accounts for some of the distinctive ways in which Chinese people use the Internet? Understanding the historical, economic, and cultural factors at play in Chinese society today helps explain some of these trends.

Cheap Connectivity. Government efforts to modernize telecommunications infrastructure across the country have helped make broadband Internet both affordable and accessible. In fact, broadband is even less expensive than dial-up.

The Move to Digital. Although many Westerners have owned, or still own, CD players, VCR machines, modems, and fixed-line phones, China's pace of economic development means that consumers have bypassed those technologies, jumping straight into the world of MP3 and DVD players and mobile phones. Internet users in China are therefore quite familiar with online media platforms and file-sharing technology.

Free Content. In China, an Internet connection grants users access to limitless quantities of free content. One of our interview subjects—Feng, a 26-year-old professional who lives in Beijing—summed it up best: "I would never pay for music and videos because we have so many free choices currently."

The Emphasis on Education. China's strong historical and cultural emphasis on education means that parents often see their child's learning opportunities as something akin to a basic material need. "My daughter's education is so critical to her future," explained Xiao Peng, a 38-year-old parent from Henan. "I am always willing to spend on anything worthwhile to give her better positioning in the future."

Chinese parents view PCs as important educational tools, not as luxuries. This sense of priority is one of the drivers of the estimated 40 million PCs sold in China in 2008. Even poor families are able to obtain PCs, because scores of small businesses sell moderately priced white-box PCs made from new and recycled parts.

As students head to college, they take these tools with them, using their laptop PCs for classroom tasks and social needs. "I use my computer to take notes in class. I use search engines to search for papers and learning materials," said Gao Lu, a 21-year-old from Beijing, who also uses IM and e-mail to communicate with friends, and who plays online games on his computer.

Yet even young professionals who might not have owned a computer in their student days find PC ownership increasingly vital to self-improvement. "If the materials are necessary and hard to get [offline], I would pay for them as e-learning, since it could save a lot of time," explained Shao Linfei, a 32-year-old from Beijing. In addition, China's high levels of literacy—more than 93 percent, according to the United Nations Development Programme—mean that not only many children but also most adults (both male and female) can read online content.

Lonely Only Children. One reason for the relative popularity of entertainment and communication via the Internet is China's one-child policy. Implemented in 1979 to curb population growth, the policy has resulted in a young Internet population that is made up overwhelm-

Chinese parents view
PCs as important
educational tools, not
as luxuries.

ingly of only children. Again, due to the cultural emphasis on education, students are often expected to study when they are at home. Their PCs give them a chance to discuss homework with classmates but also to keep themselves socially engaged and entertained by chatting, updating pages on their social-networking sites, playing online games, and downloading different media offerings.

China's Online Workplaces. As China's digital generations grow up, they take their online networks and habits with them—often to their workplaces. As important as having an at-home broadband connection may be, a great number of China's online cultural phenomena take shape during working hours. A modernizing, competitive, and globally oriented economy has filled urban office spaces with well-educated workers who use PCs and the Internet not just for their daily tasks but also for socializing and entertainment purposes. For instance, QQ, the IM platform offered by Tencent (China's largest Internet-service portal), allows workers to chat with friends while at work—outside their corporate e-mail boxes.

The State-Run Media Void. Despite the more than 50 cable-TV channels available in China, state control of the media has slowed the development of diverse and engaging television content. Print media outlets, which are also state run, are also relatively underdeveloped in terms of content. Cinema tickets are expensive and the selection is extremely limited.

The sometimes barren offerings of the Chinese media have helped to make the Internet a mainstream destination for entertainment and information. This has, in turn, created a massive content base and has altered viewing habits to such an extent that many now prefer the convenience of the customized online experience. "I rarely buy newspapers now that I can get comprehensive information from mobile newspapers, mobile Internet, and some information portals," said Dai Peng, a white-collar worker in Beijing. "I spend much less time watching TV than before, because most TV content you can easily find online, and you can watch whichever part you want, without limitation."

The Expression of Individuality. The relative uniformity of perspective on TV and in the print media also

means that Chinese Internet users find opportunities to express their individuality through their online activities. This might mean participating in online communities and blogging, discussing news on a bulletin board system (BBS), or adorning avatars with unique clothing and sprucing up a personalized page on a social-networking site. Despite the government's rigorous censorship and monitoring of Web sites, the Chinese Internet offers diverse and immediate ways to express oneself, whether as an exercise in individual style or out of a desire to air opinions anonymously.

Online Communities. As we discussed earlier, China's young people are often cooped up after school and expected to study—many of them on PCs that provide inviting online alternatives to their coursework. It's hardly surprising that adolescents use social-networking sites or online games to connect with their schoolmate communities. University students also look to form communities on the Internet. And as rural users increasingly find their way online, the Internet offers opportunities to interact with friends in other villages, as one of the rural middle-schoolers we spoke to does. Of course, Chinese users also form online communities—such as online-gaming guilds—around shared interests.

A Common Tongue. Finally, the Internet has had a subtle unifying effect on China. The diversity of Chinese dialects such as Mandarin, Cantonese, and many others—often an obstacle to comprehension of the spoken word—does not limit written comprehension because all the languages rely on the same characters. As a text-based medium, the Internet brings together people who would otherwise be unlikely—and unable—to communicate with each other.

As China's digital generations grow up, they take their online habits with them.



China's Digital Generations

From Teenagers to Middle-Agers

Our research focused on a broad group of Chinese people aged 14 to 55. (See the Appendix.) Within this group, we identified three different generations, each exhibiting very different adoption and satisfaction levels with regard to the digital experience.

- ◇ One group is the older generation, aged 36 to 55. Although they grew up before the economic boom in a frugal environment that offered little in the way of entertainment or choice, they still exhibit moderate levels of Internet adoption. Many in this age group look to the Internet to provide practical solutions to their everyday lives, such as easy access to news. This segment is also becoming increasingly comfortable with more recreational Internet use, such as social-networking sites, as well as with e-commerce. In general, this is a diverse group—and educational background, income levels, and PC availability have a strong influence on the online habits of this group's constituent subsets.
- ◇ The next group, aged 26 to 35, witnessed tremendous change in China during their youth. As beneficiaries of the country's reforms, they optimistically look for variety and new opportunities, and they value the ability to voice their opinions online. This group tends to have a high rate of adoption of digital devices and services—and appreciates the richness of information accessible via popular portals.
- ◇ The third group is the young generation—the “little emperors,” aged 14 to 25. They have grown up in an openly capitalist environment and have seen rapid modernization. Their life experience has been characterized by opportunity and choice, and they readily embrace mobile-phone use and the Internet. The

focus of their activities is on entertainment and the interactions within their communities.

Although these three age groupings provide a rough cut of the market in China, they do not capture the nuances within—and sometimes across—generations, which often differ by educational background and income level. In order to refine online behavioral traits within these age groups, we have created six consumer categories. (See Exhibit 4.) These six categories are illustrated in the vignettes on pages 14 through 16.

- ◇ *Teenagers.* Nearly nine out of ten teenagers use the Internet at least once a month (an Internet penetration rate of 85 percent), and they spend an average of 2.7 hours a day online. They usually focus on communication and entertainment, such as chatting, watching movies, gaming, and listening to music. (See the vignette “Jianhong’s Teen Experience Focuses on Fun, Friends, and Studies.”)
- ◇ *University Students.* Even more active on the Internet than teenagers, this group has a 99 percent penetration rate, matching young professionals for the highest share among the six groups. University students grew up with digital services and are now turning to the Internet to discover a world beyond family and friends, spending an average of 3.6 hours a day online. They use the Internet for information, entertainment, and communication. (See the vignette “University Student: Shane Works, Chats, Shops, and Relaxes Online.”)
- ◇ *Young Professionals.* Having benefited from the country's reforms, this group has relatively high levels of income and education. They have an Internet-penetration rate of 99 percent and are sophisticated

Exhibit 4: The Six Chinese Internet User Segments Have Distinct Motivations and Behaviors

	Most active			Most influential		
						
	Teenagers	University students	Young professionals	Young gamers	Active middle-agers	Passive middle-agers
Basics	<ul style="list-style-type: none"> ◇ 14–18 years old ◇ Have grown up with digital services ◇ 85% penetration 	<ul style="list-style-type: none"> ◇ 19–25 years old ◇ Have grown up with digital services ◇ 99% penetration 	<ul style="list-style-type: none"> ◇ 26–35 years old ◇ Educated middle-class and above ◇ First Internet experiences were while at university ◇ 99% penetration 	<ul style="list-style-type: none"> ◇ 19–35 years old ◇ Lower education and income ◇ First Internet experiences were in internet cafés ◇ 89% penetration 	<ul style="list-style-type: none"> ◇ 36–55 years old ◇ Mostly middle-class ◇ First Internet experiences were at work ◇ 67% penetration 	<ul style="list-style-type: none"> ◇ 36–55 years old ◇ Lower education and income levels ◇ Low adoption levels ◇ 38% penetration
Motivations	<ul style="list-style-type: none"> ◇ Looking for fun and also support in studying 	<ul style="list-style-type: none"> ◇ Seeking friends 	<ul style="list-style-type: none"> ◇ Focusing on work and career 	<ul style="list-style-type: none"> ◇ Looking for excitement and a sense of achievement 	<ul style="list-style-type: none"> ◇ Looking for support in daily activities 	<ul style="list-style-type: none"> ◇ Seeking to relax and kill time
Usage	<ul style="list-style-type: none"> ◇ Heavy users (2.7 hours a day) ◇ Focus on entertainment and community ◇ Willing to try new activities 	<ul style="list-style-type: none"> ◇ Heavy users with broad activities (3.6 hours a day) ◇ Focus on information, entertainment, and community 	<ul style="list-style-type: none"> ◇ Heavy users (4.0 hours a day) ◇ Focus on communication and information ◇ Some e-commerce and online transactions 	<ul style="list-style-type: none"> ◇ Indulge heavily in entertainment activities (3.2 hours a day) ◇ Spend money and long hours on these activities 	<ul style="list-style-type: none"> ◇ Occasional and pragmatic users (2.5 hours a day) ◇ Focus on information and transactions 	<ul style="list-style-type: none"> ◇ Infrequent users (1.8 hours a day) ◇ Undertake simple, basic Internet activities

Sources: BCG Digital Generations Consumer Research, 2009; BCG analysis.
Note: Penetration measures the proportion of a segment accessing the Internet at least once a month.

users of technology. They also spend the most time online, on average, at 4.0 hours a day. They engage in numerous digital pursuits, focusing on communication and information but also using e-commerce. (See the vignette “Young Professionals: Feng Uses the Internet for Nearly All of His Needs.”)

- ◇ *Young Gamers.* This group, which bridges the younger age groups—the little emperors and the reform beneficiaries—consists of people aged 19 to 35 who have not attended a university and whose incomes are usually lower than those of college graduates. Nearly 90 percent of them use the Internet at least once a month, and they spend an average of 3.2 hours a day online. They tend to play games, chat, and seek out other forms of entertainment. Even though the Internet penetration rate of this group is less than that of university students or young professionals, young gamers make up a much larger swath of the Chinese population in absolute terms. (See the vignette “Young Gamer: Chaojun Plays Games Online—Before, After, and During Work.”)

- ◇ *Active Middle-Agers.* This group, aged 36 to 55, has both high income and advanced education—and an Internet penetration rate of 67 percent. They use the Internet mainly to search for information and news, spending an average of 2.5 hours a day online. Although they are less attached to chatting and entertainment, they still tend to use these services. (See the vignette “Active Middle-Ager: Jun’s Digital Devices Keep Her Connected, Informed, and Amused.”)
- ◇ *Passive Middle-Agers.* Members of this group have lower incomes and less education than active middle-agers. At 38 percent, this group’s Internet penetration is the lowest among the six groups. Passive middle-agers lag behind the average in nearly every area, especially chatting, listening to music, downloading movies, and e-mailing. They have not grown up with the Internet and, because they lack money and education, it is understandable that they use the Internet only selectively, if at all. Still, they spend an average of 1.8 hours a day online, so they should not be overlooked entirely.

Teenager: Jianhong's Teen Experience Focuses on Fun, Friends, and Studies



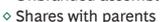
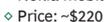
14 years old
Junior high school student in Guilin
Only child; lives with his parents

"My parents usually give me \$1.50 in allowance per school day so that I can buy some snacks and other things. Instead, I almost always use it to pay for playing Dungeon & Fighter and the QQ membership fee."

Personal monthly finances

Allowance	\$30	
Education	\$5	
Food and clothing	\$5	
Communications/entertainment	\$10	<ul style="list-style-type: none"> QQ premium services \$3 Online gaming \$3-4 Mobile phone \$3-4
Other	\$5	
Savings	\$5	

Personal digital devices

-  Unbranded assembled desktop computer
-  Shares with parents
-  Price: ~\$550
-  Nokia mobile phone
-  Price: ~\$220
-  MP3

Internet access: 512kbps ADSL at home

A typical day

AM	6:30	Jianhong's mobile-phone alarm rings, rousing him for the start of a new day
	7:30	Arrives at school and sends his mother a text message saying that he arrived safely
	10:00-10:10	Surreptitiously logs on to mobile QQ to chat with friends during a boring English class
PM	12:30-1:30	Arrives home for his noon lunch break, logging on to QQ to steal friends' cabbages in QQ Farm after finishing lunch
	3:30	Receives a text message from his mother during class reminding him to go to his grandmother's for dinner that evening
	7:30-8:00	Uses QQ to chat with classmates about that day's homework assignments
	9:00-10:00	Plays the online game Dungeon & Fighter after his homework is done

University Student: Shane Works, Chats, Shops, and Relaxes Online

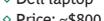
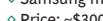


23 years old
Fourth-year university student in Beijing
Lives with classmates in a school dormitory
Only child
Family lives in Hunan province

Personal monthly finances

Income	\$320
Education	\$150
Food and clothing	\$80
Communications/entertainment	\$50
Other	\$20
Savings	\$20

Personal digital devices

-  Dell laptop
-  Price: ~\$800
-  Samsung mobile phone
-  Price: ~\$300
-  Digital camera
-  MP3

Internet access: Broadband in dormitory

A typical day

AM	9:00	After waking up, checks e-mails from professors and friends and then scans the latest financial news for interesting headlines
	9:30-11:30	Searches online for business data related to a task from his part-time job
PM	12:30-1:30	Spends his lunch break watching movies online
	1:30-2:00	Logs on to MSN to chat with friends
	2:00-3:00	Explores all kinds of online resources, such as downloadable HDTV videos, international magazines, and the latest online games
	3:00-5:00	Attends class with his laptop, following along from a PowerPoint presentation prepared by his professors
	8:00-8:30	Buys some new books on Dangdang.com, then reads jokes online as a way of relaxing
	8:30-10:30	Searches online for research sources for a paper he is writing for one of his classes
	10:30-11:30	Checks in with friends to find out how their days went and to bid them goodnight

Young Professionals: Feng Uses the Internet for Nearly All of His Needs



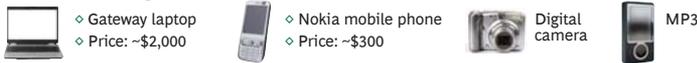
26 years old
Unmarried
Lives by himself in Beijing

"My mobile phone and the Internet are parts of my life. As a subset of my spending on these items, I usually spend \$30 a month shopping online. Because I have extensive knowledge of digital technology, friends and relatives often ask me for advice when they buy digital goods."

Personal monthly finances

Monthly income	\$735	
Education	\$30	TV \$5
Food and clothing	\$150	Broadband \$25
Communications/entertainment	\$140	Mobile phone \$60
Other (including rent)	\$250	Online gaming \$30
Savings	\$165	Movies/CDs/DVDs \$20

Personal digital devices



Internet access: 2Mbps ADSL at home

A typical day

AM	6:00	Wakes up and immediately checks Sina Sports for the results of the World Cup qualifier round played while he was asleep
	7:30–8:20	On the subway to work, reads mobile news and an e-novel on his mobile phone
	8:30	Arrives at the office and turns on his computer, which automatically logs on to QQ, Fetion, and MSN
	8:45	Gets started on the day's work assignment after receiving an e-mail from his boss
	11:30–12:00	Takes a break from work, logging on to Kaixin001.com to play Happy Farm and view friends' shared videos and stories
PM	4:30–5:00	Uses PowerPoint to write a report for his boss summarizing the work he's done for the day
	5:00–5:30	Helps colleagues buy discounted prepaid calling cards on Taobao
	6:00–6:10	Uses Fetion to send short messages to friends about where to grab dinner that evening
	9:30–10:30	After returning home, settles down to play World of Warcraft for a while before finally heading to bed

Young Gamer: Chaojun Plays Games Online—Before, After, and During Work



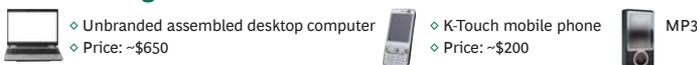
29 years old
Unmarried worker
Lives with his parents in Guilin

"I love to play online games, especially World of Warcraft. It makes my after-work life much richer. I have a really good time playing with my friends together online."

Personal monthly finances

Income	\$220	
Education	\$5	TV \$5
Food and clothing	\$45	Broadband \$10
Communications/entertainment	\$50	Mobile phone \$15
Other	\$30	Online gaming \$20
Savings	\$90	

Personal digital devices



Internet access: 1Mbps ADSL at home

A typical day

AM	7:00–7:10	Wakes up and logs on to mobile QQ
	7:30–8:00	Uses his mobile phone to steal vegetables from his friends in QQ Farm while he gets ready for work
	8:00–8:30	Visits the sports page on Kong.net for NBA news on the way to the factory
	10:00–10:30	Uses his mobile phone to listen to some pop music while taking a break
PM	12:30–2:00	Back at home on his lunch break, visits Tianya to read news and humor pages
	4:00–4:30	Uses his mobile phone to play a few QQ casual games, such as Dou Di Zhu
	7:30–8:30	After dinner, logs on to QQ to chat with some friends, mainly with the intent of lining up a group session of World of Warcraft
	8:30–10:30	Plays World of Warcraft with some friends for a while before finally turning in

Active Middle-Ager: Jun's Digital Devices Keep Her Connected, Informed, and Amused



41 years old
Manager at a cartoon company in Beijing
Lives with her husband and daughter

"Personally, I only earn \$735 per month. But my husband turns over all of his income to me, and I usually make the decisions about our purchases."

Personal monthly finances

Household income	\$1,470	
Education	\$440	
Food and clothing	\$150	
Communications/entertainment	\$150	Fixed-line telephone \$50
Other	\$360	Mobile phone \$45
Savings	\$370	Broadband \$30
		Movies/CDs/DVDs \$25

Personal digital devices



◇ Lenovo laptop
 ◇ Price: ~\$900



◇ Nokia mobile phone
 ◇ Price: ~\$440



Digital camera

Internet access: 1Mbps ADSL at home

A typical day

AM	9:00–10:30	Starts off the workday by using Excel to run some statistics about her company's cartoon-production schedule
	10:30–11:30	Logs on to Kaixin001.com to play Happy Farm with friends
	11:30–12:00	After tiring of cabbage theft, logs on to QQ to chat with friends for a while
PM	1:00	Receives a call from her boss informing her of a meeting at 2 p.m.
	1:00–1:10	Uses Fetion to send out a meeting request to colleagues via her work computer so that they can read it on their mobile phones
	5:00–6:00	Visits Sina to read the news of the day before leaving work
	8:00–9:30	After dinner, catches up on the popular TV show <i>Wo Ju</i> on Youku.com

Rural Teenager: Chao Connects with Friends via Internet Cafés and His Mobile Phone



18 years old
Rural high-school student in Heilongjiang
Only child; lives with his parents

"I don't have a PC at home but there is an Internet café in my village. I spend about three hours a day there during winter vacation and pay about \$0.20 an hour for Internet access. The Internet makes it easy for me to communicate with my friends and to have fun."

Personal monthly finances

Allowance	\$40	
Education	\$0	
Food and clothing	\$10	
Communications/entertainment	\$20	Internet café access \$10
Other	\$5	Online gaming \$6
Savings	\$5	Mobile phone \$4

Personal digital devices



◇ Changhong mobile phone
 ◇ Price: ~\$100



MP3

Internet access: At Internet café

A typical day

AM	8:30	Wakes up; realizes that he doesn't need to head to school because he's on his winter holiday
	11:00	Nonetheless, sends text messages to classmates to discuss outstanding homework assignments
	11:05–11:20	After downing breakfast, heads to the Internet café and logs on to his personal accounts
	11:20–11:30	Checks Kugou for new music and uses QQ to say hello to classmates in other villages
	11:30–12:00	Steals vegetables from friends on QQ Farm and plays Dou Di Zhu on QQ Game with classmates
PM	12:00–2:00	Plays online game Chuanqiyi
	9:00–9:30	Ends his day by using mobile QQ to chat with friends before going to sleep

The Rise of the Digital Giants

China's diverse cast of Internet users demonstrates a great variety of online behaviors. But one thing emerges that almost all Chinese Internet users share: a QQ address. Created in the late 1990s by Tencent, and based on the ICQ technology purchased by AOL from Mirabilis, QQ has evolved into an instant-messaging platform that acts as the Internet gateway for almost all new users—and has therefore been the technological basis for an enduring network of online connections for the majority of China's Internet population.

Tencent's QQ

There are 523 million active QQ accounts—a number bigger than the total population of the European Union—owned by an estimated 280 million users. University students or young professionals often migrate to other platforms for their IM needs, although many still use and maintain QQ accounts to keep in touch with high-school friends.

Indeed, most Chinese IM users cite the convenience and the cost-effectiveness of the medium as the chief reasons for the frequency of their QQ use. "It's very convenient chatting on QQ," said Yang Bo, 33, from Beijing. "You just sit back in your chair and type in whatever words you want to say. You can even leave messages when your friends are offline."

One of the reasons for QQ's huge user base is that its services are free. This means that school-age users don't have to ask for money from their parents to communicate with friends (in contrast with mobile-phone usage, for example)—and as a result, QQ is a key

way of building and maintaining friendship networks among young people.

How, then, has Tencent become a multibillion-dollar company? It derives revenue from ad traffic and from value-added services, including Internet-based ones such as online games and avatar design, as well as from mobile services, such as fee-based mobile IM and mobile games. For these services, Tencent has set up a virtual currency known as Q coins that users can purchase outright (or earn by using the mobile-phone service) and then spend on sprucing up their blog sites or avatars or buying more online-gaming time. At the same time, Tencent earns traffic-based ad revenue from its portal, search, e-commerce, and IM sites.

The development of Tencent's business model in some ways mirrors the evolution of Internet user habits. For instance, Shane, a university student, opened his QQ account nearly ten years ago when he was in junior high school—right after his parents bought the household's first PC. By 2003 he had begun spending money on "cool stuff" on QQ to compete with his classmates. Around the same time, he also opened up an e-mail account with NetEase's 163.com, but he seldom uses it. He recently signed up for Gmail, but he logs in mainly to check e-mails from professors and classmates, and not for more active social purposes.

What Tencent's Empire Says About User Stickiness

Although Tencent's portfolio of services includes more than just IM, most of its other services are offshoots of that platform, as illustrated by the digital day of Jianhong,

a middle-schooler in the tier 3 city of Guilin. Jianhong tailors his QQ use to a variety of communication needs throughout his day. For instance, he uses his QQ mobile account for a surreptitious chat with friends during a tedious English class, and then later—during his lunch hour—to steal cabbages from friends on the QQ social-networking platform. (Stealing cabbages is part of a social-networking game; see the sidebar “China Catches the Social-Networking Bug: Kaixin001.com’s Happy Farm.”) After dinner, he discusses homework with classmates on QQ before following the platform to Tencent’s online-gaming module, where he plays *Dungeon & Fighter* for an hour—he saves his \$1.50 in lunch money each day to spend on weapons in the game.

In fact, the success of Tencent’s online-gaming business illustrates the value of the stickiness of its QQ platform.

Although *Dungeon & Fighter* is a shooting game, it also has an interactive component via the QQ IM platform, thereby offering yet another dimension of interaction. Most of the young men we interviewed for this report played *Dungeon & Fighter* at some point during their day. But online games in general can be incredibly sticky. Older respondents have moved on to *World of Warcraft*, for the most part, and spend more time playing games than their younger counterparts, suggesting how compelling these games can be. “Online games are electronic drugs for me—they can provide me with different experiences that you cannot get in the real world,” said Zhou Ziyang, a 22-year-old who lives in Beijing and who spends \$44 a month on online games.

Although Tencent’s online games have seen enormous growth in the last three years, it has other offerings that

China Catches the Social-Networking Bug: Kaixin001.com’s Happy Farm

Social-networking sites boomed in 2008 among university students and young professionals and quickly expanded into all segments, with 130 million users by 2009 and a CAGR of 108 percent from 2007 to 2009. Much of the 2009 growth was driven by the social-networking game Happy Farm, which became an online sensation. The game, known as *toucai* (or “stealing cabbages”)—in which friends steal cabbages from each other’s virtual gardens—first became popular on the elite social-networking site Kaixin001.com. Before long, versions of the game had been launched by Tencent and other sites, and people from all walks of life were plotting cabbage theft during their spare moments online.

Kaixin001.com’s first move was to focus on a clear target segment: white-collar professionals, who seldom interacted on other social-networking sites. It designed platforms that addressed young professionals’ social and entertainment needs simultaneously, introducing interactive Web games available on a platform that also allowed for communication and social networking. These games started with *Slave Manor* in 2008, after which Kaixin001.com rolled out a steady stream of simple, interactive games, including a parking lot game, house buying, and, ultimately, its farm and ranch games. Simultaneously, users could adorn their particular site with pictures and a diary and could give each other gifts. “It is a perfect combination of entertainment and communication,” explained Lu Yafen, a 37-year-old from Guilin. “Stealing friends’ cabbages is another way of saying hello to them.”

It’s impossible to say why *toucai* became *the* Internet sensation of 2009, when Kaixin001.com’s parking lot game was just a flash in the pan a year earlier. What is clear is that viral networks are extremely powerful in China. Among IT-related keywords, “*toucai*” was the most searched-for word in 2009 on Chinanews.com. And while most users stole each other’s cabbages merely in the benign spirit of the game, there was also a real—and sometimes tragic—influence on offline lives. For instance, the Chinese media reported an instance of a baby dying of neglect because the nurse on duty was too busy stealing cabbages, and another case of a wife burning down her house as revenge against her husband’s *toucai* addiction.

The *toucai* phenomenon also exemplifies the trickle-down nature of social networking. A game that had first caught on among well-educated young professionals had, within several months, found its way into the habits of adolescents in tier 3 cities via Tencent’s less exclusive social-networking platform that links users into its IM system and its online-games portfolio. In order to anticipate trends, China’s early adopters will be a crucial segment to watch. And although in the case of *toucai* it was young professionals who were the tastemakers, university students are more active social networkers. At present, 51 percent of university students in China participate in social-networking sites, compared with 43 percent of young professionals and 40 percent of young gamers.

have also become enormously popular. For instance, QQshow sells clothes and accessories for users' QQ avatars, allowing them to spruce up their online personas with everything from new hairstyles to eveningwear. "I spend \$1.50 per month on QQshow. I can purchase any of the beautiful clothes on the QQshow market for my avatar," said 17-year-old Li Jing of Guilin. "It's very cool!"

Riding the Digital Wave: Sina

Tencent is not the only digital giant to have built a business empire on a deep understanding of Chinese habits and needs—but with a market capitalization of \$38 billion, it is certainly the largest. China's digital giants also include Baidu (with \$24 billion in market capitalization), Alibaba.com (with \$10 billion in market capitalization), Ctrip.com International (\$5 billion), and Sina (\$2 billion), among others. As recently as three years ago, none of these companies was clearly dominant compared with either foreign or local competitors. Since then, a decisive shift has occurred, and by 2009 the major players were in place.

In China's diverse media marketplace, Sina has risen to the top—thanks to its combination of content generation and aggregation—to establish a leading presence in the portal market. To give a sense of the growth potential, it is useful to compare China's market for content generation and aggregation with that of the United States and Japan. In 2008, content generation and aggregation had revenues of \$14 billion and represented only 10 percent of China's overall digital market, compared with \$307 billion in the United States (54 percent of the U.S. online market) and \$80 billion in Japan (39 percent).

The popularity of reading news via the Internet is remarkably high in China, with 80 percent of the Internet-using population seeking information in this way. This suggests the enormous potential of online advertising. However, the market is still fairly undeveloped. At 4 percent of China's total advertising share in 2006, online advertising represented but a small slice, although its share doubled to 8 percent of the market in 2008 and is estimated to grow to 20 percent by 2012.

At the World Economic Forum in Switzerland in early 2010, a huge delegation of Chinese journalists from across

China's media spectrum was on hand. And yet many Chinese people learned about the details of the meetings at Davos not through state television or newspapers but rather through Sina.com, the de facto news source for many millions of Chinese people. Sina is the most-accessed of China's information portals—and in terms of total traffic, it falls just behind search engines Baidu and Google.cn and Tencent's IM platform QQ. The portal has the world's largest digital-newspaper readership.

The popularity of reading news on the Internet is remarkably high in China.

Sina has already proven the online ad model to be viable—and yet Chinese readership habits are only beginning the continuous shift toward online media. Fewer and fewer Chinese Internet users find their news and general information from TV, newspapers, magazines, or books. In 2007, 79 percent of Internet users said they read newspapers, compared with only 67 percent in 2009. For magazines, the drop was even more precipitous—only 30 percent of Chinese Internet users sought out news and general information from magazines in 2009, compared with 49 percent two years earlier. Those using Internet-based sources increased to 80 percent in 2009, from 75 percent in 2007. "Sina is a must-visit Web site every day for me," said Feng, the Beijing-based young professional. "I love the news channel, as well as the sports channel."

Driven by the ability to tailor Western models to the Chinese user experience, local companies like Tencent and Sina outperformed their multinational competitors in every Internet industry in China. Yet even more impressive than outperforming foreign competitors is the fact that the digital giants have outperformed their *local* rivals, usually under intensely competitive conditions. What China's digital giants have in common is that they have found effective approaches to marketing, innovative ways of bringing products or content to users, and ways to scale rapidly. Once they have established a strong core business, they focus on improving customer stickiness. They are also focusing on the future—we see a shared emphasis on building their vertical Internet segments, expanding across value chains, and developing strategies for overseas growth.



The E-Commerce Revolution

One of the biggest trend shifts in China is the rise of e-commerce. As recently as 2007, many online consumers were wary of online purchasing and the apparent lack of enforcement or payment mechanisms. Business-to-business transactions accounted for most of China's e-commerce. But things have changed significantly. While the business-to-business segment is still the largest by total transaction value, consumer-to-consumer and business-to-consumer transactions are experiencing the fastest growth: they totaled \$37 billion in 2009 and are expected to surpass \$100 billion in 2012. We expect business-to-consumer transactions to grow 61 percent annually from 2009 through 2012, while consumer-to-consumer volume will grow 45 percent annually.

Online Consumer Behavior

The brisk growth in disposable incomes that urban Chinese workers have seen in recent years has put more money in the hands of already-keen users of e-commerce, which in turn has influenced—and will continue to influence—the habits of millions of other users.

Some 8 percent of the Chinese population now shop online, compared with just 3 percent in 2006. E-commerce adoption is estimated to jump to 19 percent of the population by 2012. Young professionals, the group that tends to be the early adopters, are at the vanguard of this trend, with 49 percent of them shopping online, followed by 39 percent of university students. They cite price as their biggest incentive to shop online, followed by convenience, efficiency, and product choice.

The purchasing activity of these online shoppers is impressive—nearly half of them made at least 11 online purchases in 2008, and 40 percent of them spent more than \$294 that year. People are increasingly buying more complex products, with apparel and accessories, books, cosmetics, and consumer electronics topping the list in 2008, compared with books, digital cards, and flowers in 2004.

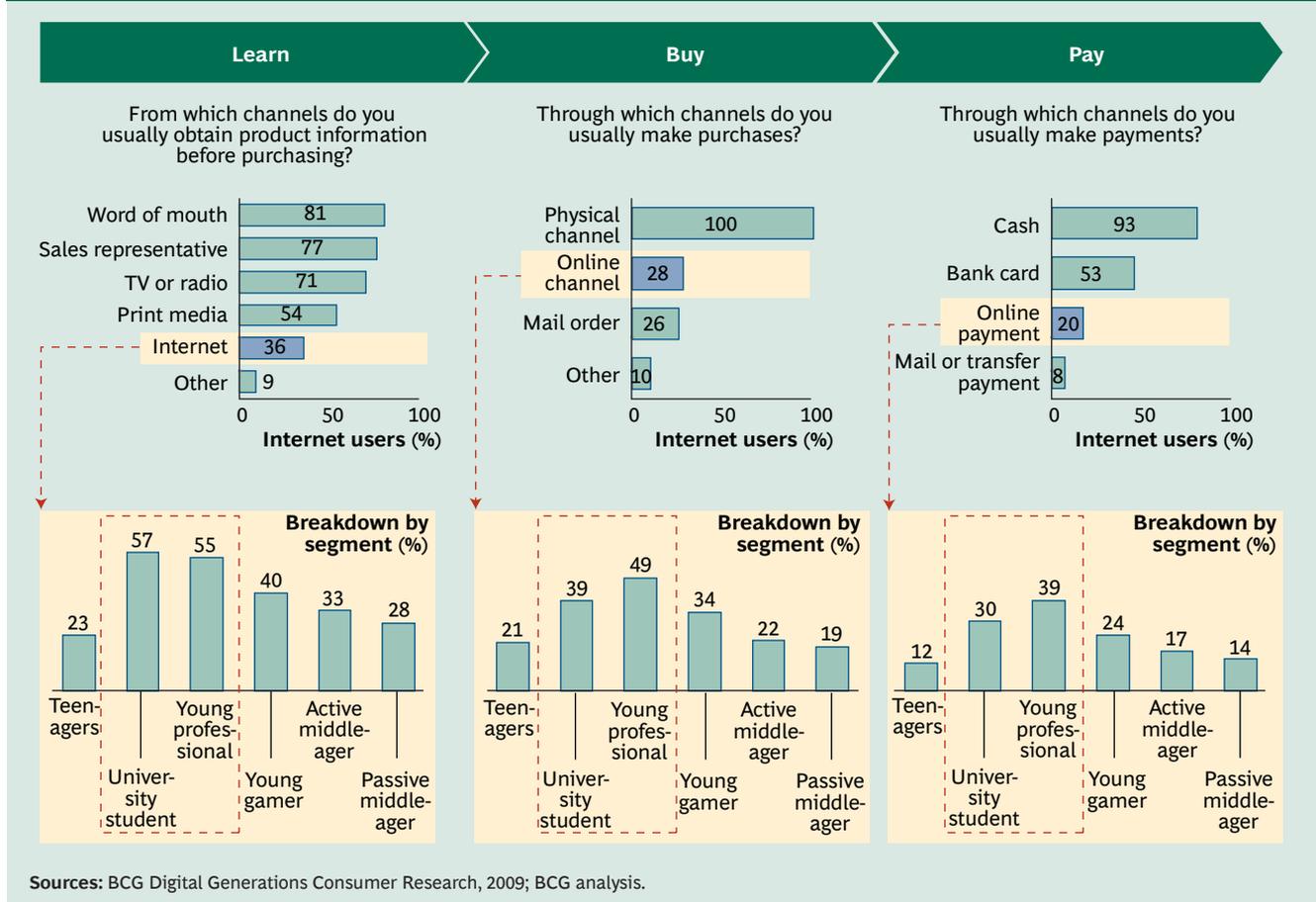
Users can pay in a variety of ways, including by cash or debit card upon delivery or, to an increasing extent, by online payment platforms, although such platforms are still in the early stages of development. Some 93 percent of digital consumers pay in cash, compared with 53 percent via bankcard—and only 20 percent use online payment systems. (See Exhibit 5.) Still, 39 percent of young professionals and 30 percent of university students say they pay online.

Doubts about quality and trustworthiness continue to be the biggest obstacles for online shopping, with concerns about “product quality” and “seller cheating” topping the list. Such concerns typically come from older users; younger Internet users are little bothered by these concerns.

Case Study: Taobao

The growing willingness to trust the quality of online products is perhaps best illustrated by the growth of Taobao, part of Alibaba Group (which also owns the popular business-to-business site Alibaba.com). When Chinese people shop online, they're generally using Taobao, which now dominates the consumer-to-consumer market with an 85 percent share of total transaction value.

Exhibit 5. University Students and Young Professionals Are the Most Active in Both Online Research and E-Commerce



Several years ago, Taobao (which means “treasure hunt”) was not a significant e-commerce presence. Its first moves were to allow all sellers to use the site for free and to launch Alipay, a secure online payment system, in 2003. It also guaranteed product quality by offering refunds to defrauded buyers and making sure that buyers could rate sellers after having made a purchase, with historical-ratings records visible to buyers.

Christine, 26, is a typical Taobao customer, with a serious online shopping habit—and she is a good example of how Taobao’s popularity has taken hold. This young Beijing professional checks Taobao and online bookstore Joyo.com (acquired by Amazon.com in 2004) each day, scouring those sites for deals, promotions, and new products. In 2009, she spent \$905, or 30 percent of her annual shopping budget, on Taobao, compared with \$1,370 offline and \$740 on business-to-consumer sites. (See the

sidebar “Christine’s Digital Week: How Does She Shop?”) Christine mainly purchased consumer electronics, including a camera, a keyboard, and earphones, although she also bought a good deal of makeup, jewelry, and clothes. One of the reasons that she turns to Taobao is the range of selection: “You can find nearly everything you want on Taobao. Many of those things you can’t find in shops.” Convenience and price are also factors, though. “It really saves me a lot of time, and I can shop anytime I want. In most cases, the prices are cheaper but the quality is still good,” she said.

Informing Consumer Choice—Both Online and Off

One reason that Chinese consumers have been able to move past their worries about product quality is the grow-

Christine's Digital Week: How Does She Shop?

Exactly how do Christine's typical shopping experiences work? Upon realizing that her camera no longer functioned one Sunday, Christine took a few minutes to review her budget. (See the exhibit below.) She determined that she could spend \$295 on a new camera. On Monday after work, Christine then turned to QQ, where she discussed various brands and models with her friends, eventually establishing that Canon and Sony were the most popular brands. She then checked out business-to-consumer site Green3c.com to select two cameras in her price range.

After hours of research, Christine finally settled on the Sony W290, which had a reference price of \$280. On Tuesday evening, Christine logged onto Taobao to complete her purchase. She input the camera model and ranked the search results by seller satisfaction, limiting the search to Beijing sellers to ensure better after-sales service. Christine settled on one for \$270, and transferred her bank payment to Alipay. Before she left the site, however, a winter-coat promotion caught her eye, and Christine authorized another transaction—this one for a \$28 winter

coat. On Thursday morning, the camera arrived by express service. Christine checked the camera before signing the receipt and then finished authorizing the payment. She also took the time to write a recommendation for the seller, helping the tens of thousands of other young professionals in Beijing—and all over China—to enjoy similar shopping experiences.

Christine's Spending Breakdown in 2009



"[Using Taobao] really saves me a lot of time. I can shop anytime I want. In most cases, the prices are cheaper and the quality is still good."

"Joyo is my first choice for books, because I can always find what I want there and read others' comments."

"For some products, you need to have real experience on which to base decisions."

	On Taobao	Business-to-consumer	Offline shopping
Makeup and jewelry 	\$270		\$295
Consumer electronics 	\$350		\$15
Clothes and shoes 	\$150		\$590
Books and CDs 	\$20	\$150	\$30
Travel 		\$590	
Other 	\$115		\$440
Spending	\$905 (30% of total)	\$740 (25% of total)	\$1,370 (45% of total)

Sources: BCG Digital Generations Consumer Research, 2009; BCG analysis.

ing supply of Web 2.0 product information on business-to-consumer and consumer-to-consumer sites. On these platforms, users write comments evaluating products as a way of keeping other consumers informed. While 28 percent of Chinese Internet users actually shop online, 36 percent obtain product information online. Again, university students and young professionals do considerably more research online before purchasing compared with other demographic groups.

Christine's digital habits reveal more about nascent trends than might at first be apparent. Like many, Christine feels that off-line shopping is necessary because some products—such as high-heeled shoes or a special keyboard—are still too risky to buy without having a “real experience” with them first. But this hesitancy is no longer about trust. Many university students and young professionals like Christine have long since crossed that threshold, and the success of each incremental transaction further entrenches the e-commerce impulse.

Another key element driving the popularity of consumer-to-consumer transactions is the importance of selection. Even for Christine, who lives in China's urban capital, the diversity of product choice online is far more inviting. And for those who live outside the commercial hubs, selection is even more valuable. For instance, Christine often sends gifts to her mother via Taobao. Her mother lives in Heilongjiang province, one of China's less economically developed provinces, and can only dream of being able to find such products in her local shopping centers.

Price transparency is also vital. Christine and other e-commerce fans are enjoying the benefits of access to hundreds of thousands of small sellers unloading goods at a tiny margin over wholesale prices. These sellers aren't necessarily trading in so-called shadow goods (which are goods that have come into China at below-market prices)—some are official retailers and maintain brick-and-mortar shops while also selling from Taobao. For instance, sellers sold 2 million handsets last year on Taobao. Location is still important, of course, and many buyers prefer to purchase from sellers whose physical stores are near enough that customers can seek product support if necessary.

Even in China's urban centers, the diversity of product choice online is very inviting.

Yet for all the subtle but powerful e-commerce behavioral trends that Christine embodies, one of the most important things to keep in mind is the simple fact of her place in the Chinese economy. A 26-year-old auditor with a master's degree, Christine is considered to be very much a member of China's upper-middle class, even though she earns only \$680 a month. As with many other young professionals, however, her income is expected to increase at a rate well above China's overall GDP growth—and at some point, her household income is likely to be augmented by the addition of a husband. Even if Christine continues to spend only 30 percent of her household income on Taobao, the growth potential that she represents is enormous.

Chinese E-Commerce's Business-to-Consumer Push: Ctrip

Consumer-to-consumer transactions are far more developed in China than business-to-consumer sales, although that says less about platforms or consumer behavior than it does about the role of small businesses in the e-commerce economy. In China's online marketplace, Taobao has acted as a catalyst for both consumers and small businesses to interact with each other. It is only now dawning on the big consumer-goods companies that they need to catch up with retailers and customers. For instance, traditional companies like Lenovo and Haier are starting to build e-commerce capabilities. For many companies, the best choice at present appears to be to set up an e-store on Taobao.

But there are a handful of Chinese companies that have already built strong business-to-consumer operations, most of them focusing on the distinct needs and requirements of a specific service. Online travel-booking agency Ctrip.com International is the biggest pure business-to-consumer platform, with \$233 million in revenue in 2008.

Ctrip's rise was far from predictable. China's travel sector was not overly ripe for entrepreneurial activity given the degree to which state-owned airlines and travel conglomerates dominated in the last decade. In addition, as recently as 2006, China's travel business consisted chiefly of small agencies that sourced tickets directly from the air-

lines. These agencies used to be nearly as common as convenience stores or hair salons, although they are increasingly irrelevant in China's wealthier cities—largely because of the rise of Ctrip, China's leading business-to-consumer travel site, as well as its competitors.

In 2006, Ctrip was still only one of a slew of online travel consolidators. One way the company set itself apart was by using direct marketing in travel hubs such as airports and railway stations, where its sales staff would encourage people to sign up. And Ctrip's success wasn't due merely to an ability to convince consumers to book travel online—in fact, it didn't even fight this fight. Early on, Ctrip grasped the problem of trust and set up call centers that allowed customers who were less digitally inclined to book travel by phone. About two-thirds of Ctrip's revenues continues to be from offline sales.

The hallmarks of Ctrip's strategy were its relentless focus on excellent customer service and the clear strategic direction set by its management team. To this day, it tweaks and evolves its platform constantly to change with the Chinese consumer ecosystem.



The Consumer Connection

China's digital generations represent vast opportunities for any consumer-related company—and a deep understanding of the needs and preferences of its different segments will be critical to capitalizing on user trends. Over the long term, it is only a matter of time before China's younger digital generations shift into the mainstream of Chinese society. Connecting with them now will allow companies to grow with them as their habits evolve.

Incorporate Consumer Behavior into Your Business Model

Companies that need to engage with Chinese consumers must interact with them through their digital lives and develop new capabilities in order to fully exploit these channels. With the pace of change accelerating, it is imperative that companies act now. What will this entail?

Be visible in the places where your customers spend time. Because the average Internet customer spends nearly three hours a day online, companies need a rich and attractive Web presence to increase awareness of their business, brands, and products. Remarkably, many companies still do not properly showcase themselves on the Web. If they have a Web site, they do not update it frequently and adequately. Corporate budgets for Web development are generally limited and skepticism remains high. Web development capabilities are also in short supply.

Provide services that Chinese consumers consider valuable and unique. Another crucial feature of a successful Web site is useful content that not only draws in

users but also keeps them coming back. While a company could provide this content itself, another strategy to consider is harnessing the power of Web 2.0, letting user-generated content create loyalty.

Goodbaby, a market leader in baby care products, has become a visible presence in the daily life of young Chinese mothers through its Web site, which has blogs, information about baby care and development, and a doctor referral section. Many companies such as Goodbaby are creating a favorable impression among consumers through their Web sites—while they also gather consumer intelligence. By closely tracking Web activity, companies can develop a better understanding of how consumer preferences and needs vary by region or city, allowing them to develop successful segmentation strategies.

Integrate the Internet into Your Go-to-Market Strategy

The rise of consumer-to-consumer e-commerce in China has had huge implications for retailers, and companies looking to stay competitive and relevant will need to consider the Internet's role in the market before developing a coherent go-to-market strategy.

Consider your online-channel strategy. There are many approaches to selling and marketing online. Companies will want to weigh whether to set up their own independent site, create a Taobao-hosted site, allow authorized retailers to act as channels, or leave it unmanaged. While all of these approaches have merits, many companies will have to bear in mind that they are playing catch-up with intermediaries that have already established their brand's presence in the market. Given the

rise of Taobao, a good starting point would be to assess the extent to which your products are sold by third parties and strategize how to ride that wave. Few companies realize how extensively their products are already being sold on Taobao, how many online sellers are doing so, and the impact of this trend.

Focus on price management. The rise of Taobao and other e-commerce platforms creates major challenges for consumer companies in China with regard to price management. The platform has brought a level of price transparency that few companies actually desire, and the geographic reach of the site has reinforced this transparency throughout the entire country. Companies with products sold both online and via traditional channels will need to confront the challenge of maintaining consistent pricing across channels.

Build on the e-commerce opportunity. It is worth remembering that the consumer-to-consumer platform presents an enormous opportunity to expand the regional presence of your brand. The Taobao channel can reach markets and consumers that are otherwise inaccessible, such as Christine's mother in Heilongjiang (mentioned in the previous chapter). And Taobao and similar platforms can be used to other advantages, such as aggregating market information. Authorized retailers of your product on Taobao likely have access to customer demographic information that you do not. Actively engaging customers on Taobao can generate valuable data on consumer behavior that can help shape the next prong of your marketing strategy.

Leverage the Collective Power of the Digital Network

Web 2.0 allows companies to develop two-way communication with Chinese consumers, who can actually contribute to a company's marketing and brand-building activities. In China, where Internet users have flocked to blogging and other pursuits that allow individual expression and personalization, online activities are an especially powerful lever. Companies can test advertising messages online and even allow product enthusiasts to drive viral-marketing campaigns.

Customers who express their enthusiasm for a product can become a highly effective sales force. They can also participate in after-sales support by exchanging questions and answers on product-specific bulletin boards. Intel, for example, has launched a blog in China that allows visitors to express their ideas freely, enabling the company to tap into the concerns and needs of its customers.

Few companies realize how extensively their products are already being sold online.

Customize products and services for China's online consumers, communities, and channels. With online activities so central to the lives of so many Chinese—and playing a role in everything from learning and shopping to dating and relaxing—companies have an opportunity to set themselves apart by delivering high-

quality online experiences and creating innovative products and services. Banks need to understand their customers' digital behavior to optimally design online and mobile-banking services; food and beverage companies need to adapt their products to fit a lifestyle that revolves around a computer screen; and technology companies need to develop different products for different user groups.

Reach out to influencers such as university students, young professionals, and young gamers. In order to address the needs and earn the trust of China's new digital consumers, companies must court the influence brokers who network, who are vocal, and who have gained a following online. As a first step, companies need simply to be aware of "online chatter." Only then can they join the conversation by, for example, sending press releases to popular bloggers or answering questions and adding comments on online forums. Because consumers may balk at a commercial intrusion into what they regard as a noncommercial space, companies need to walk a fine line between being part of the discussion and being seen as an agent trying to dominate or manipulate it. One way to counter the latter perception is to set up company- or product-specific discussion boards and blogs.

Several Web sites have demonstrated tremendous power to shape consumers' opinions. E-commerce sites like Taobao are increasingly becoming clearinghouses for product information. In addition, China has its own social-networking sites, where users can create groups according to interests. There are also numerous online forums and blogs that sway consumer behavior.

This isn't just an opportunity to sharpen market strategy—it's a necessary step for setting up active damage-control mechanisms in the event that unfavorable information sweeps the Chinese Web. In the past, companies operating in China have suffered negative business consequences by failing to act swiftly enough in response to small ripples of dissatisfaction that began online and spread to the sales counter. In early 2007, a leading global consumer company had to remove a brand from the market after questions about the brand's quality arose. Although customers' complaints originally surfaced online, the company did not detect the extent of customer dissatisfaction early or accurately enough. Under mounting pressure, the company had little choice but to retreat.

Similarly, in 2006, Chinese consumers generated widespread online criticism about a specific aspect of a product made by a global electronic-devices manufacturer. In the absence of an effective response from the company, the criticism quickly spread to other aspects, including overall product performance and customer service.

Use the Internet to Advertise Your Brand and Build Trust

Branding is a new but critical activity for companies in China. BCG's research suggests that brands are more relevant for Chinese consumers than for their counterparts in Europe or the United States.¹ Given the lingering reluctance that Chinese consumers display toward online transactions and commerce, the power of brands—and their ability to convey trustworthiness—is especially important on the Web.

Many companies, however, continue to target consumers both through television and through the outdoor advertising that was prevalent during the country's initial economic liberalization. Many marketers still regard television as the most effective medium for building basic brand awareness. The Internet allows companies to deliver more targeted and specific messages, whose impact can be more easily measured.

Explore the potential of the rapid mobilization of the Internet. As mobile-phone and Internet use dramatically

The power of brands and their ability to convey quality is important on the Web.

increase, companies will have greater opportunities to exploit these media—but they should also keep in mind the convergence of online consumer habits in a single mobile device. Companies will want to innovate services that cater to mobile-Internet users and develop mobile platforms in their marketing strategies.

Earn higher returns on advertising dollars by using integrated online-marketing campaigns. Even with the convergence of mobile devices and Internet use, companies should exploit various tiers of media by taking an integrated, multichannel marketing approach. This allows companies not only to maximize their returns on advertising expenditures but also to

develop a more sophisticated targeting of customer segments.

Reach out to consumers in lower-tier cities and rural areas. China's digital revolution is built on Internet and mobile-telephony infrastructures that extend deep into the western reaches of the country. This coverage will allow companies to overcome an enduring challenge: how to reach consumers in small cities and regions at the edge of existing distribution channels. Digital devices offer a fast and cheap way for companies to directly access those potential customers. At the very least, companies can educate them about products and solicit feedback.

Build organizational capabilities to address the digital space. In order to fully exploit the digital opportunity, companies need to build their organizational skills by strengthening teams in consumer research and online marketing and ensuring that the sales operation can manage multiple channels.² The creation of online-marketing capabilities will be especially challenging. Marketing and sales professionals who understand consumers' use of the Internet and mobile phones are in high demand. It will also be difficult to outsource these capabilities because few advertising agencies in China have fully embraced online and mobile platforms. Against such constraints, global companies might be tempted to interfere unnecessarily in Chinese marketing and sales

1. See *Winning the Hearts and Minds of China's Consumers*, BCG Focus, September 2007.

2. See *The Consumer's Voice—Can Your Company Hear It?* BCG report, November 2009.

activities. Unfortunately, the head office is unlikely to be able to act swiftly or to understand local needs and specifics. These activities need to be handled on the ground.

Mobile Internet: The 3G Opportunity

One distinctive feature of the Chinese market, as compared with other markets, is that mobile-phone owners use their devices for a broader range of activities—particularly for entertainment and communication needs. In addition to calling and sending short text messages, Chinese mobile-phone users send multimedia messages, play mobile music and games, download ringtones, and watch mobile videos more than do users in the other BRICI countries or in the United States and Japan. And while the United States and Japan both have clear leads in mobile-Internet usage—with vastly more-developed 3G networks—nearly one-quarter of Chinese mobile-phone owners use their devices to go online, which is more than in any of the other BRICI countries by a significant margin.

But although the number of Chinese users grew to 233 million in 2009, mobile-Internet use in China is still far from developed—nor is it clear how much of this activity is mobile-broadband usage. The current lack of a developed mobile-broadband market points to a growing opportunity for mobile applications in the future, particularly as 3G develops. Many of China’s digital consumers are dissatisfied with the speed of mobile Internet, which has curbed their usage. “It’s too slow when I am using my mobile to visit Internet sites,” said Feng, the young Beijing professional. But even though Feng is aware of 3G’s potential, he does not yet feel that it is ready to fill the void. “Currently, 3G is too expensive and has coverage problems,” he said. The lack of selection of mobile apps is another sticking point. “I will use mobile Internet if the 3G services are mature and the price is cheaper, and also if there is more mobile-specific content,” said Chen Yu, 26, of Guilin.

Both the software and the bandwidth must catch up with consumer expectations, although many mobile-apps companies are already on the move, and the government continues to pressure the telecom providers to accelerate 3G network upgrading. Recent 3G penetration rates show how underdeveloped the space is. However, the wide-

spread use of both the Internet and 2G mobile devices for music, gaming, and video hints at the immense potential opportunity here.

The activities and principles outlined in this report are universal, but each company needs to define its own China-specific objectives and road map, depending on its industry and starting point. Different customer groups have different online-consumption patterns, and although it may be tempting to spring immediately into action, companies should first spend time segmenting their customers, defining priorities, and establishing a systematic approach to engaging with the various user segments.

These steps will enable companies to tailor a market strategy to the tastes, needs, and habits of China’s diverse cast of Internet users. Reaching these consumers is the first step toward capturing China’s digital opportunity—an opportunity that our research shows is as gigantic as the nation itself.



Appendix

Researching China's Digital Generations

In late 2009, BCG conducted an extensive consumer-research campaign focused on urban and rural China. We interviewed 1,700 people from 12 cities in 11 of China's 22 provinces. China's cities are typically categorized into five tiers on the basis of population and income level. We conducted 400 interviews in Beijing, Chengdu, and Shenzhen; 300 interviews in the tier 2 cities of Harbin and Hefei; 400 interviews in the tier 3 cities of Yangzhou, Taizhou, and Guilin; 300 interviews in the tier 4 cities of Fushun and Xiangtan; and 300 interviews in the tier 5 cities of Yibin and Gaoping.

We interviewed people who were between 14 and 55 years old; interviewees were selected on the basis of age, gender, and income level to form a representative sample of the sociodemographic composition of each city tier. Interviews were conducted by experts using a variety of formats, including focus groups, workshops, diary-keeping, and game-playing exercises. The interviews covered a broad range of questions about usage patterns, attitudes, motivations, and aspirations.

Finally, we used BCG's city-income database and more than 20 third-party sources to determine the overall number of Internet users and mobile-phone owners in China and to define the demographic composition of China's city tiers. In addition, we interviewed experts from various sectors, including media, Internet, and software companies; device makers; telecommunications operators; and venture capitalists.



For Further Reading

The Boston Consulting Group publishes other reports and articles that may be of interest to readers of this report. Recent examples include the publications listed here.

**The Keys to the Kingdom:
Unlocking China's Consumer
Power**

A report by The Boston Consulting Group, March 2010

China's Luxury Market in a Post-Land-Rush Era

A White Paper by The Boston Consulting Group, September 2009

**Winning Consumers Through
the Downturn: 2009 BCG Global
Report on Consumer Sentiment**

A report by The Boston Consulting Group, April 2009

**Wealth Markets in China: The
Beginning of the Race for China's
Rich**

A Focus by The Boston Consulting Group, October 2008

**Foreign or Local Brands in China?
Rationalism Trumps Nationalism**

A Focus by The Boston Consulting Group, June 2008



Note to the Reader

Acknowledgments

We would like to acknowledge the following members of the BCG team for their support in preparing and writing this report: Ma Hongbin, Xu Ning, and Benson Qian. We also would like to acknowledge members of the editorial and production team, including Katherine Andrews, Angela DiBattista, Kim Friedman, and Janice Willett.

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