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INTERNET DEVELOPMENT IN CHINA AND ITS IMPACT ON BUSINESS PRACTICE

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Executive Summary

Since its first appearance in 1995, the Internet development in China has been among the fastest in the world. Despite the fact that the price of a PC is still a big expenditure for most Chinese households, the Internet users in China has reached 17million by July 2000.

The continuous expansion of bandwidth of Internet connection and the flourishing of numerous Internet ventures support this development. Most of these Internet ventures are set up and owned by private individuals. While most major industries in China, especially media and telecommunication industries are still dominated by state-owned enterprises, and the private sector is still facing difficulty in obtaining financing from banks and other sources, this fact is particularly interesting: How those successful Internet ventures got started and financed, how the capital evolved in these ventures, and how their business models differ from the those of their US counterparts are the major issues addressed in this paper.

We have carried out two case studies of the most successful Internet ventures in China, one portal Sina.com and one stock exchange platform Stockstar.com. Established in 1998 by a then 31-year old electric engineer Wang Zhi Dong in Beijing, Sina.com was built on its strength in Chinese character platform, and provided comprehensive news and community services. Its growth was supported by venture capital, and thus was transformed continuously by the shareholders towards more market-driven and more global. The strong technological expertise in Chinese platform and the solid understanding of the Chinese community made Sina.com an incomparable number one portal in China. Even after Yahoo! and AOL have launched their Chinese version website, Sina.com is still a dominant portal.

The success of another Internet venture Stockstar.com provides a rich example of doing business in the Chinese context. Gao Li Min, an ordinary clerk at Shanghai Subway

Company with neither capital nor important ‘connections’ in China, established and grew the online stock exchange platform Stockstar.com by leveraging the strength of a state-owned telecom company and foreign capital. It now has 8 million daily page views and more than 1 million registered users.

These two cases represent the entrepreneurship in the Internet area in China and the active involvement of foreign capital in fuelling their growth. Their successes have a profound impact on the business practice in China and the public’s view towards private enterprises.

I. Introduction

Walking on the main commercial streets in the downtown of Shanghai, you look around trying to figure out the character of this industrial and financial centre of China. Besides skyscraper office buildings and fancy department stores, you find yourself flooded in the billboard advertisements of 'www.etang.com', 'www.renren.com', etc. Buses pass by, too fast to see clearly the colourful ads on them, but you cannot miss the last few characters: '… .com'.

When people link Internet and e-commerce with China, they tend to refer to the price of PCs, the infrastructure, the usage of credit card, and the Internet penetration to conclude that it will take another 3-5 years for Internet business to be taken seriously in China. This is indeed far from the truth. The Internet development in China is among the fastest in the world. By the first half of the year 2000, the number of 'online' PCs in China, i.e. PCs connected with Internet, rose to 6.5 million, and the total Internet population reached 17 million.[1] From 1999, Legend, the biggest computer company of China, has become the No.1 PC seller in Asia-Pacific region with 9.1% of total market share.[2] Starting in 1995, the Internet in China has developed from educational, scientific and technical research areas to commercial applications. Recent statistics show that around 100 thousand domain names have been registered in China and there are more than 70 thousand Chinese websites existing.[3] The enthusiasm and entrepreneurial spirit among young people have never been so strong. In November 1999, China.com, a then almost unheard-of website in China, got listed on Nasdaq. It raised more than USD80 million through its IPO and achieved a market capitalization of USD 345 million on the first trading day.

[1] The Wall Street Journal, July 28, 2000
[2] Excluding Japan, IDC research report, http://www.idc.com
[3] *Survey Report On Internet Development In China*, July 2000, China Internet Network Information Centre

In this paper, we will analyze the Internet development in China. By conducting two case studies of a Chinese portal and a stock exchange platform, we are trying to explore three issues:

1). How these successful Chinese Internet ventures get started and financed
2). How they differ from US models and whether they can compete with US Internet ventures if the latter come to China
3). How these Chinese Internet ventures are gradually changing the business practice in China.

Finally, we will try to forecast the Internet development in the next few years.

II. Internet Development in China

The Internet first appeared in China in 1995. By the end of 1999, China had 7 major networks, CASnet (China Association of Science), CERnet (Education & Scientific Research Net), ChinaGBN (Golden-Bridge Public Economic Information), ChinaNet (Public internet), UniNet (operated by China Unicom Company), CNCnet (Net-connect Public network), and another network developed on the resources of the army.[1] Among them, ChinaNet (operated by China Telcom) has the most extensive network, covering most areas of China. The total bandwidth by June 2000 was 1234Mbps.[2]

[1] *China Computer World*, Jan 31, 2000
[2] *Survey Report On Internet Development In China, July 2000*, China Internet Network Information Centre

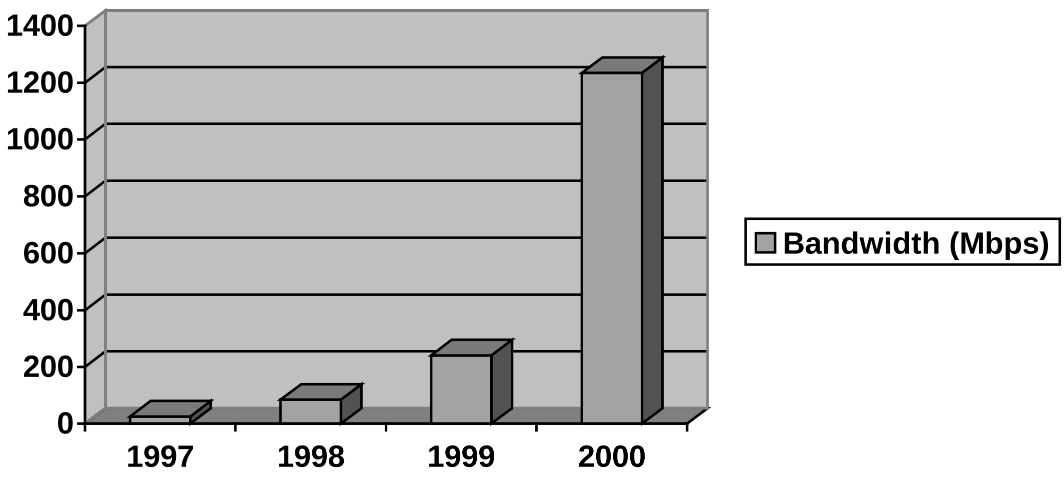

Figure 1: Internet Bandwidth in China 1997-2000. (*Source: Survey Report On Internet Development In China, July 2000 and Oct 1997)*

Thanks to the widespread of telephone service and the decreasing ISP (internet service provider) charge, more and more people can easily access and afford Internet. For instance, now in Shanghai and other big cities, by using whichever phone, public or private, one can just dial a 4-digital number, and connect his PC or laptop to Internet via modem. The charge is slightly higher than normal phone calls, but the users do not need to register at local ISP in advance, which is rather convenient for travellers. The Internet connection fee in major cities is USD 0.55 per hour by PPP method, including ISP charge and telephone charge, USD 0.8 per hour by ISDN, and USD 5.6 per hour by ASDL.

The accurate number of Internet users in China has always been controversial, as statistics vary a lot. After comparing the figure from different resources, however, the most convincing number comes from China Internet Network Information Centre: 100 thousand in 1996, 620 thousand in 1997, 1.18 million in 1998, 4 million in 1999, and 16.9 million in 2000. Due to multiple users of individual Internet account, the actual number could be even higher. By the year 2001, the Internet users in China are expected to double and reach 34 million. By the year 2003, it is predicted that there will be more than 80 million Internet users in China, which will account for around 6% of total population.[1]

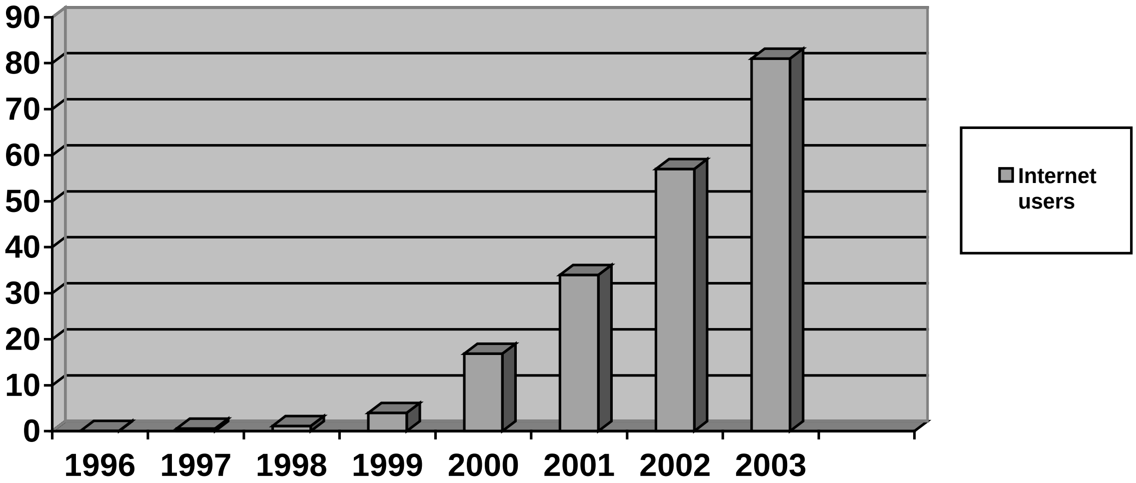

Figure 2: Internet users in China 1996-2003 (in million)

Besides PCs, TV top-sets could be an alternative for Internet access. The majority of individual surfers use PPP method to connect, while universities and companies tend to use the DDN or ISDN method. The government is encouraging people to use ISDN by lowering the service charge. By 1999, around 130 thousand individual surfers use this method.[2] Other connection methods like ADSL and Cable Modem are still rare.

It is believed that total Chinese websites are around 20 thousand by March 2000. However, in 1999, total online advertising revenue was still less than USD 10 million and the turnover of e-commerce was less than USD 30 million.[3] The major constraints and challenges are:

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[1] Predicted by Goldman Sachs, *China's Tangled Web, BusinessWeek, July 17, 2000*
[2] *China Computer World, Jan 31,2000*
[3] *China Computer World, Jan 31,2000*

1). Legislation is lagging behind and security for online transactions is a major concern

2). Online payment is the bottleneck as credit card payment is not widely used

3). Mainstay industries' involvement is still weak

There is clearly a sign that the government is catching up with the legislation, especially upon China's entering into WTO. By entering WTO, China agrees on eliminating all tariffs by 2005 on IT products such as computers, semiconductors and all internet-related products. The year 1999 is called 'Government Online Year', which means that all government departments are required to put public resources and information online. The mayor of Shanghai has announced that the IT industry is to be the mainstay industry of Shanghai and the municipal government will invest heavily in the IT infrastructure in the next 5 years, with implicit purpose to compete head on with Singapore and Hong Kong for the IT centre of Asia. More and more industries start to realize the importance and power of the Internet and are working hard to catch up the trend.

Despite fluctuation on the policy on ISP and ICP (internet content provider) and the lack of widely used credit card payment, many Internet ventures have achieved great success. Even after the world-brand US websites localized their service to the Chinese market, some Chinese counterparts can still compete, and are gaining an upper hand so far. Through those stories, the entrepreneurial spirit, the active role of venture capitalists in providing seed money, and the involvement of investment banks are sending a new message of management and business practice to the business community in China. Their relative number may not be large yet, but their influence will have a long-term effect.

III. Why These Chinese Internet Ventures Succeed and How

Case A. www.sina.com

Established	:	December 1998
Daily page views	:	34 million[1]
Founder	:	Wang Zhi Dong
Feature	:	Portal

1). How did it get started and financed

While outsiders talk about China.com[2] and its IPO on Nasdaq as the first Chinese Internet stock, they probably do not know that the site had nothing but an invaluable name. It was only ranked No.39 most popular website in China by the end of 1999 in a survey.[3] People in the Internet community, especially those who work at Sina.com make no effort to conceal their scorn at China.com. After all, Sina has undoubtedly been the most influential number one website in China.

Background

Born in 1967 in a small town in South China, Wang Zhidong got his Electricity Engineering degree at Beijing University in 1988. As one of the founders and chief programmer at Suntendy Electronic Information Technology and Research Company, Wang developed the first Chinese Character platform under MS-DOS and Windows environment, Chinese Star. It combined the display and input of Chinese characters, giving users choices among different methods of inputting Chinese. Until today, though Microsoft has developed Chinese Windows and bundled Chinese input (as it has always been doing), the newest version Chinese Star is still superior in intelligent inputting and much more user-friendly.

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1 *Sina.com Q4, 2000 Financial Report*
2 http://www.china.com
3 *Survey Report On Internet Development In China, July, 1999*

In 1993, Wang was headhunted to Stone Group, one of the largest pioneer IT companies in China. The cost was high for Stone: it invested 5 million HK Dollar in setting up a new subsidiary company Richwin. Wang became the CEO and claimed 21% equity of the new company. It was rare in China at that time for anyone to claim such a big share of a company in which he did not invest any money from his own pocket. The pay-off was also high for Stone: their first product, Richwin Chinese, a similar product to Chinese Star, soon overtook Chinese Star in the market as the No.1 Chinese platform. However, in 1993, with the appearing of the Chinese version Windows 95, Richwin had to look for a new growth point.

In January 1996, a US investment banker from RSC Company, Mr.Sandy Robertson, came to China looking for investment opportunities. He was introduced to Richwin and agreed to lead the first round financing of USD 6.5million to the company together with another two venture capitalists including Walden International Investment Group, an active venture capital firm in Asia. The purpose was to transfer Richwin into an international company while still using the talents in China to develop software. From then on, Richwin and Wang started to understand what management really meant. Like many entrepreneurs in China, Richwin had in fact been controlled by Wang and his family. The original programming code was in the hands of his brother while his wife was the CFO. A lot of arguing and quarrelling aroused between RSC and Wang, until finally RSC worked out a more generous option scheme for Wang. In return, Wang agreed to have RSC appoint a professional CFO and some other managers. It was a great achievement for RSC in transforming a traditional Chinese-style company into a modern structured company with a professional management team.

Due to the introduction of Sandy, Wang went to Silicon Valley several times in 1995 and 1996. The Internet ‘manic’ at Silicon Valley fascinated Wang, especially the legendary IPO of Netscape during that period. He decided to set up a Chinese website. By the end of 1998, Sinanet.com was set up and soon changed its name to Sina.com, which means in Chinese ‘New Wave’.

Starting up

From the very beginning, ambitious Wang had set the target for Sina.com: it should be the most comprehensive Chinese portal including as many services as possible, and the first stop and one-stop for every Internet surfer in China, an AOL type homepage for every Chinese.

It seemed too ambitious but due to Wang's incomparable talent in Chinese platforms, the efficient western style management of the company, as well as sufficient capital, Sina.com was able to sign up more programmers and partners than its competitors, and offer a user-friendlier platform, quicker news and free email service. Big names could be found in the list of partners: IBM, Intel, Motorola, HP, Legend Computer, China Telecom, China Economic Information Centre, etc. Although not a first mover as an Internet portal in China, Sina.com soon became the No.1 most visited portal within merely a few months. This made the second round financing relatively easy. As a matter of fact, the record high fund raising was even above the most optimistic expectations.

Developing

On May 10, 1999, at Sunnyvale California, Sina.com announced the completion of its 2nd round financing of USD25 million. This time, it was led by Goldman Sachs, which by itself was a recognition of its success. It was joined by several other investors including the Economic Board of Singapore. At that time, people started to forget the name Richwin, who then only possessed less than 15% of the total share after dilution. Wang himself had about 5% of the total share. The majority of the company shares fell into the hands of venture capitalists and investment banks. And people began to regard Sina.com as an independent Internet company.

After the 2nd round financing, Sina.com was allowed to be more aggressive in the market place. Besides providing more comprehensive all-including news, it launched more and more services: free chat rooms, search engines, free software download, financial data analysis, free online virus killers, video games, etc. Wang had learned a great deal from his early-year's failed battle with Microsoft in becoming the dominant Chinese platform. He knew well how to leverage the market leader position and bundle different services into Sina.com. Investment bankers encouraged Wang's ambition when he set up overseas offices and launched Sina.com's branch site in Hong Kong, Taiwan, and North America, with tailor-made news and contents aiming to attract all Chinese in the world. By the 4th quarter of 1999, Sina.com achieved an almost unsurpassable lead over all other portals and its visitors were increasing day by day. It had become a truly international company both in the sense of its shareholder/management components and its business operations. Now it came to the time for 3rd round financing, and probably the last one before the imminent IPO.

This time, more big names joined in, trying to catch up the last chance onto the train to fortune. Dell Computer led this round of financing of total USD60 million. Investors included Softbank, Sumitomo Corporation, Creative Technology, United Overseas Bank of Singapore, as well as 2nd round investors like Goldman Sachs and the Economic Board of Singapore. In July 2000, the board of directors at Sina.com seemed to reflect to a large extent its history and its status quo: besides Wang, people can also find the names of the Chairman of Stone Group, the Founder of Walden International Investment Group (seed fund provider), and the CFO of Softbank. (Appendix 3)

Future

When asked about Sina.com's vision and its future revenue (obviously, its current revenue from advertisement cannot cover its expenses at the moment), Wang said, 'Every product of Sina.com is developed on a strong software basis. Internet and software are inseparable. Internet has no fixed model, neither do online products and services. We have a very strong software developing team, which makes it possible for us to build up a platform to develop and offer different kinds of products and services.'

‘In the future, our profit will come from 4 channels: sales of software and Internet tools; advertising fees; membership fee for tailor-made news and information; and online exchange commission. We have the biggest Chinese customer base, which can turn into huge profit.’

Now, Sina.com has officially registered in the US and keeps two headquarters: one in California, one in Beijing. The US headquarter is responsible for securing new technology and information, and the Beijing headquarter is responsible for development and marketing. In the meantime, it has two major sales offices in Taiwan and Hong Kong.

Wang has long been expecting the IPO on Nasdaq. He was certainly disappointed by China.com’s IPO before Sina.com and had a strong argument with Goldman Sachs regarding the IPO timetable. Due to the instability of senior management, Goldman Sachs declined a quick IPO, which annoyed Wang. Recent information revealed that Sina.com finally dismissed Goldman Sachs and signed up Morgan Stanley Dean Witter as the underwriter for their IPO, as the latter agreed on a quicker IPO on Nasdaq.

Despite the dispute on the IPO timetable, Sina.com is expected to file its IPO this year, which will be the largest Chinese Internet venture ever listed on Nasdaq.[1] Despite the fact that there are many existing portals in China and more are set up every month, no one can or is likely to challenge the No.1 position of Sina.com. Many of the existing and newly set up portals are positioning themselves as niche players, e.g. focusing on job searching or targeting university students. Wang’s ambition plus Sina.com’s strong foundation in technology and sufficient capital will strengthen Sina.com’s leading position in the Chinese portal war.

[1] While we are writing this paper, Sina repacked its America, HK and Taiwan business and filed the IPO of this part at Nasdaq. The most important mainland China business was excluded due to prolonged procedure to getting approval from China Securities Regulatory Commission. It finally got listed on Nasdaq on April 14. The first issuing was 4 million shares. That week, Nasdaq index suffered one of its biggest losses in history. However, Sina.com opened at USD17 per share and stayed at about USD20.

2). How does it differ from US models and whether it can compete with US Internet ventures if the latter come to China

Sina.com vs. AOL

With the United States being the most advanced Internet pioneer, one may naturally think that Sina.com has been following the model of AOL (American Online). In fact, it may monitor AOL day by day for inspiration, but Wang insists on building everything according to the need of the Chinese market, a market sufficiently big for him.

The fundamental difference between AOL and Sina.com is that AOL is an ISP (internet service provider) as well as an ICP (internet content provider), while Sina.com is only an ICP, due to tight control of ISP by the Chinese government. Therefore, AOL has a strong billing capacity and stable revenues from subscription fee. It offers not only Internet access but also sophisticated and tailor-made services to its members. Sina.com has no billing power and has to provide everything for free to attract large online traffic which in turn attracts advertising.

Both of them have a strong leader, Steve Case and Wang Zhidong. Both of them have the vision of the Internet in the future, and have grown their business as fast as they could in different business and economics context. AOL built up its success from a series of acquisitions: from ICQ to Netscape, from MovieFone to Time Warner. Sina.com operates in a totally different environment, and it built up its success through the incomparable understanding and technology of Chinese platforms and continuous improving of the quality.

Sina.com's web page has a similar layout to AOL's but puts more emphasis on news instead of online shopping. The reason is simple: online shopping is not yet widely accepted in China and most people use the Internet to search for news and chat with others. However, it is not difficult for Sina.com to set up the e-commerce facilities whenever the environment becomes more favorable.

At the beginning of 2000, AOL launched its Chinese version site: http://aol.com.hk. It targets the Hong Kong market but AOL makes no intention to hide its interest in the mainland China. Is it a big threat to Chinese Internet portals? Will Sina.com still be able to compete if AOL finally launches its full Chinese version targeting mainland China?

The outlook is not bleak at all for Sina. There are several reasons that Sina.com may win over AOL on the Chinese market. First, due to the regulation in China, AOL is unlikely to obtain the right to do an ISP in China, so it loses one of its most important advantages.

Second, while AOL is launching its Chinese version website, it has to build and operate on a different technical platform. It is much easier for AOL to copy its structure into a French or German version than into Chinese characters. Therfore, it has no technology advantage in the market.

Third and most importantly, the habit of Internet surfers in China is very different, which means that the existing way of news group arrangements and searching methods of AOL may not be appealing to the Chinese. If it wants to succeed, it may have to re-do the whole structure to cater to local taste. It is much more than translation and a few modification. In this way, AOL will lose the advantage of operating globally. It will be like operating a completely new venture in a different environment with little to copy from other subsidiaries and little scale of economics to achieve.

In summary, we think that an Internet portal is very hard to transplant to another totally different culture, and Sina.com will remain competitive in the Chinese market.

3). How these Chinese Internet ventures are gradually changing the business practice in China

The Internet virtually opens the door to information to everyone. It makes tight control and censorship almost impossible. Websites like Sina.com have been changing the way people look for information. Many times, it was Sina.com that first disclosed what happened in China. For instance, when China and the US reached agreement on China's entrance into WTO last year, Sina.com was the first to disclose all detailed conditions online. This annoyed the authority, which did not want to disclose everything the US and China had agreed on immediately. The major newspapers, all state-owned, did not carry out any detailed report. But on Internet, it was a different world: almost every portal was eager to explore the content so as to attract more readers (surfers). The Internet companies like Sina.com simply make news control impossible and the access to information no longer a privilege.

More importantly, while AOL has taken the advantage of its high market capitalization and purchased Time Warner, why couldn't Sina do the same thing? Of course, the capital market in China is still not liquid enough as government and state-owned-enterprises have a majority share in most listed companies. However, as China is transiting irrevocably into a market economy, the possibility is high that these successful Internet companies may step into the 'real' economy and accelerate the steps of privatization.

Case B. www.stockstar.com

Established	:	March 1997
Daily page views	:	8 million[1]
Founder	:	Gao Li Ming
Feature	:	Online stock exchange and financial news

1). How these successful Chinese Internet ventures get started and financed

[1] News release from the company's website

Very few Internet ventures are making a profit in China now, and very few in the world, too. It has even been a common sense for investors not to look at revenue or profit figures of Internet companies.

Unlike many other Internet companies, Stockstar.com, an online stock exchange platform in Shanghai, set up its goal very clearly from the beginning: making money. It had a clear idea on when and how. It positioned itself in probably one of the fastest growing industries in China - stock exchange. And two years after its establishment, it did breakeven and started to make money. The success of Stockstar.com is a very good example of how to do business in China, how to explore good business opportunities and in the meantime, how to leverage the strength of state-owned enterprises.

Background

The founder of stockstar.com, Mr. Gao Li Ming keeps a very low profile in China. Outside the Internet community, few people know him. He did not hold a high diploma from universities abroad, nor a key position in some big-name companies before setting up Stockstar.com. However, inside the Internet circle, he is highly respected as a visionary, a modest but legendary star in e-business.

Gao graduated from Shanghai Fu Dan University in early 1990's, majored in Mathematics. After graduation, he worked at Shanghai Subway Company. During that period, he spent most of his spare time trading stocks and futures. His mathematics background, however, did not earn him a fortune in these two markets.

In 1994, Gao happened to get touch with the Internet. At that time, he was among the very few people in China who happened to know about the Internet. He was immediately fascinated. He knew that his chance and fortune were coming.

Although the commercial prospects of the Internet were by no means clear in China at that moment, Gao foresaw the great opportunity in combining the stock market and

Internet technology. He once said to some people, ‘I believe that those to be traded online should be something standardized. The more standardized the better. It will be much easier to provide value-added services to these standardized products and processes, thus much easier to make money.’ At that time, no one really understood what this mathematics graduate talked about. In Gao’s eye, stock exchange was probably the most standardized product. All the processes of quoting and trading were very standardized and they were always required to be so. China’s stock market was developing really fast, so was the Internet. He knew very well that if he could combine these two things, the opportunity was immeasurable. Undoubtedly, few people in China had such a farseeing perspective at that time.

Starting Up

In 1995, for a small clerk like Gao at Subway Company, developing such a business idea into an Internet venture in China was very difficult, if not totally impossible. Without money (few VCs in China at that time), manpower, or patented technology, Gao seemed to lack everything fundamental to set up the business. Again, he demonstrated his farseeing ability.

He thought about a possible cooperation with Shanghai Telecom Administration Bureau. It was a wild idea then for an individual, almost without anything, to suggest a cooperation with a big state-owned enterprise. In fact, few entrepreneurs would do that, in fear of the bureaucracy, old mindset, loss of control, etc., arising from the cooperation with a state-owned company. However, Gao had his reasoning. ‘Shanghai Telecom has its nearly monopoly advantage in telecommunication in this commercial centre of China, and has huge capital. By working with them, I may lose control and eventually have a small share, but without them, I cannot possibly succeed. This is my only chance.’

Indeed, Gao submitted a business plan, or rather, a report, to Shanghai Telecom Administrative Bureau in 1995. In his report, there were three major reasons for setting up an Internet online stock brokerage company. First, the stock price quoting was always at different trading floors. It could not enter millions of offices and homes, unless via Internet. Second, the market analysis and comments in newspapers were always too late. One could not provide real-time information and send it by articles and charts to a majority of people, unless by electronic means. Third, the physical trading floors were too expensive, both in terms of infrastructure and of operating cost. Only a virtual trading floor, i.e. online, could extend its reach rapidly and cheaply. Of course, Gao also mentioned revenue source and profit prediction: at first the revenue would come from software development for the Stock Exchange Bureau and other stock brokerage firms. Later it would come from online transaction fees. By today's judgement, this business plan may seem to be unfocused. However, just because of this 'realistic' revenue and profit proposal did Gao finally get support from Shanghai Telecom Bureau.

Although the report was well thought, it was not until one year later that Shanghai Telecom Administrative Bureau realized the importance of the Internet and decided to set up the venture, Stockstar.com, as one of its many projects. Gao was appointed as an outsourced Vice General Manager of this new venture, as no one inside Shanghai Telecom had a clear idea of what to do exactly. An official of Shanghai Telecom held the General Manager position, which was a nominal position with no operational responsibility in the company. This arrangement was a symbol of control that could justify Shanghai Telecom's capital investment. Gao held 20% shares of the company and had to be responsible for everything, from recruitment to development and marketing.

Developing

Since then, Gao used Shanghai Telecom's capital and infrastructure, and outsourced most technicians to develop the platform. He himself was also a key technician in product development. The website was put up in early 1997 and was being refined continuously. It soon became the most visited website of all Shanghai Telecom's websites.

As formerly proposed, Gao also developed software for stock brokerage firms in order to breakeven. By the end of 1997, Stockstar.com did breakeven and was making profit. The software development might be deviating from the online business Gao really wanted to do, however, this experience enabled Gao and his technicians to better understand the stock market and the trading system. Later, it was very easy for them to develop software for online trading and stock market analysis, which users could download.

Up to 1998, its online services were all free. Stockstar.com provided real-time stock price quoting and analysis. However, it had not provided real-time trading service yet. Most users watched their online quoting at home and traded by telephone through different brokers. In preparation for online trading, Gao was working hard to create a sufficient population to his website by offering free services. At the same time, he was applying to the authority for the right to do online stock brokerage business.

In the 2nd half of 1998, Gao had some major negotiations with Shanghai Telecom. He wanted to separate Stockstar.com from Shanghai Telecom as an independent legal entity instead of a subsidiary under Shanghai Telecom. At that time, due to the fast development of Stockstar.com and its ever-increasing population, several venture capital firms approached Gao wishing to invest. According to a leading VC in China, Stockstar.com had three superior characters: a very good technical platform, a very good positioning in a very good market segment, and a very good visionary leader. Gao felt that it was his chance now to take full control of the company, in reality as well as nominal.

It was amazing that Gao, lacking financial background, would figure out a kind of MBO (management buyout) proposal. He and his major technicians set up another company, Mei Nin Computer Technology Company. With the support from Lian Chuang Investment, a major VC in China, Gao and his technicians bought back a major share of the Stockstar.com and turned it into a Joint Venture between Mei Nin Computer Technology and Shanghai Telecom. Shanghai Telecom was still a major shareholder with around 35% shares and the remaining 30% belonged to Lian Chuang, who also committed another USD 10million for further development.

Now Gao was the CEO of the new company, Stockstar.com, which was no longer a subsidiary of Shanghai Telecom but could still use the resources and support of Shanghai Telecom. With the financial support from the VC, Gao could focus his entire effort on building the online stock exchange platform. As most Internet companies spent a lion share of VC money in marketing, Gao insisted that marketing was not everything for Stockstar. He said, '30% of the money should be invested in building infrastructure, 30% in management, including building up the best team in China, and the remaining 40% in marketing'. Gao and his team developed several very useful analytic software programs for users to download, free of charge. And many famous analysts wrote articles for them. The daily page views reached 10 million by the end of 1998.

At the beginning of 1999, Gao still could not get the right of online stock brokerage from authority. He decided to go ahead by establishing a partnership with brick-and-mortar brokerage firms. Three months later, in May 1999, he formed a partnership with Hong Kong & Macau Stock Brokerage Firm (HKM), one of the biggest brokerage firms in China. Since then, everyone can open an account at HKM and trade either at HKM's many physical trading floors in China or through Stockstar.com. All the settlement is done by HKM and Stockstar earns a certain amount of fee from HKM for transactions through Stockstar. The brokerage fees for both methods are the same. In fact, brokerage fee is the same rate everywhere, as regulated by the authority. Stockstar.com attracted population not by lower fee, but by quick service, comprehensive analysis, and a tailor-made trading environment. For instance, it can be easily modified by users to show only the quoting of their favorite stocks, and the real-time analysis and technical charts by customers' preference. By the end of April 2000, the daily page views reached 18 million. Stockstar had become the No.1 stock-related website in China, and is far ahead of any competitors in the market.

Future

Gao is not so eager to go through an IPO. Stockstar.com is already generating profit and financial support for further development is sufficient. Due to their very low operating cost and very low investment requirement for expansion, their profit margin is high. Both Gao and Lian Chuang, the major VC backing Stockstar.com, agreed to wait some time until Stockstar has grown even bigger to have a more favorable market price than now.

At the same time, Gao has a hidden concern. He has always dreamt of doing online brokerage and clearing by himself one day, rather than through some partner like HKM and earning merely a small percentage of the transaction fee. Up to now, the regulation is still tight and there is no sign that Stockstar can obtain the right of online brokerage in the near future.

One alternative for Gao is to set up a real brokerage firm to do all settlement while all transactions are to be done online. The investment could be smaller than other brokerage firms as Gao does not need very big spaces. But still he needs to set up many offices nation-wide to do the settlement and logistics. This is very costly and more important, it deviates from Stockstar's main strategy.

Therefore, it seems that the best strategy for Gao is to stick to the partnership with HKM, while waiting for the future loose of regulation on online brokerage. However, there is always a great threat that other powerful brick-and-mortar brokerage firms may set up their own full-service online platforms and compete seriously with Stockstar.

One of the best approaches for Stockstar in its current situation could be to position itself as a neutral platform and tie up the most important brokerage firms as its partners. Only by pooling the resources of different brokerage firms can Stockstar sustain its leading position in this market.

In April 2000, right after one of the biggest downfalls of Nasdaq in history, Goldman Sachs decided to invest in Stockstar.

2). How does it differ from US models and whether it can compete with US Internet ventures if the latter come to China

<u>Stockstar.com vs. Schwab.com</u>

It is hard to compare Stockstar.com with other major online stock brokerage firms in the US or Europe, like Schwab, E*Trader, etc., as the regulations and operating environments are totally different. Schwab or E*Trade compete mainly on low brokerage fee. Investors all over the world can send cheques or deposits by credit card to them and trade stocks online. They offer good service. Although the service may not be as good as that offered to institutional clients, these online brokerage firms charge a very attractive discount transaction fee. Stockstar.com can not compete on brokerage fee, which is tightly regulated by the authority. However, it can compete on better services, as well as very low service charge. Due to these differences, Stockstar did not, or could not copy anything from its foreign counterparts like Schwab.

However, the tight regulation in China could be a blessing for Stockstar.com. Unlike in US or Europe, most stock traders in China are private individuals, rather than institutional investors. They trade at a high frequency by themselves at thousands of trading floors of different brokerage firms all over the country, and represent a majority of total trade volume. This large, fragmented investor body is most desirable for Stockstar.com. It can compete on a large scale to attract these individual investors by good service and a comfortable trading environment, but may not be very competent to attract big institutional investors who demand professional research and superior services.

On the other hand, due to the regulation, there will not be a price war on brokerage fee. This is of great advantage to Stockstar and serves as a big entrance barrier for new comers. With its current scale and high growth rate, Stockstar is very difficult to surpass by competitors. The most effective weapon for competitors or newcomers is probably a price war, but this possibility is eliminated by the regulation of the authority. While Schwab attacked traditional brokerage firms like Merrill Lynch successfully by low brokerage fee, it also faces great competition from newcomers who offer an even lower fee. Stockstar does not need to worry about that. Moreover, it can enjoy a very good profit margin.

3). How these Chinese Internet ventures are gradually changing the business practice in China.

The influence of Stockstar.com in China is huge. It is believed that there are more than 30 million individual stock traders in China. They used to crowd the different trading floors to monitor the quoting and do the trading. When the market was bullish, the trading floors could be very crowded. Actually one cannot possibly analyze anything in such an environment. The whole activity of trading is, to a great extent, like gambling.

Now with Stockstar, investors can do their homework at home and analyze their portfolio. Moreover, Stockstar opens a 'classroom' online and publishes a lot of articles on how to invest. This helps individual investors to better understand the market and many of them will evolve to rational long-term investors instead of active day traders (or gamblers). In fact, many people buy computers now and one of the major incentives is to receive the services of Stockstar to facilitate their trading.

In summary, we believe that Stockstar.com not only provides value-added service to users, but also serves as an indispensable media to 'educate' immature investors, to make them more rational and adopt a correct attitude towards investing.

III. Forecast of Internet Development in China

a. Investment

The Internet is developing very fast in China, almost at 100% growth rate per year. In 1999, about 90% of all investments came from the government compared to only 10% from private investors. However, more investment is expected to come from private sectors. In the year 2000, the investment from the private sector will exceed 25%, and in the next three years, this percentage will increase to 60%, surpassing the government to be the most important financial force in Internet development.[1]

b. Internet population

In 2000, the Internet users in China have reached 17 million. And they may reach 81 million by year 2003.[2] Although there is debate at this moment on which will be the major medium for Internet surfing, PC, mobile phone or TV top-set, etc, we anticipate that the PC will still be the major medium to go online in China in the next three years.

c. Revenue of Internet business

There are four main sources of revenue in the Internet business: usage of the infrastructure, online services, advertising, and e-commerce. The unit rental fee and the usage charge of the infrastructure, e.g. cable, ISDN, etc., will decrease. However, due to the explosive growth of the Internet population, the total revenue will increase steadily.

In the next three years, most online services will still likely be free, except for some very special tailor-made services, which may charge a nominal membership fee. The free-of-charge model will remain the only way to create a big customer base and to survive in the fierce competition.

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[1] *China Computer World, Jan 31, 2000*
[2] Predicted by Goldman Sachs, *China's Tangled Web, BusinessWeek, July 17, 2000*

Online advertising will increase rapidly. In 1999, total revenue of online advertising was around USD 8 million. In the year 2000, the total revenue will reach USD 40 million.[3] And in the next three years, this figure is expected to increase at an average of 80% per annum.

E-commerce, both B2C (business-to-consumer) and B2B (business-to-business) will enjoy fast development. Since the credit card payment is still not a general practice in China, the bottleneck of online payment will not be easily solved in the short term. In the next few years, COD (cash-on-delivery) will still be one of the methods of payment as well as credit card payment. In 2000, the total turnover of e-commerce in China will be around USD1 billion.[1] It is expected to reach USD12 billion in 2002, and USD25 billion in 2003.

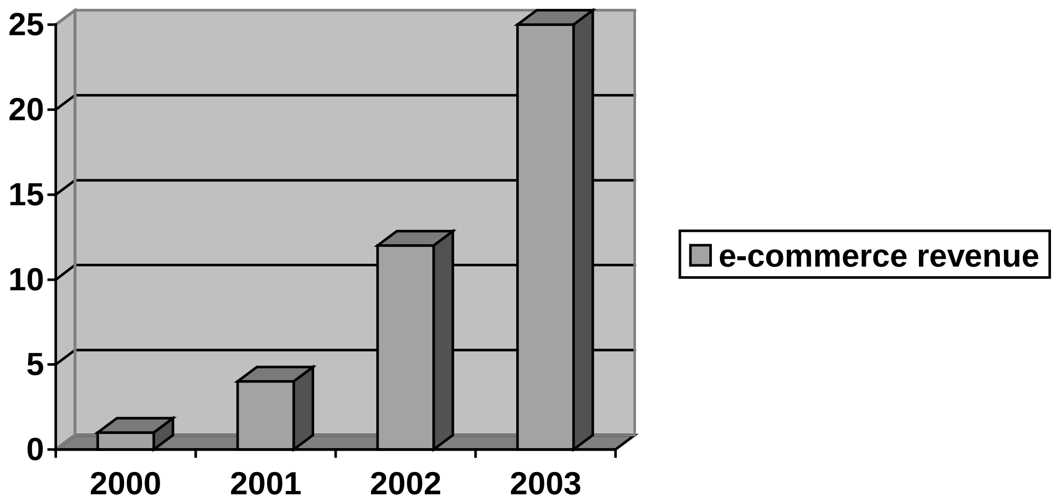


Figure 3: Predicted e-commerce turnover in China 2000-2003 (USD in billion)

d. Impact on business practice

[3] *China Computer World, Jan 31, 2000*

More and more people are using the Internet as a major way to communicate, collect information, chat with friends, trade stocks, and make purchases. Everything will be more transparent, news, price of products, stock analysis, etc. The access to information is no longer a privilege.

Currently, the pioneers in e-commerce are mostly new start-ups. However, more and more traditional companies are starting to offer products and services online. In 1999, many major computer and consumer product manufacturers in China have put up their websites and are offering online purchasing and services. More small firms are utilizing start-up Internet companies to provide technical support in setting up websites. For example, 8848.com, a B2C start-up, provides a platform for many small enterprises. They offer free service in setting up and maintaining virtual shops for these small enterprises in the 8848.com website and only charge a small percentage fee for any online transaction realized through them.

In the next three years, it is expected that the number of traditional industrial companies setting up their online service will grow at 300% per annum. More small and medium-sized companies will adopt the 'shopping-mall' model to outsource Internet companies to provide services in setting up and maintaining their virtual shops online.

During the next three to five years, the Internet will keep growing at a very fast rate in China, which is already one of the most dynamic places for Internet development.

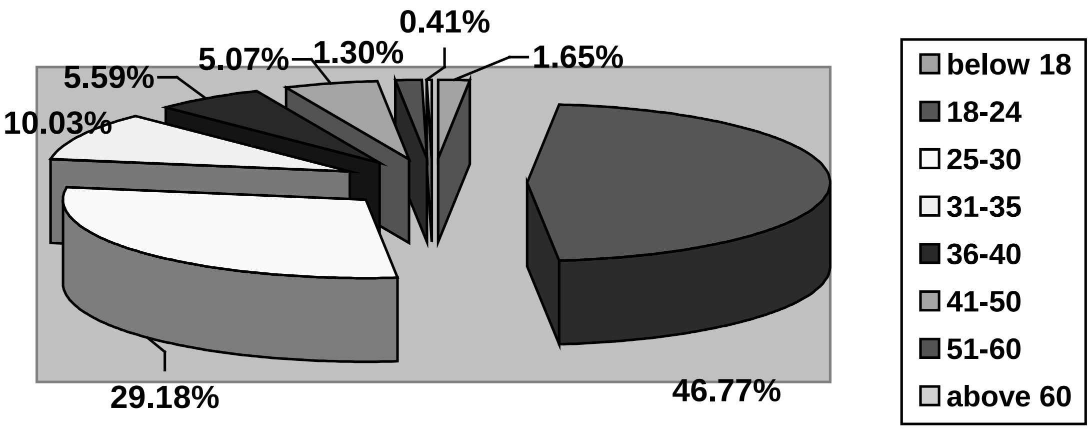
[1] *China Internet Institute Report, July, 2000. (http://www.cii.net.cn)*

Appendix 1

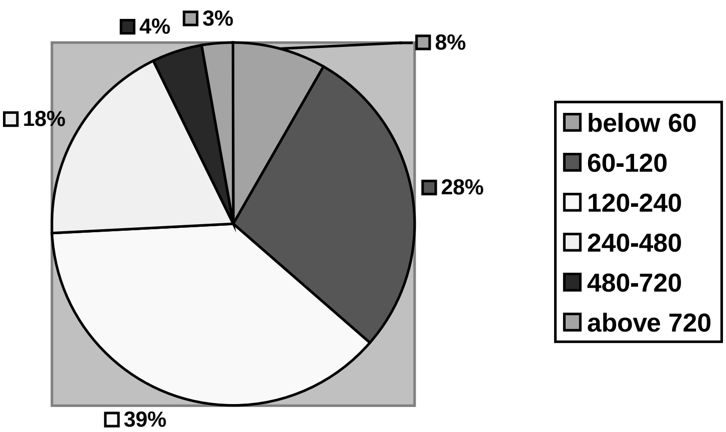
Demographic composition of Internet users in China

(*Source: Survey Report On Internet Development In China*, July 2000, China Internet Network Information Centre)

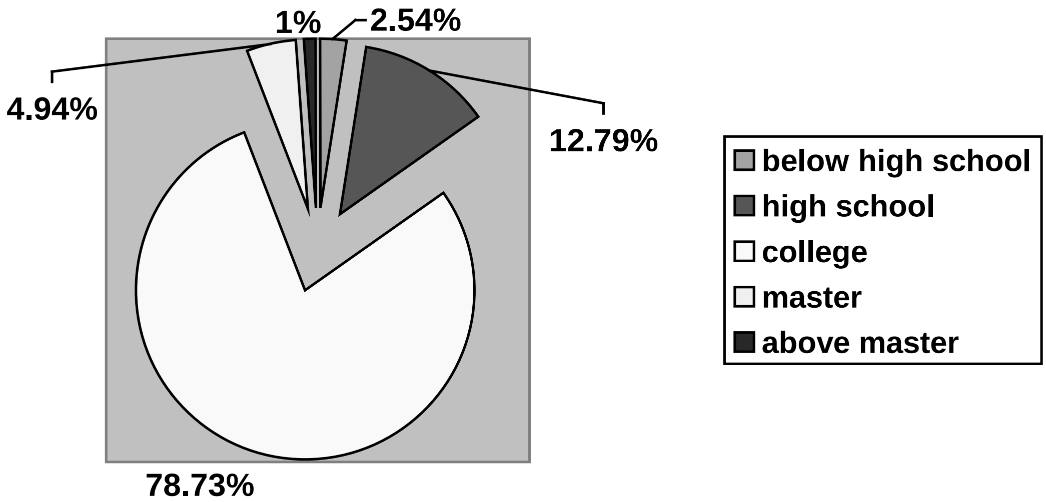
a. By Age



b. By Income



c. By Educational Level

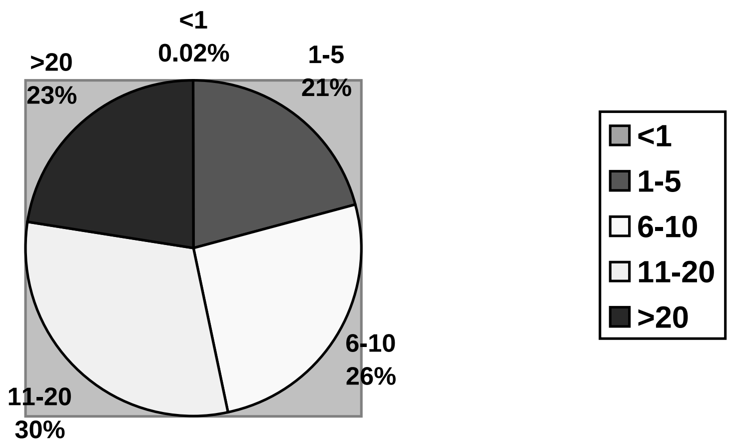


Appendix 2

Surfing habits of Chinese Internet users

(*Source: Survey Report On Internet Development In China*, July 2000, China Internet Network Information Centre)

a. Hours of using Internet per week



Average online hours per week: 16.54

Appendix 3

Sina.com Board of Directors

(As of July, 2000. Source: http://www.sina.com*)*

Daniel Chiang, Chairman, SINA.com

Selected in 1998 by Inter@ctive Week Magazine as one of "Asia's Internet Moguls," Mr. Chiang held the position of Chief Executive Officer at SINANET.com before his election as Chairman. Prior to joining SINANET.com in 1996, he was President of Trend Micro, Inc., an international corporation specializing in Internet virus protection and content security for large enterprises. Under Mr. Chiang's leadership, Trend Micro expanded from a 10-person operation to a multi-national company with more than 200 employees and 1997 revenues of $60 million. He holds a master's degree in Political Economy from the University of Texas, Dallas, and a bachelor's degree in Diplomacy from National Cheng-chi University, Taiwan.

Zhidong Wang, Chief Executive Officer and President, SINA.com

Zhidong Wang founded BSRS, China's largest Internet and software company, in 1993. BSRS gained fame throughout the global Chinese community with the 1994 launch of Rich Win, a software that finally made the Internet Chinese-friendly by allowing Net browsers to recognize and display Chinese characters. BSRS merged with SINANET.com in 1999, creating SINA.com web sites.

An entrepreneur from the beginning of his career, Mr. Wang also founded both Suntendy Electronic Information Technology and Research Company and Chinese Star, where he developed the first Chinese-language adaptation of the Microsoft Windows operating system. He holds a B.S. degree in Engineering from Beijing University.

Dr. Pehong Chen, Chairman, President and CEO, BroadVision

Dr. Chen is a renowned expert and leader in the field of new media software technologies. Prior to starting BroadVision, he was Vice President of Multimedia Technology at Sybase, responsible for the company's interactive initiatives. Dr. Chen founded and served as President of Gain Technology, a leading supplier of multimedia software tools. At Gain, he pioneered multimedia as an enabling technology for a new generation of business applications that engage end-users and consumers in a process of interaction and information exchange. Gain was acquired by Sybase, a leading supplier of database software, in 1992 for over $100 million. Before founding Gain, Dr. Chen was a project manager at Olivetti Research Center, in charge of multimedia and user interface development.

Yoshitaka Kitao, CFO, Softbank Corp.

Mr. Kitao has served as Executive Vice President and Chief Financial Officer of Softbank Corporation since 1995. He was appointed President and Chief Executive Officer of Softbank Finance Corporation in 1999. He has served in the same positions at E*Trade Japan K.K. since 1998. Mr. Kitao is also President/CEO of SoftVenture Capital Co., Ltd., Softbank Ventures, Inc. and Softbank Contents Partners Corporation. He concurrently holds the position of President of Cybercash K.K. and is a Director of Trend Micro, Inc. He has served as Director of Nomura Wasserstein Perella Co., Ltd. from 1992 to 1993, Managing Director of Wasserstein Perella & Co., Inc. from 1989 to 1992 and General Manager of Nomura Securities Co., Ltd.'s Corporate Finance and Services Dept. from 1992 to 1995.

Lip-Bu Tan, Founder and Managing General Partner, Walden International Investment Group

Mr. Tan has been active in the U.S. venture capital industry since 1982. In 1986, he introduced and pioneered the U.S. venture capital investment concept in Asia and has continued his involvement in the Asia-Pacific region. During the last decade, Mr. Tan has successfully built WIIG into an international venture capital firm with a strong local presence in both the U.S. and Asia. He has also served as a Director of Creative Technology Ltd., Premisys Communications, Inc., Integrated Silicon Solutions, Inc., and several other public and privately held companies. Mr. Tan holds a master's degree in Nuclear Engineering from the Massachusetts Institute of Technology and an MBA from the University of San Francisco, where he serves on the Board of Trustees. He received his bachelor's degree from Nanyang University, Singapore.

Ter Fung Tsao, Chairman, Standard Foods Taiwan LTD.

Mr. Tsao has served as the Chairman of Standard Foods Taiwan LTD since 1986. Before joining Standard Foods, he was the Exploratory Engineer and Director of Process Development for the Quaker Oats Company in the U.S. In 1981, he returned to Taiwan to continue working for Quaker Oats as Operations Manager, Marketing Manager and Managing Director. Mr. Tsao received his bachelor's of science degree in Civil Engineering from Cheng Kung University in Taiwan, his master's degree in Sanitary Engineering from Colorado State University, and his doctorate degree in Food & Chemical Engineering from Colorado State.

Duan Yongji, Chairman, Stone Group

A co-founder of Stone Group, Mr. Duan currently serves as the Group's Chairman. Mr. Duan is also the President of Zhongguanchun Development, the "Silicon Valley" in Beijing. A graduate of Qinghua University and a research fellow at Beijing Aeronautic College, he held a senior position at the Chinese Aeronautical Research 621 Laboratory from 1982 until 1984. In 1992, Mr. Duan was acclaimed as China's Outstanding Privately Owned Technology Industrialist and heralded as a Chinese Technology Entrepreneur.

Management Teams

Zhidong Wang, President, Chief Executive Office and Director

Daniel Mao, Chief Operating Officer

Before joining SINA.com, Daniel Mao served as vice president of Walden International Investment Group, overseeing investments in technology-based companies in the United States, China and Hong Kong. He has served as a director for numerous companies in the areas of telecommunications, networking, software, Internet services and technology, semiconductors and medical equipment.

In his college years, Mao started up an enterprise software company. He holds a master's degree in Engineering Economic Systems from Stanford University and a bachelor's degree in Computer Science from Jiaotong University in Shanghai, China.

Victor Lee, Chief Financial Officer

Victor Lee joined SINA.com as CFO in November 1999, bringing the company over 18 years of financial management experience in multinational firms. Lee previously held the position of Vice President and Acting Chief Financial Officer at VLSI Technology, a semiconductor manufacturer. He was instrumental in completing VLSI's acquisition by Philips Electronics in the summer of 1999. From 1989 to 1997, Lee was Director of Finance at Advanced Micro Devices. His experience at AMD includes 10 years managing Asian finance operations and serving as co-project leader of the company's China assembly operations start-up. Lee received his M.B.A and Bachelor's degree in Industrial Engineering and Operations Research from the University of California, Berkeley.

Hurst Lin, U.S. General Manager and Vice President of Business Development

A co-founder of Sinanet.com, Lin oversees SINA.com's U.S. operations as well as all aspects of business development. Previously, he served as a consultant with Ernst & Young Management Consulting Group, focusing on marketing and operations in telecommunications and technology companies. Lin has also held marketing, engineering and management positions at Octel Communication, Inc. and NYNEX. He received his MBA from Stanford University and holds a bachelor's degree in Electronic Engineering from Dartmouth College.

Yan Wang, China General Manager

Mr. Wang has served as General Manager of China Operations for SINA.com since September 1999. He previously held the post of Executive Deputy General Manager for Production and Business Development in China. In May 1996, Mr. Wang founded the SRSnet.com division of Beijing Stone Rich Sight Limited, a wholly-owned subsidiary of SINA.com'. From 1996, he served as the head of the SRS Internet Group and created one of the earliest eCommerce Web sites in the People's Republic. Mr. Wang holds a bachelor's degree in Law from the University of Paris.

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