

REPORT

China's Digital Generations 3.0

The Online Empire



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CHINA'S DIGITAL GENERATIONS 3.0

THE ONLINE EMPIRE

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EXECUTIVE SUMMARY

CHINA HAS BECOME A major Internet market with increasingly sophisticated consumers.

- In 2011, Chinese consumers spent 1.9 billion hours *a day* online—an increase of 60 percent from two years earlier.
- By 2015, China will add nearly 200 million users, reaching an Internet population of more than 700 million users—double the combined number of Japan and the U.S.
- Between 2011 and 2015, online retail sales will triple to more than \$360 billion.

Companies that want to win in China’s consumer market must understand both these new consumers and their rapidly evolving digital lifestyles.

- Half of Internet users say that the Internet is their most trusted source of information, followed by television at 30 percent and newspapers at 15 percent.
- Between 2008 and 2011, the online share of consumer spending increased from 11.8 percent to 14.3 percent. Between 2011 and 2015, per capita online spending will likely rise by 15 percent annually.

To understand China’s digital generations, companies need to understand how they experience the Internet in their daily lives.

- The market can be broken into eight segments, defined by age, income, and location.
- The rural market, for example, has 26 percent of Internet users and 22 percent of Internet hours—big numbers for a segment that

has not received the same attention as the urban and youth segments.

Online buying and selling, including group purchasing, is the second-fastest-growing activity after microblogging.

- Companies cannot have a major presence in China without having an online presence, not only to generate sales but also to engage with customers where they spend so much time.
- In 2010, more products were purchased on Taobao, a major online marketplace, than at China's top five brick-and-mortar retailers combined.
- Even when they are not actually shopping online, many consumers research products online that they eventually buy in physical stores. Twenty-five percent of consumers research online before buying offline.

Companies with ambitions in China should have a strong Internet presence and strategy. They need to meet their customers in the places where they spend time, and increasingly that is online.

- Channel management and digital marketing should be two primary focus areas.
- More fundamentally, many companies will need to transform their operations and organization to take advantage of the opportunity to sell to and engage with China's digital generations.

IN CHINA, THE INTERNET IS EVERYWHERE

CHINA MAY STILL BE classified as an emerging market, but on the Internet it has arrived. By 2015, China will add nearly 200 million users, reaching an Internet population of more than 700 million—almost double the combined number of Japan and the U.S. (See Exhibit 1.)

If not by 2015, then shortly thereafter, China will likely become the largest online retail market in the world, with close to 10 percent of retail sales occurring online. It already has more online shoppers than any other market, including the U.S.

While China is a huge online market, it is not an easy one. Although consumers are rapidly gaining sophistication, they have their own patterns of online consumption and behavior that are different from those of consumers in the West. The big three Internet companies—Alibaba, Baidu, and Tencent—have a firm hold on their corners of the market (e-commerce, search, and messaging, respectively) and are working hard to consolidate their positions and move into new fields.

The Boston Consulting Group has regularly tracked the evolution of China's digital consumers since 1998, and this report is the latest in our series chronicling the epic transformation of China's consumer landscape. Companies that want to succeed in China's consumer market must understand both

these new consumers and their rapidly evolving digital lifestyles. They also need to learn how to reach, sell to, and retain these consumers as they create the world's most important consumer market of the future.¹

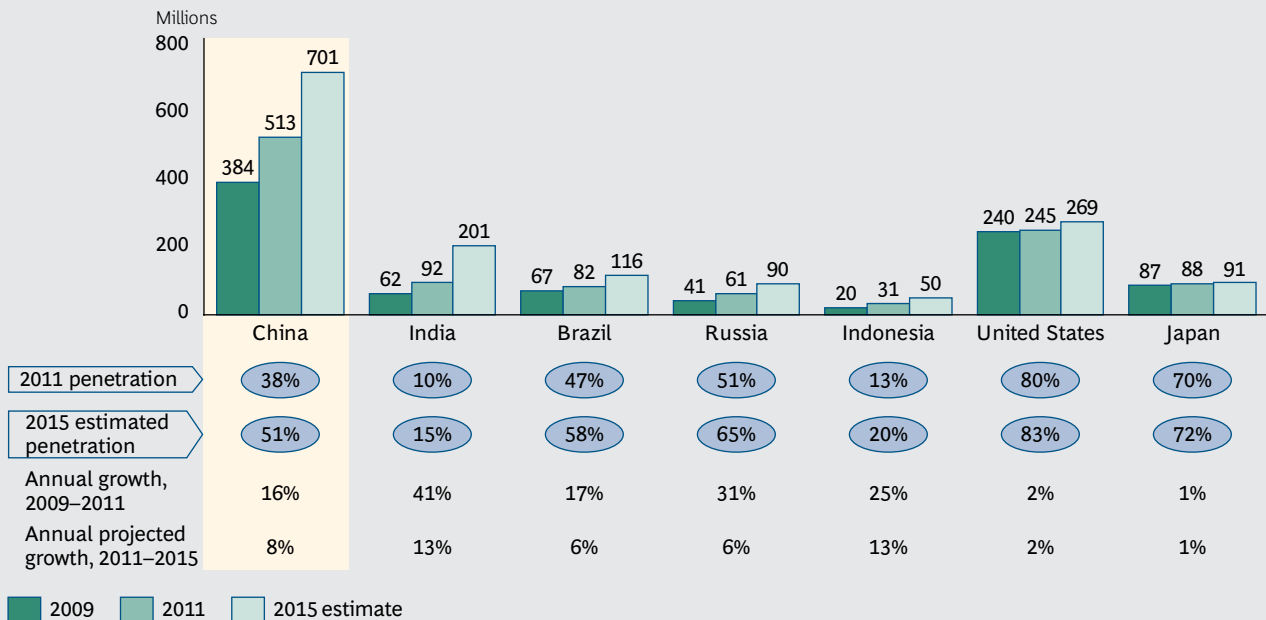
A Massive Mass Medium

Just a few years ago, the digital life in China was dominated by young urban residents. Not any longer. The nation's overall penetration rate will exceed 50 percent by 2015, compared with 38 percent in 2011. The Internet will soon replace newspapers as the medium with the second-highest daily reach, after television, in urban areas. Among individuals under the age of 30, the Internet's penetration is almost as high as television's.

China already has more online shoppers than any other market, including the U.S.

Increasingly, the Internet is becoming a staple in the everyday life of Chinese consumers across a wide spectrum of lifestyles and incomes. In fact, the Internet has spread so widely and so quickly that we have added two groups to our Internet market segmenta-

EXHIBIT 1 | By 2015, China Will Have Nearly Twice the Number of Internet Users as the U.S. and Japan



Sources: Business Monitor International; China Internet Network Information Center; Economist Intelligence Unit; International Telecommunication Union; BCG analysis.

Note: Internet users are defined as individuals aged 6 and older who went online in the past six months.

tion: seniors (defined as individuals aged 51 and over) and rural residents.

Rural residents will contribute more than one-third of the Internet’s growth between 2011 and 2015—a rate faster than between 2008 and 2011. The urban senior segment will likely grow by 22 percent annually between 2011 and 2015, making it the fastest-growing segment. (See Exhibit 2.)

In 2011, Chinese consumers spent 1.9 billion hours *a day* online—an increase of 60 percent from two years earlier. This surge was powered by both an expanding Internet user base and a greater online presence. The average time online per person increased from 2.8 to 3.6 hours per day between 2008 and 2011. Chinese users average about an hour a day more online than U.S. Internet users. Television viewing, meanwhile, declined from 1.7 to 1.4 hours during those years.

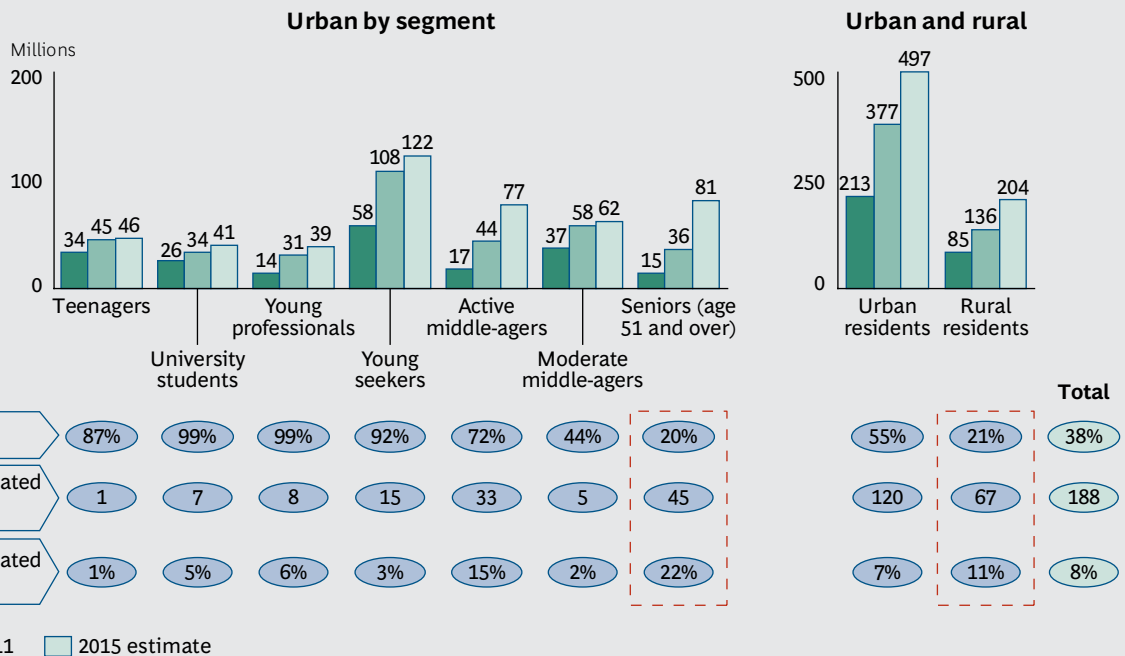
Far from crimping the expansion of the Internet, the government is encouraging its growth. During the current five-year plan, which runs through the end of 2015, the government has committed to spending \$250 billion on broadband infrastructure. Indeed, in response to con-

sumer demand for more and faster Internet, the government launched an antitrust probe of China Telecom and China Unicom that has prompted the two dominant carriers to agree to accelerate their broadband rollouts, lower prices by 35 percent, and increase speeds.

In 2011, Chinese consumers spent 1.9 billion hours a day online.

As the quality of infrastructure improves, the Chinese will be surfing the Web more often at home and at work and less often at Internet cafés. They will also be relying on their mobile phones. In 2011, 69 percent of users said they used their phones to access the Web—up 30 percentage points in just three years. The share of hours spent accessing the Internet on mobile devices is rising rapidly among all age groups. In fact, seniors spent 30 percent of their Internet hours on mobile devices in 2011, compared with just 9 percent in 2008. Mobile access will rise as 3G penetration increases from 9 percent in 2011 to 31 percent in 2015.

EXHIBIT 2 | Older and Rural Residents Will Drive Future Growth



Sources: China Internet Network Information Center; National Bureau of Statistics of China; Economist Intelligence Unit; BCG analysis.
Note: The total number of urban residents is greater than the sum of urban residents by segment because it includes children between the ages of 6 and 11. Some numbers have been rounded.

As the Internet becomes ubiquitous, it will play an even larger role in China. Half of Internet users say that the Internet is their most trusted source of information, followed by television at 30 percent and newspapers at 15 percent, according to our research. Trust and familiarity go hand in hand. The more time that consumers spend on the Internet, the more they trust it.

Young professionals and university students lead the pack in putting their faith in the Internet, with 70 percent and 63 percent, respectively, citing it as their most trustworthy information source. Only 27 percent of users aged 51 and over, on the other hand, said that the Internet is their most trustworthy information source. (See Exhibit 3.)

Not Just Fun and Games

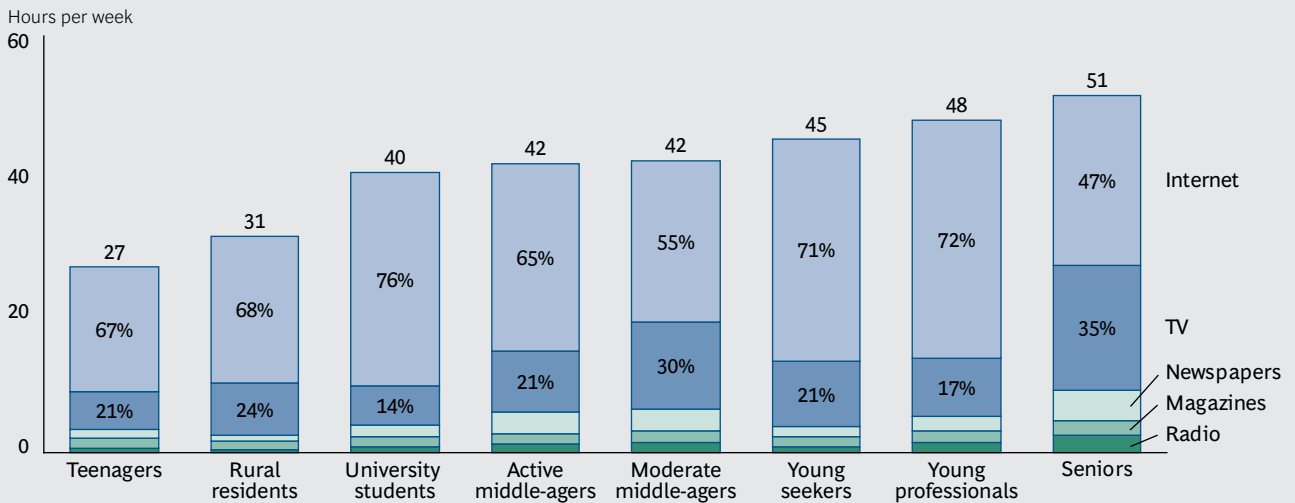
In the early days of the Internet in China, users gravitated to leisure pursuits such as watching videos and listening to music. Those activities are still highly popular, especially among younger users. China has local sites similar to YouTube, such as Tudou and Youku, which have agreed to merge, and simi-

lar to Hulu, where traditional programming is offered, such as iQiyi and LeTV.

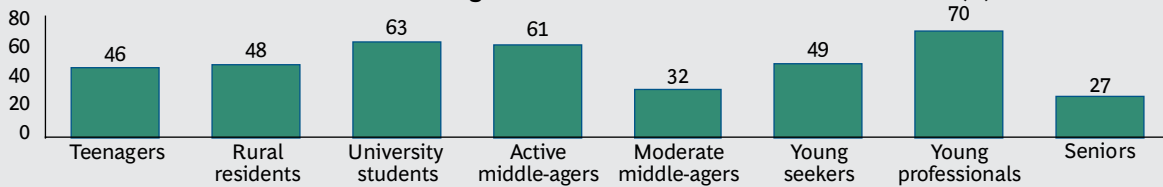
As their comfort level and sophistication have grown, users have branched out from entertaining themselves to a more diverse mix of activities including those they once avoided, notably e-commerce. Between 2008 and 2011, the online share of consumer spending increased from 11.8 percent to 14.3 percent. Between 2011 and 2015, per capita online spending will likely rise by 15 percent annually, more than doubling the expected overall increase in consumer spending and reflecting both the rising level of trust by consumers and the greater protections put in place by merchants.

Along with e-commerce, users are spending much more time on community-oriented and information activities. Community-oriented activities include e-mail, instant messaging (IM), and forms of social media. (See Exhibit 4.) Sina Weibo, a Chinese version of Twitter, has attracted more than 300 million users in less than three years of operation. Sina Weibo once handled 32,312 posts per second, surpassing Twitter's peak traffic record. *Weibo*

EXHIBIT 3 | The Heaviest Users Trust the Internet the Most



Share of users choosing the Internet as their most trusted source (%)



Sources: BCG survey of 2,000 consumers from first- to fourth-tier cities and rural areas; BCG consumer focus groups; BCG analysis.

EXHIBIT 4 | Community and E-Commerce Activities Are Rising Swiftly



Sources: BCG survey of 2,000 consumers from first- to fourth-tier cities and rural areas; BCG analysis.

(pronounced *WAY-bo*) means “microblog,” and there are several competing services, but Sina’s is the most influential.

Weibos are generating both national and local conversations on important social issues that have historically been kept under wraps. In July 2011, one of China’s bullet trains crashed in Wenzhou, in the southeast of the country, killing 40 passengers. Sina Weibo quickly became, in the words of a *Wall Street Journal* columnist, “a conduit for inconvenient truths and cynical speculations about the accident.”

Environmental activists have begun to post daily or even hourly readings of air quality in China’s pollution-draped cities. The publicity generated by these readings has forced the government to revise its policies on collecting and publicizing air quality data in a nation where hundreds of thousands of premature deaths are attributable annually to air pollution.

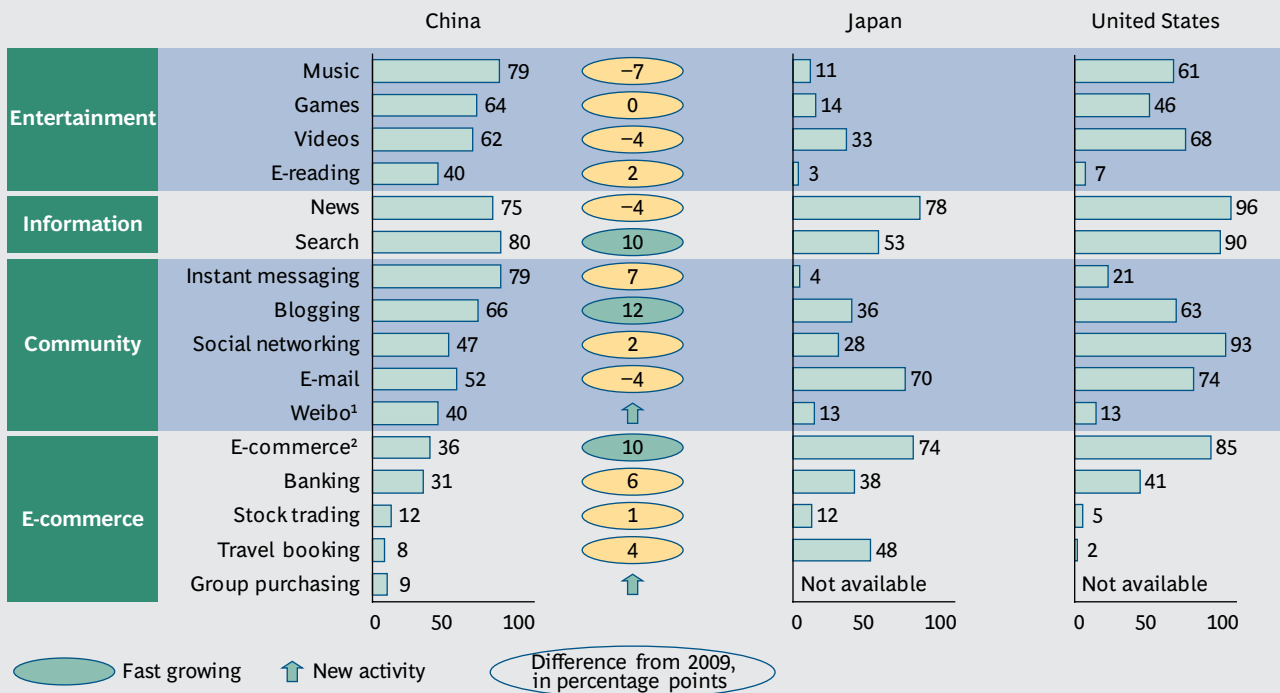
The government has an uneasy relationship with this new-found passion for public discourse. In late March, Sina Weibo and Tencent Weibo, the two largest microblogging sites, temporarily suspended the ability of users to comment on posts. This restriction was part of a temporary crackdown on social networking brought on by political unrest.

As the Internet in China becomes a home for digital shopkeepers and an instrument for public discourse and social change, it will also start to look and feel similar to the Internet of more developed nations. In fact, in some cases, Chinese consumers are more avid users of online services than U.S. consumers are.

For instance, 79 percent of Chinese Internet users send instant messages, compared with just 21 percent of U.S. users. They are also bigger consumers of online music (79 percent versus 61 percent) and e-reading (40 percent versus 7 percent). (See Exhibit 5.)

EXHIBIT 5 | Search, Blogging, and E-Commerce Are the Fastest-Growing Activities

Percentage of Internet users engaged in various activities in 2011



Sources: China Internet Network Information Center (CNNIC) reports from July 2009 and July 2011; U.S. data from ComScore 2011; Japan data from Mobile Content Forum 2010–2011; BCG analysis.
¹CNNIC did not track microblogging until after 2009.
²E-commerce includes online shopping and online bill payment.

When Chinese consumers access the Internet from mobile devices, they are frequently more adventurous than their counterparts in Japan and the U.S., listening to music, reading books online, or engaging in social networking. (See Exhibit 6.)

Chinese Internet users are also maturing. Between 2008 and 2011, the average age of an Internet user rose from 24.7 to 28.9 and approached the average age of users in the U.S. (30.0) and Japan (30.4). The aging of the Internet reflects both new users and the general aging of the population. In 2011, the 51-and-older segment made up 24 percent of the Chinese population; by 2015, it will make up 28 percent.

Maturity means that future growth of the user base will slow. China's Internet population is expected to increase by 8 percent an-

nually between 2011 and 2015—one-half the annual rate of the previous two years.

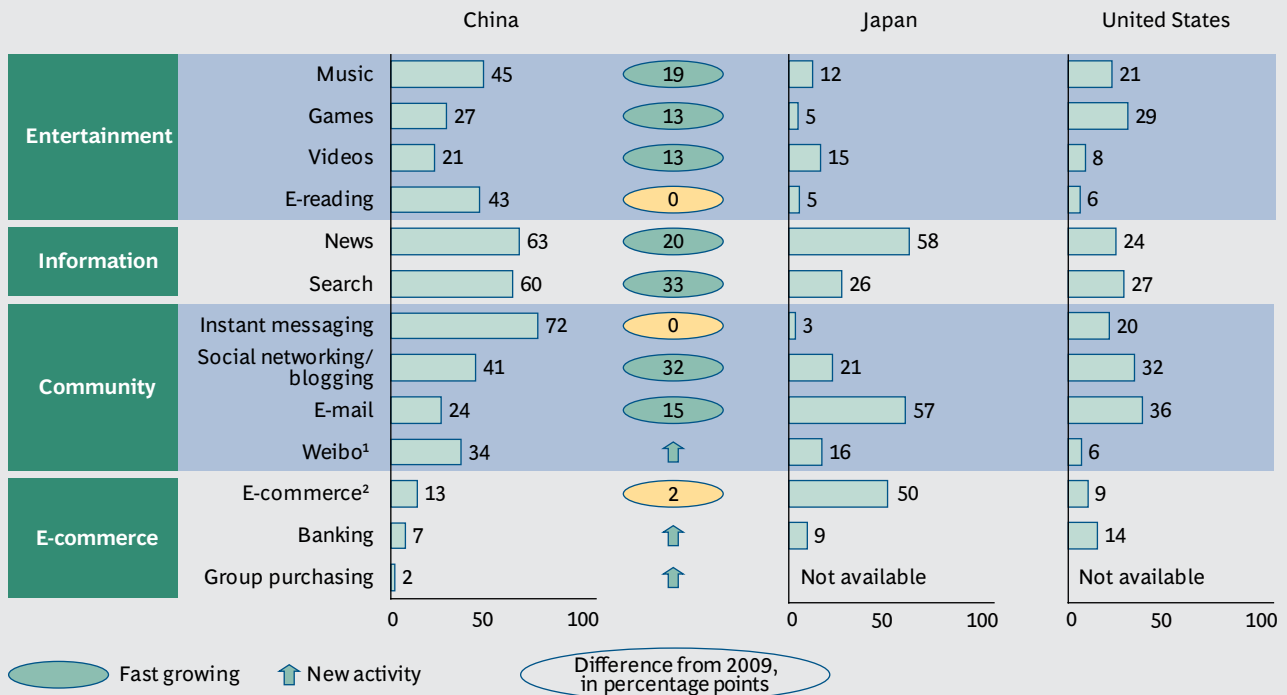
However, opportunities will continue to expand, even as user growth flattens. Online retail sales, for example, are projected to grow more than 30 percent annually between 2011 and 2015. Companies that acquire scale and customer loyalty in China's online market will have achieved a solid foothold, ensuring future growth.

NOTE

1. See *China's Digital Generations 2.0: Digital Media and Commerce Go Mainstream*, BCG report, May 2010; and *China's Digital Generations: The 570-Million-Hour Opportunity*, BCG report, July 2008.

EXHIBIT 6 | Mobile Internet Activities Are Growing Swiftly

Percentage of mobile users engaged in various activities in 2011



Sources: China Internet Network Information Center (CNNIC) reports from July 2009 and July 2011; U.S. data from ComScore 2011; Japan data from Mobile Content Forum 2010–2011; BCG analysis.

¹CNNIC did not track microblogging until after 2009.

²E-commerce includes online shopping and online bill payment.

THE CHANGING FACE OF THE INTERNET

TO UNDERSTAND THE INTERNET in China, it is necessary to look at it through the lenses of users and learn how they experience it in their daily lives. The Internet is not monolithic in China or anywhere else but rather a broad canvas across which users can move among interests and activities. It is crucially important for companies that want to reach consumers in China to understand them on their terms and not impose mental maps drawn from other markets.

In previous reports on China’s digital generations, we relied on six segments, based on in-

come and age, to provide that perspective. Those six segments are still valid but do not accommodate rapid recent growth among older generations and rural residents. Accordingly, we have added a rural and a senior segment. (See Exhibit 7.)

The segmentation helps identify both top-down and bottom-up views of the Internet market in China. The view from the top has some surprises. The rural market has 26 percent of Internet users and 22 percent of Internet hours—big numbers for a segment that has not received the attention that the urban

EXHIBIT 7 | Eight Ways to Segment the Internet

	Teenagers	University students	Young professionals	Young seekers	Active middle-agers	Moderate middle-agers	Seniors	Rural residents
Age	12–18	19–25	26–35	26–35	36–50	36–50	51+	12+
Basics	Grew up with the Internet	Grew up with the Internet	Educated and middle class	Lower education and income	Middle class and familiar with the Internet	Lower education and income	Grew up without the Internet	Lower education and income
Motives	Fun and study	Maintain social connections	Make work, life, and play easier	Excitement and achievement	Support in daily activities	Relaxation and fun	Stay in touch with family	Entertainment and diversion
Usage	<ul style="list-style-type: none"> • Light • Videos and IM • Willing to try new activities 	<ul style="list-style-type: none"> • Light • Videos, IM, and weibo 	<ul style="list-style-type: none"> • Heavy • Wide usage across the board 	<ul style="list-style-type: none"> • Heavy • Videos, games, IM, and e-commerce 	<ul style="list-style-type: none"> • Moderate • Videos, news, and e-commerce 	<ul style="list-style-type: none"> • Light • Videos, news, and IM 	<ul style="list-style-type: none"> • Light to moderate • Videos, news, and IM 	<ul style="list-style-type: none"> • Light • Videos, games, and IM

Sources: BCG survey of 2,000 consumers from first- to fourth-tier cities and rural areas; BCG analysis.
Note: IM = instant messaging.

and youth segments have. In fact, the rural market has more users than the young-seeker segment—individuals aged 26 to 35 who have not been to college—which historically has led the pack. The senior segment may be the latest to use the Internet, but it is catching up quickly. The average senior user is on the Internet 3.5 hours a day—almost as much time as active middle-aged users. (See Exhibit 8.)

Our segmentation is broad and basic, filtering the market through the screens of age, income, and location. And while it is battle tested, there is no substitute for companies doing their own consumer research, developing their own insights, and targeting discrete groups of consumers through multiple channels.

All the Segments Matter

The Internet in China continues to be dominated by entertainment, especially video. But there is growing usage in e-commerce, community-oriented, and information activities. The eight segments, however, do not participate in these activities equally. (See Exhibit 9.)

Younger users tend to spend more time online but, other than young professionals, are not yet spending large sums of money online. Middle-aged users spend less time online than their younger peers, who grew up with the Internet. The willingness of middle-agers

to experiment online rises with education. Although seniors and rural residents have been largely overlooked and are newer to the online world, they are rapidly making the Internet a part of their lives.

The senior segment may be the latest to use the Internet, but it is catching up quickly.

Teenagers. Teenagers are big fans of IM and all forms of online entertainment. Like their older peers in college, they are also starting to use such services as Sina Weibo to communicate with friends. They spend 2.6 hours a day online—the lowest among all the segments.

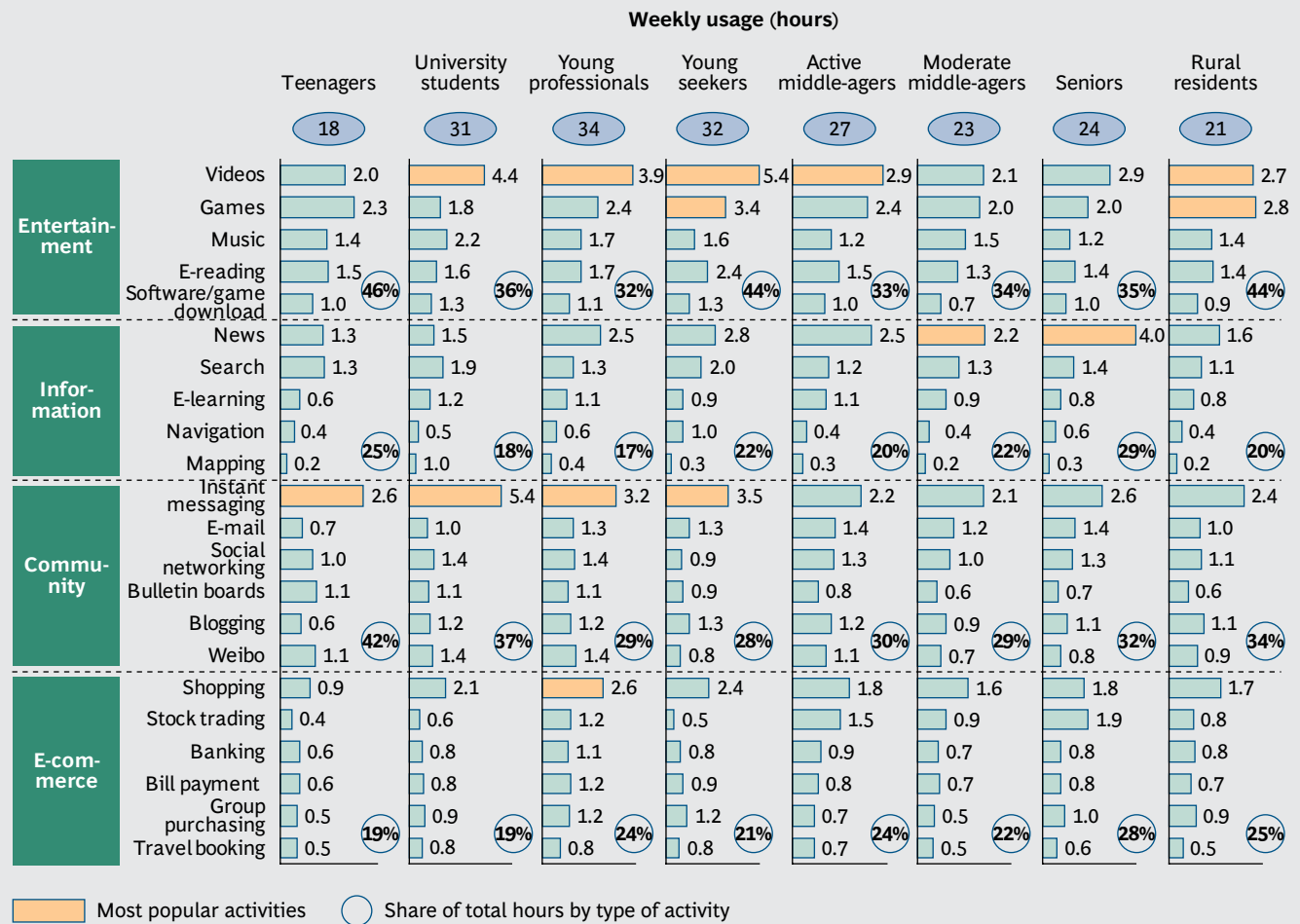
University Students. More than any other segment, university students use the Internet to communicate with friends and family and to build online communities. They are the heaviest users of IM and, along with young professionals, the most active users of weibo, devoting 1.4 hours a week to this service. Despite limited disposable income, they spend 2.1 hours a week shopping online—the third-highest total among the segments.

EXHIBIT 8 | Young Seekers and Rural Residents Are the Biggest Segments

	Teenagers	University students	Young professionals	Young seekers	Active middle-agers	Moderate middle-agers	Seniors	Rural residents
Population (millions)	52	34	32	117	61	131	184	550
Internet penetration ¹	87%	99%	99%	92%	72%	44%	20%	23%
Average daily usage (hours)	2.6	4.4	4.9	4.6	3.9	3.3	3.5	3.0
Share of total Internet users	9%	7%	6%	22%	9%	12%	7%	26%
Share of total Internet hours	6%	8%	9%	28%	10%	11%	7%	22%

Sources: BCG survey of 2,000 consumers from first- to fourth-tier cities and rural areas; BCG analysis.
¹Penetration is defined as the share of individuals who use the Internet at least monthly.

EXHIBIT 9 | Online Hours Vary Across Segments



Sources: BCG survey of 2,000 consumers from first- to fourth-tier cities and rural areas; BCG analysis.
Note: Since activities may overlap, total hours may be less than the sum of hours for each activity.

Nearly all university students are online at least monthly.

Young Professionals. Members of this segment are online the most and are the most adventurous. The average user spends 3.9 hours a week watching online videos, 3.2 hours on IM, and 2.6 hours shopping online. Young professionals spend the greatest amount of time on e-commerce, leading or tying other segments in every individual activity except for stock trading, where they are beaten by the active-middle-aged segment and seniors. Like university students, nearly all young professionals log on to the Internet at least monthly. (See the sidebar “A Day in the Life of a Young Professional.”)

Young Seekers. Members of this segment are the same age as young professionals but are

less educated and have lower incomes. They are the heaviest users of online entertainment services, especially videos and games, but their online lives are much richer than just movies and fun. Young seekers spend more time reading news online and conducting online searches than any other segment. They are also the second-most-active online shoppers. Responsible for 28 percent of all Internet hours, they are a group to be reckoned with.

Active Middle-Agers. While these users spend less time online than young professionals, they have similar usage patterns, with entertainment and community their two largest categories of online activity. They like to shop, trade stocks, and conduct banking online but are not yet big users of online search, compared with other segments. Along with the

A DAY IN THE LIFE OF A YOUNG PROFESSIONAL

Jing, 28, is single. She lives in Beijing but seemingly spends all her time on the Internet. As she says, “All of my needs can be met in the digital world—both products and knowledge.”

Jing spends about five hours a day online, and about 60 percent of her purchasing is directed through online channels. A young professional with a monthly take-home income of \$1,200, Jing is not alone in her fascination with the Internet. Many of her peers are equally drawn to the Internet’s convenience and conviviality and commercial venues.

On the way to work, she catches up on weibo posts. When she gets to her office, she reads and replies to e-mail and conducts online searches. During lunch, she looks for the latest bargains at Taobao. If she is unsure about the quality, she buys from the brand’s official website instead. After lunch, Jing relies on the Baidu search engine and Yahoo! Finance to collect data for a client report. At the end of the workday, Jing logs on to Tuan800 to find movie and dinner deals.

But her online day is not yet done. In the evening, she chats online with friends and watches the latest episode of *The Big Bang Theory* and *Desperate Housewives* on Sohu HDTV, an online site. Before retiring, she spends a few minutes on her iPad.

Jing sometimes complains about information overload. “It is overwhelming and time consuming surfing the Internet,” she says. But she—and many other young professionals—wouldn’t have it any other way.



senior segment, they spend the most time per week on e-mail.

Moderate Middle-Agers. This segment is demographically analogous to the young-seeker segment. These users have less income and education than active middle-agers, but—unlike their younger peers—the gravitational pull of the Internet is much weaker for them. Their daily average usage of 3.3 hours is lower than all segments except teenagers and rural residents. As a share of total time online, they are relatively active online shoppers and readers of online news.

Seniors. You can call them senior, but don’t call them unsophisticated. Of the eight segments, they spend the most time reading news online—four hours a week. They also spend more time trading stocks online than active middle-agers. (In interviews and focus groups, they say that their children frequently help them with this activity.) The Internet allows them to stay in touch with their

children and grandchildren through IM and e-mail. (See the sidebar “Gray and Getting Used to the Internet.”)

Rural Residents. Although rural residents are relatively light users, their three hours a day online are not put to waste. The Internet enables them to access goods and services that otherwise would be out of reach. They like to shop online and they spend more time than any other segment, except young seekers, playing online games—about 2.8 hours a week. They are also big users of IM. (See the sidebar “Basic Necessities.”)

Online Goes Mainstream

Over the four years that we have tracked the digital generations in China, many Internet users have moved from one segment to another or migrated to more sophisticated activities within a segment. The Internet is becoming entwined with routine activities at work and at home.

GRAY AND GETTING USED TO THE INTERNET

Defen is 59 years old and has been online for only the past three years. She is emblematic of many other older residents who are new to the Internet and just starting to find their balance in the online world. Defen is retired, and she and her husband have a monthly take-home income of \$650.

Defen likes the connections the Internet provides her daughter and the entertainment value of playing games on the Kaixin social-networking site. But she is also intimidated by the online world. It is, she said, “too complicated for me to learn new things, like online shopping.”

Despite her misgivings, Defen is trying to become comfortable with this new medium. Besides playing games, she chats with her granddaughter and reads news online and her daughter’s weibo posts. Her daughter has helped her buy wine from 360buy.com, and she bought a laptop online with the help of her son and daughter-in-law. She has no interest in buying clothes online. She estimates that she does 15 percent of her spending online.

Defen also has an offline life, listening to music and watching China Central Television and Beijing Television.



Young Professionals and Young Seekers. This shift is especially apparent among teenagers who went on to become young professionals and young seekers. As recently as six or seven years ago, these individuals were high school students watching traditional television, chatting with friends through QQ in Internet cafés, and experimenting with Baidu search.

Young professionals bank and trade stocks online with greater frequency.

Upon graduation, the future young professionals went to university, while the future young seekers entered vocational school. But their online experiences were remarkably similar. They stopped watching broadcast television, gained access to computers, and plunged into online videos, social networking, and information gathering. They started using e-mail and relied on search to answer academic questions. As a college student in Beijing said, “It’s more about relationships and information.” They also started to buy online.

The online paths of the two segments diverged when the individuals entered the workforce. While both groups spent less time on QQ chat, the young seekers gravitated toward online games and the young professionals started posting on Sina Weibo and other microblogging sites. Today, the young professionals spend more time on community-oriented services in order to make work and career connections, whereas the young seekers are more inclined toward information services, especially online news, while continuing their focus on entertainment. A recent graduate working in Beijing said, “Work requires me to learn faster and more,” while a 26-year-old young seeker living in Zhongshan, in Guangdong Province, said he was looking to “connect to the society, learn new things, and relax.” Members of both segments are active online shoppers, but young professionals bank and trade stocks online with greater frequency.

Active and Moderate Middle-Agers. These two segments also began their Internet journey from similar spots a few years ago. They started by experimenting with chat applications and online games and surfing the Web. Neither segment would qualify as

BASIC NECESSITIES

Tao is a 25-year-old high school graduate who lives in a rural town called Wenxin outside Chengdu in western China. He owns a PC and a 2G phone and views the Internet largely as an entertainment portal. It is “convenient and fun,” he says. “I surf the Internet when I am bored.”

Most of his time online is spent playing games and watching movies and videos. But he does check the news, on both his computer and his phone. He bought both a bag and a phone from Taobao. Although he was disappointed in the quality of the bag, he was pleased with the price and performance of the phone. He buys minutes for his phone online and also spends about \$10 a month playing online games. About 10 percent of his buying is conducted online.

Tao is frustrated with the Internet’s speed. He is intrigued by smartphones with their potential for offering a better mobile Internet experience.



heavy users. As one active middle-ager said, “It was more about entertainment.”

In the last two years, active middle-agers have become adventurous in their online activities. Of the 22 online activities we tracked, the active segment spent more time than the moderate segment on all of them except for music, search, and navigation. Active middle-agers are starting to view the Internet as a part of their everyday life, while moderate middle-agers still view it as an adjunct.

Two quotes sum up the contrast. An active middle-ager told us that the Internet was “part of my life. I get information, go shop-

ping, watch video, and play games.” A moderate middle-ager, on the other hand, said he was “not that addicted to the Internet, but it is convenient and helpful.”

WHILE the eight segments help to illuminate the differences within China, the Internet has the power to draw the sprawling nation together, by both serving as a soapbox for a national conversation and extending companies’ commercial footprint.

THE POWER OF DIGITAL DIALOGUE

THE WEIBO POSTS ABOUT the train crash in Wenzhou and smog-shrouded cities are emblematic of the awakening of a national conversation about issues of public concern and private interest. Blogging and microblogging have higher penetration rates among Internet users in China than among those in the U.S. or Japan. The growth curve of Sina Weibo to generate 300 million users in less than three years looks more like a straight vertical line.

Sina Weibo was launched in June 2009, after the government blocked Twitter and Fanfou, a Twitter clone. Since then, the service has grown both virally and through clever marketing. Sina Weibo has encouraged celebrities in business, show business, and the media to join, and some of them have attracted tens of millions of followers.

Although weibos follow the 140-character limit of Twitter, the Chinese characters themselves contain far more information, allowing posters to convey much longer and more complex thoughts. If tweets are phrases, weibos are paragraphs.

Weibos have become a fast-moving stream of collective consciousness. While controversy and complaints may receive the most attention, especially in the Western media, celebrity gossip is a more common form of currency. Users also post news stories, exchange photos

with former classmates, and comment on recent purchases.

This wellspring of opinions is forcing companies and the government to respond. While the role of weibos in the overall marketing landscape is still evolving, companies at least need to be able to respond swiftly and decisively when their products and services are called into question on microblogging sites and elsewhere online.

Weibos have become a fast-moving stream of collective consciousness.

In 2010, a large dairy was the victim of an online smear campaign orchestrated by a rival that could have severely damaged its brand without a rapid response. The rival spread false rumors that the dairy's brand of powder baby formula caused premature sexual maturity in baby girls.

Besides crisis control, companies ought to be examining how and when they can harness the power of online conversations to burnish their brands. Vancl, an online clothing retailer, has been especially successful at this approach, which is explored in the next section.

Positive commentary about products and services, in other words, can go viral just as easily as gossip and news about catastrophes.

Even the government is getting into the act. As of October 2011, government agencies across all 34 provinces had created nearly 20,000 weibo accounts. Police agencies have cracked cases with the help of clues provided through weibos. Nanjing, a city of 5 million in eastern China, has started to post air quality readings on Sina Weibo.

There is also a more controversial side to the government's involvement with weibos. With 300 million users, Sina Weibo is probably too big to shut down—but not too big to monitor. All Internet companies in China practice a

form of government-supervised self-censorship in order to stay in business. Sina has a team that monitors content 24 hours a day on Sina Weibo. During the Arab Spring, for example, many posts about Egypt were scrubbed from the site. The more recent crackdown on commenting on Sina Weibo and Tencent Weibo is further evidence of the government's involvement.

When it comes to conversation, it is hard to put the genie back into the bottle. In late 2011, the government announced that people must start using their real names to open weibo accounts. The jury is out on whether the new rule will slow, change, or deflect the conversation.

E-COMMERCE IN CHINA

IN THE PAST TWO YEARS, Chinese consumers have opened their wallets and pocketbooks online. Online buying and selling, including group purchasing (through the Chinese equivalents of Groupon), is the second-fastest-growing activity, after microblogging.

These rapid rises in usage reflect more than just expansion from a small base. Online shopping is now the fourth-most-popular online activity in China, and two of the more popular activities—IM and online games—are declining in usage.

Online shopping is here to stay. Companies cannot have a major presence in China without having an online presence, not only to generate sales but also to engage with customers where they spend so much time. The Internet today in China is similar to television in the 1960s and 1970s in the West—the place where consumers congregate and companies need to locate.

China has 193 million online shoppers—more than even the U.S. with 170 million, more than double the number in Japan, and five times that of the U.K. By 2015, China's e-commerce market will rival that of the U.S. Between 2009 and 2011, the share of Internet users who shop online rose from 28 percent to 36 percent and is likely to reach 47 percent by 2015. E-commerce's share of total retailing could reach 8 percent by 2015. (See Exhibit 10.)

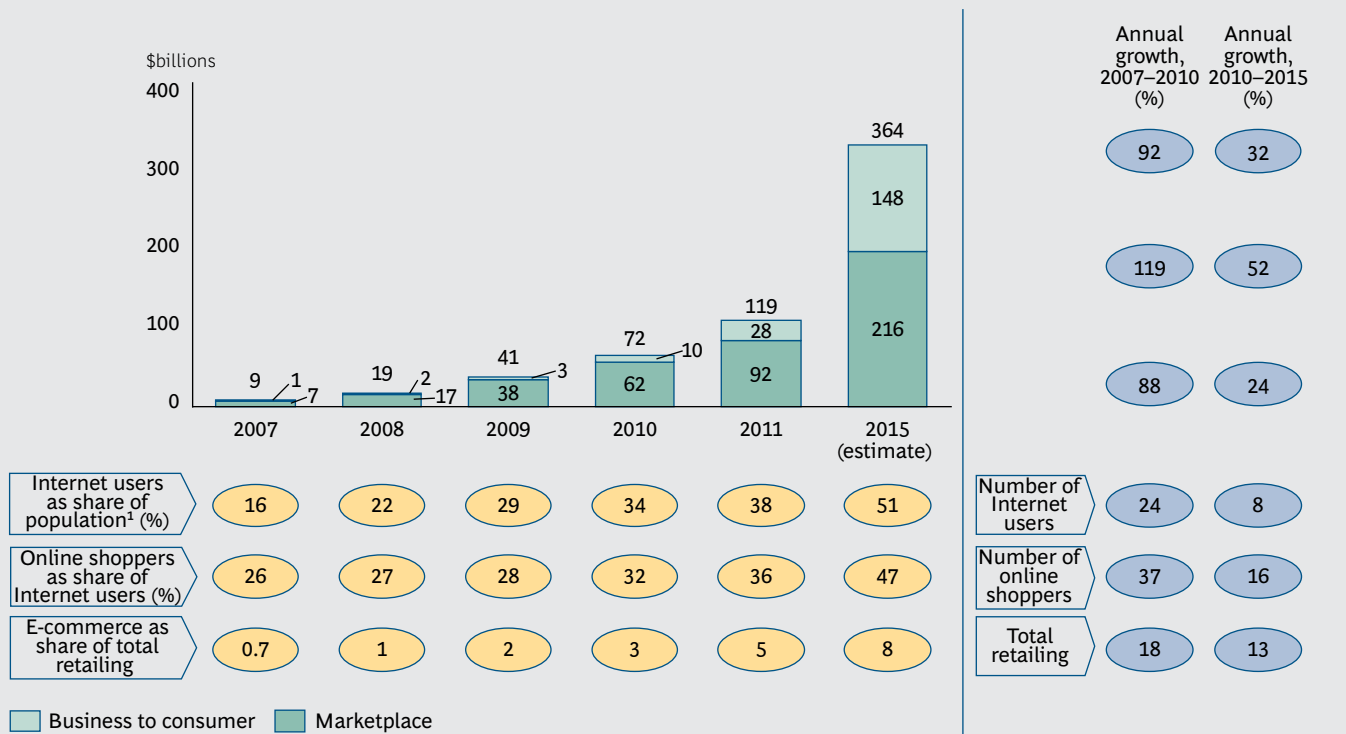
Except for teenagers, all segments of Internet users in China spend at least 1.6 hours a week shopping online. University students, young professionals, and young seekers are devoting at least two hours a week to it. University students and young professionals are devoting about 12 percent of their spending to online purchases.

One of the key challenges for companies is to encourage their customers to shop online, because, our research shows, once they make the leap, they quickly become avid Internet shoppers. In focus groups, consumers who had devoted only 5 percent of their spending to the online channel in 2008 said they had increased the share to more than 50 percent by 2011.

The Internet today in China is the place where consumers congregate and companies need to locate.

Even when they are not actually shopping online, many consumers research products online that they eventually buy in physical stores. Twenty-five percent of consumers research online before buying offline—almost as many as the 29 percent who both research and buy online.¹

EXHIBIT 10 | E-Commerce in China Is Likely to Reach 8 Percent of Retail Sales by 2015



Sources: iResearch; Economist Intelligence Unit; Euromonitor; analyst reports; literature search; BCG analysis.

Note: Some numbers have been rounded.

¹Internet users are defined as individuals aged 6 and older who went online in the past six months.

While the market for the sale of physical goods is expanding rapidly, the sale of digital content is in a slower growth mode. Sales of online videos, music, games, e-books, and other digital content are expected to rise by 14 percent annually between 2011 and 2013—about one-third the rate of online sales. E-books make up slightly less than a third of the digital-content market and are expected to grow slightly faster than the market. Online video, the smallest slice of the market, is the fastest growing, expected to expand 64 percent annually between 2011 and 2013.

Big Players

E-commerce in China has developed its own personality. While there are analogues to Amazon and eBay in China, the nation is not on a parallel track to the U.S. or anywhere else. There are three main types of commercial activity:

- A galaxy of both consumer-to-consumer and business-to-consumer marketplaces

that are frequently compared to eBay and Amazon Marketplace but have their own local flavor.

- Business-to-consumer vertical sites such as 360buy.com, which started selling electronics but now sells a wide variety of goods. These are similar to Amazon.com and Buy.com.
- Business-to-consumer brand sites, such as Vancl, that sell merchandise directly to consumers and are analogous to the online stores of consumer brand companies in the West.

Marketplaces. Alibaba Group currently dominates consumer e-commerce in China through its Taobao consumer-to-consumer and Tmall business-to-consumer sites. In 2010, 81 percent of transaction value flowed through these portals. More products were purchased on Taobao in 2010 than at China's top five brick-and-mortar retailers combined, with 48,000 products sold per minute.

Taobao has worked hard to achieve this scale. It has developed extensive data-analytics capability in order to understand buying and usage patterns, created an in-house university to allow merchants to share best practices, and developed an instant-messaging system that allows buyers and sellers to share product information.

Alibaba's Alipay escrow-payment system has become the most common payment method for e-commerce in China. More than 60 percent of consumers use it on Taobao and Tmall, and approximately 20 percent use it on business-to-consumer sites.

Tmall has created a showroom in Beijing where customers can visit 270 rooms stocked with furniture and other household products that they can purchase at a kiosk or online from home. The showroom satisfies consumers' desire to see and touch products—an experience that cannot be replicated online.

"I always want to buy furniture online. The price is so much cheaper than at offline stores, but for the expensive, durable stuff, I just cannot decide if I cannot touch it. Tmall solved this problem," one consumer told us.

Taobao and Tmall's customer-rating system enables shoppers to judge the quality and authenticity of goods they receive from merchants. About 44 percent of Chinese Internet users post at least one product review every six months, compared with 20 percent of U.S. Internet users.

The Taobao site is referred to as a consumer-to-consumer portal, but it more accurately is a marketplace where the overwhelming majority of products sold are new, not second-hand. Sellers are frequently suppliers that have not found success with other retail channels or distributors selling excess inventory. Many brand companies are still unaware of the extent to which their merchandise is sold by others on Taobao.

Alibaba created Tmall, which features professional merchants, to draw brand companies online and to generate fee income. Taobao is supported by advertising. (See the sidebar "The Sky's the Limit.")

Business-to-Consumer Vertical Sites. For higher-quality goods and after-sales support, consumers have begun to visit more traditional business-to-consumer sites such as 360buy.com and Dangdang. Business-to-consumer revenues are expected to grow twice as fast as consumer-to-consumer revenues between 2011 and 2015.

360buy.com is the second-largest business-to-consumer site in the country, after Tmall, and the largest that sells inventory directly to consumers. In 2011, it generated about \$4.9 billion in sales by discounting prices and providing speedy delivery.

About 44 percent of Chinese Internet users post at least one product review every six months.

The company received a \$1.5 billion cash infusion in 2011 from private investors, including Russia's Digital Sky Technologies—one of the largest institutional investors in Facebook. It is putting the investments to work in building customer-service and logistics operations. It can process 300,000 orders a day, and in 25 cities it offers same-day delivery for items ordered before 11 a.m. and next-day delivery for those ordered before 11 p.m. Within three years, 360buy.com's logistics network will cover 95 percent of China's cities. The company is also focused on making the customer experience easy and satisfying. It offers cash-on-delivery payment, a simple Web interface, and a guarantee of product quality. The company pledges that if a customer complains about a product, a delivery person will return within 100 minutes to take it back. Analysts expect 360buy.com to go public in the next year.

Business-to-Consumer Brand Sites. Vancl is the largest business-to-consumer brand site in China through several innovative online approaches to generate sales and engage with customers. The company has been an active advertiser. In 2008, the year it was founded, Vancl's advertising budget was nearly as large as its revenues. By 2010, Vancl was the largest

advertiser on online video sites and the fourth-largest online business-to-consumer retailer in China.

The heavy online push has been paying dividends. Vancl generated more than \$500 million in sales in 2011—up sharply from about \$300 million the previous year. The company has been willing to sacrifice margins in order to build scale. But it is not just trying to be a low-cost provider. It experiments with ways to improve customer satisfaction, such as offering free trials when products are delivered and free delivery.

The company also has an active presence on Sina Weibo. The chief executive, designers, and regular employees all write posts, and the company encourages fan clubs to form and discuss clothing on Sina Weibo. As part of its weibo strategy, Vancl has offered free merchandise to celebrate Chinese Valentine's Day.

To encourage customer engagement, Vancl created its Star program. Customers post photos of themselves modeling Vancl clothing, and other users get to vote.

Vancl complements these online approaches with traditional billboard advertising aimed at its youth clientele that features well-known blogger Han Han and actress Wang Luodan.

Big Trends

Online shopping in China is quickly becoming a social experience. Consumers—and venture capital—are flocking to sites on which conversations about and comparisons of products are the centerpieces.

While general group-buying sites, akin to Groupon, have been experiencing a shakeout in China, where it is estimated that thousands closed last year, more focused outlets are

THE SKY'S THE LIMIT

Tmall is Alibaba's answer to the freewheeling experience of Taobao. It is more like a traditional mall, with product categories housed on virtual "floors," storewide sales, and a loyalty program. Tmall, which means "sky cat" in Chinese, authenticates all merchants and requires them to pay transaction fees, both to generate revenue and to ensure a better shopping experience.

Alibaba wants shoppers to be able to visit a wide variety of stores, not only those of big brands such as adidas, Ray-Ban, and Gap but also smaller merchants that have outgrown their Taobao storefront. The formula seems to be working. Tmall is home to about 50,000 merchants and 200,000 brands. About 10 million people visit the site daily. On Singles Day, a big shopping day in China, Tmall stores recorded more than \$500 million in sales, thanks to heavy discounts and promotions. Transaction volume was estimated to reach about \$16 billion last year and should exceed \$30 billion in 2012. Tmall is already more than twice the size of 360buy.com, the number two business-to-consumer site.

Tmall benefits from its ties with the main Taobao site. Searches on Taobao automatically return Tmall shops, and the majority of Tmall users say they know about and trust the site because of Taobao. Although consumer perceptions of Tmall's delivery and fulfillment are still not as favorable as those of other business-to-consumer sites, they are quickly catching up and vastly better than the perceptions of Taobao.

Tmall's success is not unblemished. When the site announced higher fees in October 2011, smaller merchants mounted online protests. The smaller merchants were worried that the fee hike would jeopardize their business and favor larger companies. They protested by buying goods from larger vendors on Tmall and then demanding refunds, hurting those vendors' ratings, and communicated their displeasure on microblogs like Sina Weibo. After hearing this feedback, Tmall adjusted its policies and began helping qualified Taobao merchants migrate to Tmall.

finding footholds in the market. In particular, there has been a proliferation of three types of sites: group-purchasing-based business-to-consumer sites such as Jumei, a cosmetics group-buying site; social-networking-based business-to-consumer sites such as Meilishuo, which targets female online shoppers; and review and mobile commerce sites such as Dianping. These sites help consumers navigate the often-confusing and cluttered online marketplaces.

When consumers buy products on Jumei, they are encouraged to write reports on their experiences and share pictures. They receive coupons for their reviews.

Meilishuo, meaning “beauty talk,” is just that: a place where women—and only women—can gather online to converse about clothing and cosmetics. By following other users, women can view their purchases and recommendations, and find links to buy products from various online merchants. According to the company, Meilishuo has more than 9.6 million registered users and generates \$100 million in monthly sales for Taobao.

Dianping is a local lifestyle and consumer review site that has been a pioneer in mobile services. It provides location-based business information, consumer reviews, and discounts, and allows users to “check in” to stores and locations. At the end of 2011, it had more than 42 million active monthly users and 1.5 million merchant members, and it covered 2,300 cities. It receives more than 600 million monthly visits, about 80 percent of them from mobile users.

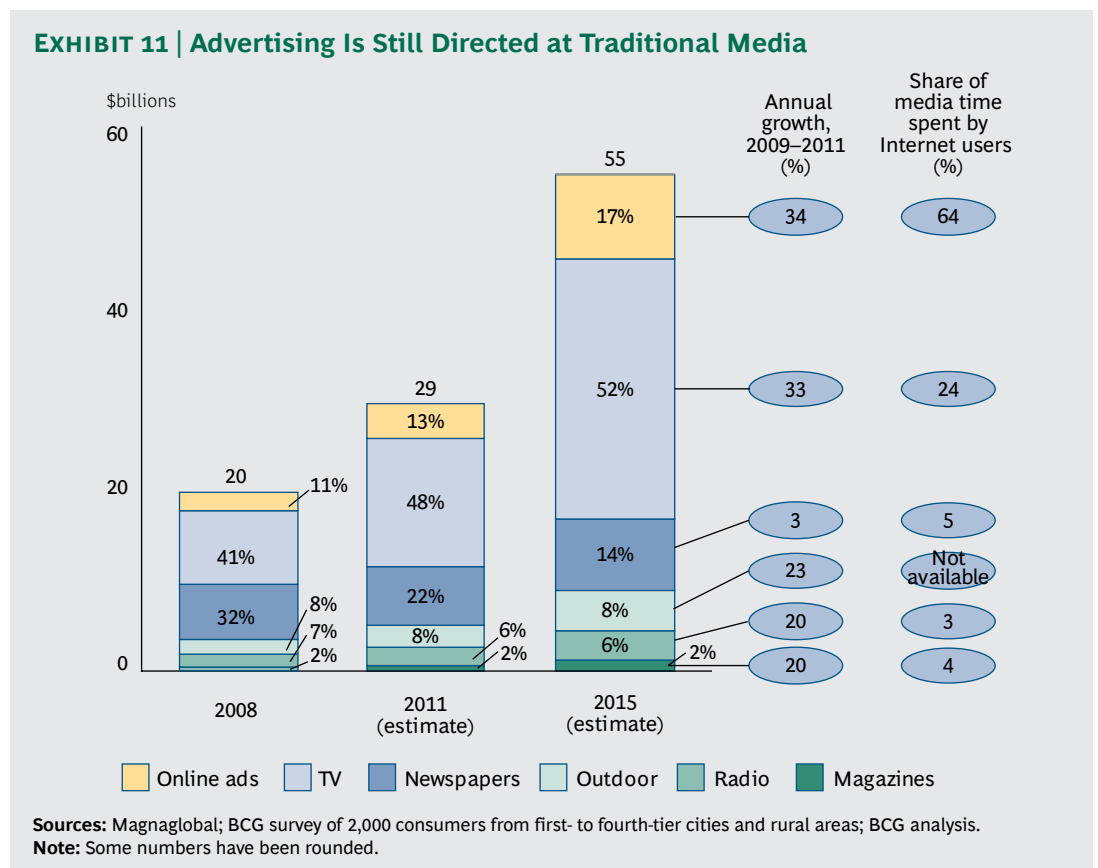
NOTE

1. The research also found that 31 percent of consumers did both their research and buying offline and that 15 percent researched offline but purchased online.

THE ONLINE ADVERTISING OPPORTUNITY

A DISCONNECT CURRENTLY EXISTS between how Chinese consumers spend their time and how advertisers spend their money. Advertisers have begun to increase their online spending, but the mix is still heavily skewed toward traditional media. (See Exhibit 11.)

The share of overall ad spending devoted to the online channel is expected to rise from an estimated 13 percent in 2011 to 17 percent in 2015—far less than the 64 percent of media time that users now devote to the Internet, according to Magnaglobal, a forecasting firm. Advertisers still plan to increase television’s



share from 48 percent to 52 percent in 2015, even though Internet users spend only 24 percent of their media time watching television. By contrast, in the U.S., where consumers spend less time online, advertisers currently devote about 6 percentage points more of their media spending to the online channel.

Video advertising is in fast-growth mode. Advertising on online video sites grew by 58 percent between 2009 and 2010 and likely grew even faster between 2010 and 2011. This is still a small market, with only an estimated \$600 million spent on online video ads in 2011. Given the amount of time Chinese consumers spend watching videos, it deserves even more attention.

In a recent survey of chief marketing officers conducted by IBM, those at Chinese companies reported being less ready than their peers in other markets. For example, 80 percent of Chinese CMOs said they were unprepared for the rapidly growing opportunity to leverage consumer online data, compared with the global average of 71 percent. Likewise, 74 percent of Chinese CMOs said they were unprepared for the growth of new digital channels and digital devices, compared with 65 percent of global peers.

While the local findings of this survey were limited to CMOs of Chinese companies, few, if any, Western companies have cracked the code for reaching China's digital consumers.

A CALL TO ACTION

EVEN IF COMPANIES NEVER intend to sell online, they must embrace China's online world. It is consuming 1.9 billion hours a day of people's attention. Young professionals, a highly desirable consumer segment, average 4.9 hours a day online. The Internet may be more important to brand building and overall awareness in China than television was in the U.S. during its heyday.

To date, the business "story" about the Internet in China has centered on the three giants: Alibaba, Baidu, and Tencent. Their moves still matter because they signal where the market is heading: toward mobile, video, and social-networking platforms.

China's online world is consuming 1.9 billion hours a day of people's attention.

But the broader focus in China should be on what *all* companies are doing to reach and hold on to China's digital generations. All companies with ambitions in China should have a strong Internet presence and strategy. They need to meet their customers in the places where they spend time, and increasingly that is online. The Internet is not just another channel. A few key challenges con-

front companies as they sell to engage with China's digital generations.

New Business Models. Companies cannot necessarily rely on what has worked in other markets, as the stumbles of many Western companies have amply demonstrated. But they can tap into the current fascination of the Chinese people with the online experience to experiment with new ways to build relationships with Chinese consumers. In particular, the popularity of weibos and online videos presents opportunities to both engage with customers and develop new revenue streams through innovative online business models.

Consumer Insight. Companies need to develop a deep understanding of digital consumers in China. The market is moving too swiftly and is sufficiently different from any other market to rely on old or imported segmentation strategies. The payoff for taking the time and spending the resources to understand these consumers on their terms will be real and enduring.

Channel Management. The channel conflicts that companies face in the West are magnified in China because of the resale of their goods on Taobao and other online marketplaces. Companies do not completely control the destiny of their own products. Most companies in China have barely started to

explore the potential of the mobile channel. Companies need to try to develop a coherent channel strategy and build the systems to trace sales through multiple channels.

Digital Marketing. In the online world, brands are built by well-managed conversations with consumers, rather than through the simple broadcast of messages. Companies need to create an integrated digital-marketing plan that emphasizes online presence and dialogue with consumers. They will have to regularly review the alignment between marketing mix and consumer trends. They must monitor and respond to online conversations about their products and services, engaging and building relationships with consumers. They should also review and select the right professional-services partners that understand and can guide them through these choices.

Digital Transformation. Companies will have to build new capabilities and a new organization and culture in order to manage their online presence and multiple channels.

Business Development and Partnership. While they certainly should build their internal capabilities, companies will not be able to do it alone. Sooner or later, they will have to partner with other players to fill in gaps in their capabilities, distribution, or technology. The sooner they start educating themselves on their needs and the field of potential partners, the stronger their negotiating stance will be.

The most important step is the first one. Companies cannot win in China unless they understand and embrace China's digital generations. They are the future of the largest consumer market in the world.

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.

Going to Market in Developing Economies: The Challenge of Channels

An article by The Boston Consulting Group, February 2012

The Digital Manifesto: How Companies and Countries Can Win in the Digital Economy

A Focus by The Boston Consulting Group, January 2012

Going to Market in Developing Economies: The Consumer Insight Advantage

An article by The Boston Consulting Group, January 2012

The World's Next E-Commerce Superpower: Navigating China's Unique Online-Shopping Ecosystem

A report by The Boston Consulting Group, November 2011

Turning Local: From Madrid to Moscow, the Internet Is Going Native

A Focus by The Boston Consulting Group, September 2011

The Internet's New Billion: Digital Consumers in Brazil, Russia, India, China, and Indonesia

A report by The Boston Consulting Group, September 2010

China's Digital Generations 2.0: Digital Media and Commerce Go Mainstream

A report by The Boston Consulting Group, May 2010

China's Digital Generations: The 570-Million-Hour Opportunity

A report by The Boston Consulting Group, July 2008

NOTE TO THE READER

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Acknowledgments

The authors would like to thank Mark Voorhees, Ashley Peng, Linfeng Yang, Elaine Jiang, Veronica Li, and Nature Wang for their assistance in the writing of this report. They also thank Gary Callahan, Kim Friedman, and Sharon Slodki for their contributions to its editing, design, and production.

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