

February 5, 2007

Internet Boom in China Is Built on Virtual Fun

By [DAVID BARBOZA](#)

SHENZHEN, China — When Pony Ma, the 35-year-old co-founder of China’s hottest Internet company, sends a message to friends and colleagues, the image that pops up on their screens shows a spiky-haired youth wearing flashy jeans and dark sunglasses.

That is not how Mr. Ma actually looks or acts, but it is an image that fits well with the youthful, faintly rebellious nature of a company led by somebody who may be China’s closest approximation to Sergey Brin and Larry Page, the young founders of Google. In the two years since Mr. Ma’s company, Tencent, went public in Hong Kong, it has grown into a powerhouse that has crushed everyone else in the field.

No other Internet company in the world — not even Google — has achieved the kind of dominance in its home market that Tencent commands in China, where its all-in-one packaging of entertainment offerings and a mobile instant-messaging service, “[QQ](#),” has reached more than 100 million users, or nearly 80 percent of the market.

“Everyone talks about eyeballs,” said William Bao Bean, an Internet analyst at Deutsche Bank Securities. “Well, they’ve got all the eyeballs in China. And now they’re beginning to cash in on that.”

But the rise of fast-growing companies like Tencent is also worrying the Chinese government, which strictly regulates the Internet and is wary of the Web’s ability to mobilize huge online political communities or perhaps to nurture underground economies.

A few weeks ago, China’s Central Bank — which oversees the country’s \$2.6 trillion economy — even went so far as to issue a warning about Tencent’s virtual currency, Q-coins, which allow customers to shop online for games, music and even virtual furniture.

A Central Bank official said the agency was studying whether Tencent’s online tokens were a threat to China’s currency, the yuan or renminbi. He also said the authorities would crack down on the coins if they were used to engage in money laundering.

That is far from Tencent’s intention. Already one of China’s wealthiest entrepreneurs — worth an estimated \$850 million — the soft-spoken Mr. Ma says he simply wants to let people in China use the Web the way they want.

“I think every Internet user likes personalization,” Mr. Ma said during an interview here. “In 2005 and 2006, we came up with a new strategy: ‘Online Lifestyle.’ ”

While America's Internet users send e-mail messages and surf for information on their personal computers, young people in China are playing online games, downloading video and music into their cellphones and MP3 players and entering imaginary worlds where they can swap virtual goods and assume online personas. Tencent earns the bulk of its revenue from the entertainment services it sells through the Internet and mobile phones.

Another distinguishing feature is the youthful face of China's online community. In the United States, roughly 70 percent of Internet users are over the age of 30; in China, it is the other way around — 70 percent of users here are under 30, according to the investment bank Morgan Stanley.

Because few people in China have credit cards or trust the Internet for financial transactions, e-commerce is emerging slowly. But instant messaging and game-playing are major obsessions, now central to Chinese culture. So is social networking, a natural fit in a country full of young people without siblings. Tencent combines aspects of the social networking site MySpace, the video sharing site YouTube and the online virtual world of Second Life.

“They have what I call the largest virtual park in China,” said Richard Ji, an analyst at Morgan Stanley. “And in China, the No. 1 priority for Internet users is entertainment; in the U.S., it's information. That's why Google is dominant in the U.S., but Tencent rules China.”

Tencent's rapid rise is one reason America's biggest Internet companies, like Yahoo, Google and eBay, have largely flopped in China. Analysts say the American companies struggle here partly because of regulatory restrictions that favor homegrown companies, but also because foreign companies often do not understand China's Internet market, which is geared primarily to entertainment and mobile phones.

Google has lost market share to the search engine Baidu. Yahoo recently transferred its operations to a Chinese company, [Alibaba.com](http://www.alibaba.com). And eBay, even after buying one of its biggest competitors in China, has continued to lose ground; last December it handed its Chinese operations over to Tom.com, which is based in Hong Kong, in a joint venture.

Chinese youth prefer instant messages to e-mail messages; they play games, form communities and even adopt virtual personas, or avatars, which requires selecting an online image or personality and then buying that character [virtual clothes](#), hairstyles, furniture and perhaps even a virtual pet that must be fed with virtual pet food.

It is a world that now dominates the life of Li Meixuan, a 21-year-old college student in Beijing who became hooked on Tencent's QQ offerings in high school.

“I play with QQ about three to five hours a day,” said Ms. Li. “I usually play QQ games, buy game stuff from the QQ Game and buy decorations for my QQ show.”

Tencent will not release statistics on how its Q-coins are doing, but analysts say the currency is so popular that an underground economy in Q-coins has emerged, even though the coins are not redeemable for

cash. Mr. Ma dismisses talk about the coins harming the Chinese currency.

“The media has misled the public,” he said. “A Central Bank official said that Q-coin did not affect the renminbi; it adds vibrancy to the economy. Our competitors raised this to intentionally cause panic.”

The controversy has done nothing to dim the company’s stock price, which has soared about 200 percent over the last year, giving the company a market value of roughly \$7 billion. The rally was fueled by Tencent’s rising profit, which jumped 221 percent through the first three quarters of 2006, to \$100 million.

Tencent was founded in 1998 by college buddies here in this southern China city, led by Ma Huateng, or Pony Ma, as he is known in English.

Mr. Ma has a boyish face and a quiet demeanor. But he is one of China’s most respected entrepreneurs. And when he shows up at Internet conferences in China he is mobbed by young people eager to have a picture taken with him or to shove their name cards into his pocket.

Mr. Ma earned a degree in computer science in 1993 from Shenzhen University, where his professors remember him as a diligent student who always stood out.

“He left a deep impression on me,” said Wang Jingli, the former chairman of the university’s computer science department. He recalled how he once assigned Mr. Ma to solve a classic chess problem called the eight queens puzzle. “He gave me all the answers in graphics, which was very rare among the students I taught.”

Later, Mr. Ma worked as a software developer for a paging and telecommunications company. But after making a lot of money trading stocks in his free time, he founded Tencent with his boyhood friend Zhang Zhidong. It was one of the first companies to offer instant messaging in China. But in the early days, profits were hard to come by.

“They didn’t really have a revenue model, and they didn’t know how they were going to make money,” said Shirley Yeung, who was among the first to invest in the company for PCCW, the Hong Kong telecom operator. “They were a bunch of young techies working in a crummy building but passionate about creating something new.”

In 2001, the company got a big infusion of capital from MIH, a division of a South African media company called Naspers. MIH paid \$35 million to acquire about 50 percent of the company.

Tencent’s fortunes improved later that year when the company teamed up with China Mobile, the giant state-owned mobile operator, to forward Internet messaging to mobile phones.

“That was our first bucket of gold,” Mr. Ma said.

By 2004, Tencent was making a handsome profit on revenue of more than \$130 million and Goldman

Sachs was brought in to take the company public in Hong Kong, where Tencent's offering raised \$184 million in June 2004.

Since then, the company has been on a tear. Other big Chinese Internet companies, like Sina, Sohu, Netease and Baidu, are trying to keep pace. And so are the American Internet companies, like MySpace, which is looking to enter China's market.

But Mr. Ma is not standing still. "There are a lot of opportunities in the market now," he said. "The leader of the market today may not necessarily be the leader tomorrow."

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