

Asia Report for South East Media Network

December 2009

Introduction

The overriding view from observers in Asia is 'what a difference a year makes'. The market for media consumption and expenditure has yet to revert to optimal levels but macro conditions have improved and the momentum in Asia's growth story is back.

The Asian economies of China, India and Indonesia are either roaring back to something like top form, while Korea and parts of Southeast Asia are also recovering fast. In spite of a recent softening, the climate for financing has improved overall with buoyancy returning to equity markets, making it easier for domestic content and media players to access capital in public markets rather than rely on still-conservative private-equity investors.

All this adds up to good prospects for UK companies seeking opportunities in burgeoning Asian markets and for encouraging inward investment.

The report highlights some examples of Asia's prowess in digital content - a *smorgasbord* of trends from leading consultancies and the author's first hand impressions. Much of this is based on regular visits to China which as the world's largest and fastest growing market provides an abundance of opportunities.

Firstly, a couple of points about some of the underpinning infrastructure driving the exciting growth of the content industries in Asia where just three countries - China, Japan and Korea - have more Internet and mobile users than the US and Europe combined.

Leading Broadband Infrastructure

The more advanced broadband infrastructure in several Asian countries compared with that of the UK positions the Region well to exploit current and future advances in the distribution and consumption of digital content.

In the *2009 Broadband Leadership*, conducted by the Saïd Business School in Oxford and the University of Oviedo in Spain, and sponsored by Cisco, Asia occupies the top three spots and has four in the top ten.

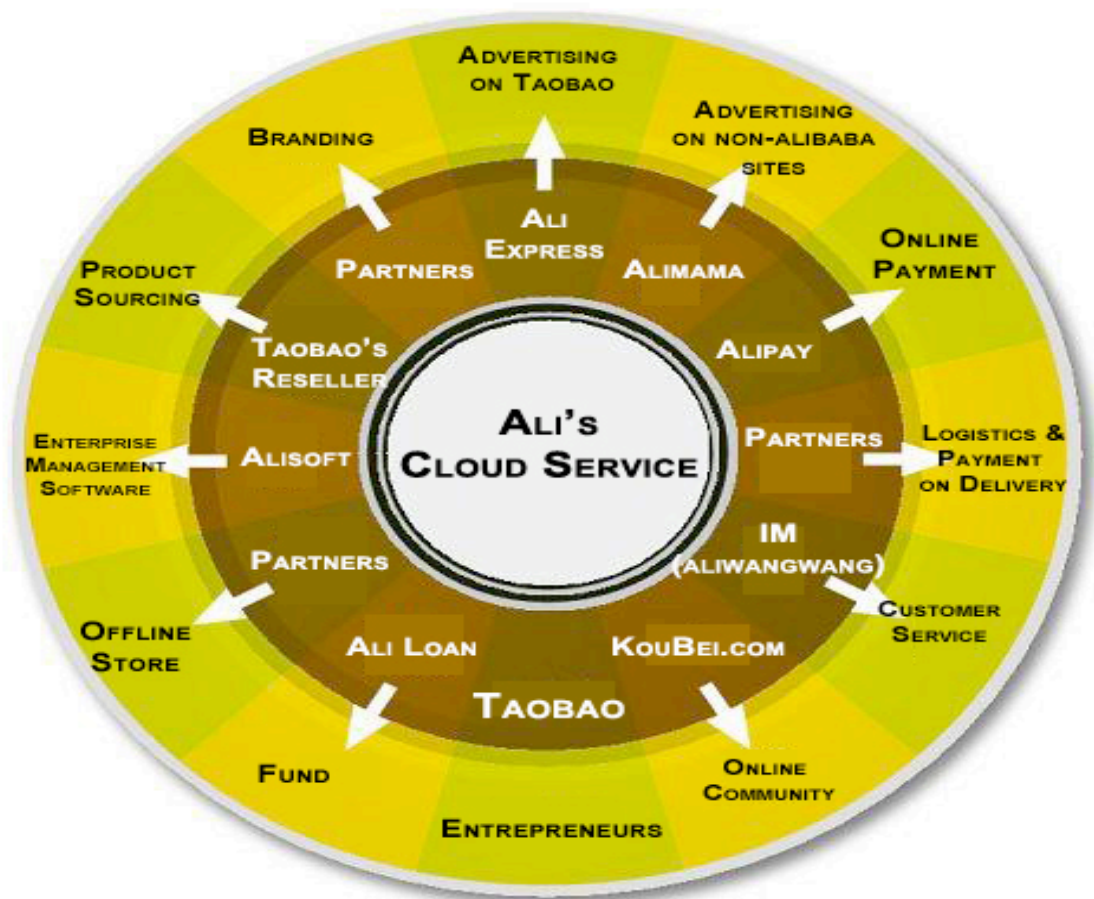
		Broadband Penetration (% of households)	Broadband Quality Score 2009	Broadband Leadership 2009
1	South Korea	97%	66	139
2	Japan	64%	64	115
3	Hong Kong	99%	33	111
4	Sweden	69%	57	110
5	Switzerland	90%	40	108
6	Netherlands	83%	46	108
7	Singapore	96%	32	107
8	Luxembourg	99%	27	107
9	Denmark	82%	45	106
10	Norway	84%	38	102

Cloud Computing Poised for Take Off – Evolution of Web 2.0 Ecosystems

Cloud Computing is taking off in Asia with Singapore emerging in pole position. For example, Amazon recently picked Singapore as the primary location in the Region for its cloud infrastructure. The significance is that developers and businesses located in Asia, e.g. web technology startup entrepreneurs, as well as those with a multi-national presence, will be able to leverage Asia-based infrastructure to minimize latency and optimise performance. This will facilitate planning of technology investments and provide better service to end-users in Asia.

The following diagram in *The Founder* by Jimmy Cheng demonstrates how Alibaba, the leading international Chinese Internet company, is developing a Cloud ecosystem. For example, its English language B2B website is accessed by suppliers and buyers from anywhere across the globe.

The diagram illustrates that Alibaba is looking at every corner of the Internet industry from online to offline, from e-commerce making lots of money to Web 2.0 gathering millions of users, from wired to wireless. For example, Taobao is the e-commerce (and around Taobao, recently more effort is being spent on its own Social Network Service (SNS), open platform, etc); Alipay solves online payments; Koubei is building an active online community; Aliwangwang, the Instant Messenger enables communication with the seller, the customers and friends; Alisoft is the SaaS (Software as a Service) platform, and strong partnership with third parties and government help on logistics, setting up offline stores, branding, etc.



Pervasiveness of Social Media

There is so much talk about Facebook, Twitter and LinkedIn that sometimes digital cognoscenti in the West forget that there are mature and thriving social media ecosystems elsewhere. In China, for example, most Western SNS and micro-blogging sites were blocked in 2009.

Many Westerners would be surprised at just how savvy the Chinese netizen really is regarding social media and Web 2.0 applications. Chinese netizens are twice as likely to use chat and three times more likely to micro-blog, blog and use video conferencing than American users, according to a finding of the Netpop Research study.

Sites such as QQ, Douban, tianya.cn, Renren.com, 51.com and video sites like Youku.com and Tudou.com are playing a bigger role in shaping Chinese netizens' ideas and perceptions in almost all areas: society, culture, education, commerce and even politics. The Internet is a key factor driving China's rise, the transformation of businesses and shaping new forms of consumer behaviour. And China is still at the beginning of the "S" curve of adoption as barely 1/4 of its population is online. There are lessons for the West.

The following diagram outlines the main companies in various segments of the Chinese social media landscape (acknowledgement to Fred Cacazza). This provides information about the Chinese social media landscape for those who want to work with Chinese social media. The list comprises only a small percentage of the large number of innovative companies operating there.

Chinese Social Media Landscape



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<http://www.sinotechgroup.com.c>

Business Model Innovation

China's unique market scale has enabled alternative business models to become viable, which companies in the IM (Instant Messaging) space and online gaming companies have cleverly exploited by charging only cents for certain services, but multiplying them by many millions.

For example, Tencent (owner of QQ) like its local competitors in the instant messaging (IM) space could not cover its costs with advertising only and decided to offer personalised avatars – likely based on their success at various companies in South Korea. Later on, Tencent added casual games and more services. Today, about 90 per cent of its revenue comes from its virtual currency (a prepaid account that allows easy transactions within a closed system to buy designs, e.g. for personal pages), and barely 10 per cent from advertising. The magic is the combination of technology and business model innovation, understanding the social dynamics of the users, excellent execution and scale.

There are some opportunities for Westerners to tap into this phenomenon. For example, QQ International right now has over 200,000 users since its official launch in October 2009. On QQ International's official site, the slogan says "Expand your Guanxi in China on QQ International." Guanxi means Social Connections.

Explosive and Profitable Growth of On-Line Games

The growth of social networking sites in China highlighted above and their cross-pollination with games is one of the key Internet trends in China in 2009.

Some evidence is emerging that the explosive and profitable growth of on-line games in Asia may over time show a similar trend in the West. For example, according to Pearl Research, the market in China grew more than 63% to reach USD2.8 billion in 2008. The latest figures are now close to a little over USD4 billion. Playing games constitutes a small-ticket item and users have not cut back as much on this type of discretionary spending during the recession.

While the current numbers fall short compared to that of the United States (currently first in the world), China is expected to grow up to 68 billion yuan (USD10 billion) accounting for almost half of the world market by 2012. While one may take these figures with a grain of salt, it is hard to argue against the general consensus on the growth opportunity of online games in China. The magnitude of online games from MMORPG (massively multiplayer online role-playing games) to fun casual games to online games are a staple in the pop culture of China's youth.

The characteristics of social games (lower development costs, free to play and viral/serendipitous avenues for discovery) go a long way towards explaining this trend over the last year in that sector relative to the traditional games industry, and why this growth has been dominated by startups and not the big publishers. Adding weight to this, Electronic Arts believes that there will be a decline of games on physical media beginning next year.

To highlight just one company, Shanda Games, and how they are exploiting convergence. They are at the cutting edge in both their online game strategy, as well as in their aspirations to be a true multi-platform media company. Shanda went public at the end of September on NASDAQ. Now all of a sudden they are sitting on a heap of cash USD2 billion and with a very strong fiduciary duty to make good

returns to their investors. In June 2009 they entered the mobile market with the acquisition of a mobile entertainment service company and recently announced a joint venture with Hunan TV to produce and distribute movies and television series. Observers predict that the macro effects of these deals will define the media industry in China - and possibly with ramifications globally as well.

On a less positive note for Western companies, the China authorities have banned foreign investment into its lucrative online games industry in an effort to tighten control over its virtual worlds. The new directive disallows joint ventures, wholly owned enterprises and cooperatives, and indirectly influencing Chinese games companies through agreements or technology support.

Pre-Eminence in the Virtual Goods Economy

The economy continues to boom for virtual goods with Asia continuing to lead the pack in virtual world spending. Financial analyst Piper Jaffray estimates that US citizens will spend USD621 million in 2009 in virtual worlds; estimates of the Asian market are many times larger. Research firm Plus 8 Star predicts spending at a staggering USD7 billion in the past year.

Virtual worlds are luring hundreds of thousands of users to make money selling virtual goods from clothing and furniture to art and gazebos, as well as services such as virtual wedding planning, translation or architecture. The most successful have become millionaires from the trade.

There are now nine Chinese online game companies listed on Nasdaq and HKSE. The total market value in November was USD52 billion, twice as much as Blizzard + EA + Ubisoft + Take Two. The comparison for Westerners is humbling, considering the hype around the rapid growth of the U.S. market. Virtual goods of course do not exist in the real world. They're digital bits such as weapons or character clothing in games. Games companies have figured out that they can offer consumers free games as an attraction, and a sizable percentage of those consumers will pay for virtual goods in small transaction amounts. One of the hottest markets now is buying virtual goods to grow crops in farming games.

Some additional background to put the massive influence of virtual goods in Asia in some context for the UK (thanks to Plus 8 Star):

The virtual goods market took off in Asia first because they were a way to monetise online games, which were the only titles that took off in Asia because of retail game piracy. Online games could not be easily copied because users had to authenticate themselves when they logged in. At first, subscriptions ruled, as they did with the biggest online fantasy role playing game, Activision Blizzard's World of Warcraft. But now the virtual goods market has taken hold.

Asia was the first region where virtual goods topped USD1 billion, with much of the action starting around 2005. South Korea's Nexon was one of the first companies to

pioneer the virtual goods business model in its online role-playing games, the most popular of which is MapleStory, which has more than 92 million registered users. In China, Tencent is expected to generate revenues of USD1.5 billion to USD2 billion from its QQ chat/game service, with most of that money coming from virtual goods revenue (see section on Business Model Innovation). China's total market could generate over USD5 billion in virtual goods revenue in 2009.

Japan also has a big virtual goods market. That country's top three social networks are generating more than USD1 billion in revenues, mostly through mobile games and services. In Japanese games, some rare virtual items are worth more than USD1,000 due to their scarcity. More commonly, you can buy a rare virtual horse for USD60. Korea, meanwhile, is generating about USD1 billion in virtual goods revenue annually.

The names of the top Asian social networks companies are virtually unknown here. In China, the leaders are Tencent, Renren, Kaixin001, and 51.com. In Korea, it's Cyworld. In Japan, it's Mixi, Gree, Nani Suru, and DeNA. Many of those companies are making more money than Western social networks such as Facebook. The Asian companies are also moving into the U.S. The No. 7-ranked app developer on Facebook is 6Waves, a Hong Kong company that has created over 100 applications.

The pioneering freemium business models for on-line games emanating from across Asia will have lessons for adoption in the West. Some key questions and challenges for the UK market are:

- To what extent will virtual goods catch on in the UK – in PC and mobile environments?
- What is the revenue potential?
- How will virtual goods in on-line games impact sales of console games?
- What can UK companies in the South East learn from Asian companies both in terms of technology and business models?
- Will cash rich Asian companies in this space move westward and engage with the UK?

As Plus 8 Star aptly puts it, for Western companies trying to make money in virtual goods, the message is "better hurry!"

China, Singapore and Thailand Betting Big on the Creative Industries

China plans to spend billions of dollars in the next few years with the aim to develop media and entertainment companies that rival global media conglomerates such as News Corporation and Time Warner. With top-level guidelines set by China's State Council, the overall plan envisions the creation of entertainment, news and culture companies that depend less on government backing, and more on private investment, both local and abroad. In short, China will finally open up at least some doors to foreign investments and control.

The Singaporean Government's aim, backed by multimillion, multiyear investments, is to develop Singapore as a global city for information, communications and the arts - a creative economy. Delivery of these aims is through a three-pronged Creative Industries Development Strategy: Singapore Media Fusion Plan, Design Singapore and Renaissance City Project 2.0. This link on SEMN's website provides additional information <http://www.semn.org.uk/information/Singapore%20Opportunities.ASPX>

The Thai Government last month launched a fund to the tune of 20 billion baht (about GBP360 million) to support the growth and investment in local creative industries. Specifically this refers to developing creativity, innovation, craftsmanship and design within the economy, seeking to invest in ideas and projects that leverage copyright and patents. Creative Industries account for between 10 and 12 per cent of Thailand's GDP – a higher proportion than that even of the UK.

Such stimulus programmes for the Creative Industries suggest opportunities for UK companies, for example, in Design, Publishing, Television and Film, Games, Research and Development, Education and Training.

China's Rise as an Attractive Outsourcing Destination

China is now increasingly challenging India as an outsourcing destination across the Creative Industries. The combination of several factors now makes many Chinese cities an attractive destination for outsourcing by UK companies. These include superb infrastructure, huge government investment, the world's largest technical talent pool, growing respect for Intellectual Property, the high number of people with excellent English language skills, the capability to scale, attention to quality and price competitiveness.

The Creative Industries are thriving in many cities across China. Many hi-tech, innovative companies have emerged with strong track records in demonstrating high levels of competence in outsourcing and in forging effective partnerships with Western companies.

China's growing number of outsourcing providers are rapidly moving up the value chain. Areas of specialisation include:

- Software and Application Development across all industries, including Testing and Maintenance
- New Media and Content Management, including Games, eLearning, Web Design, Flash and 3D Animation
- Translation and Localisation
- Product Lifecycle Management
- Telecoms, including iPhone apps
- Embedded technology
- Semi conductor chip technology
- R&D

The author is a frequent guest at Chinese Government sponsored Outsourcing Conferences, is an Advisor to the International Institute for Outsource Management and a Council Member of China's Import and Export Software Network.

Succeeding in the Asian Market

In the Chinese Internet market, for example, it is quite simple to explain why most foreign companies fail. Some acquired local firms that looked similar to those back home, only to realise later that their source of income was from an entirely different business, which was often neither stable, scalable, nor replicable overseas. Others tried to run their business like back home, but failed to recognise the local market structure and differences in income, usage, and business practices.

As 8 Plus Star puts it well: 'When selling a China story to investors, simplification helps. When running the business, simplification hurts.'

Western companies need to be willing to be innovative and adaptable, or at least willing to embrace the evolutionary process through partnerships.

Foreign companies need to understand the Chinese mindset of seeking to blaze a new image of China as a promoter and originator of high technology and innovation while at the same time maintaining an unrelenting focus on execution.

To take Taobao as an example - China's enormously successful version of eBay: Their modus operandi highlighted by Metan Group is based on an 'execution-oriented' style as the most effective way to grow a company in China and that 'to sacrifice the best ideas for the sake of execution is necessary.' Being one of the most dynamic and fragmented markets in the world, a reasoning and analysis-based management system is viewed as simply too slow to react in a market like China. This breeds 'analysis to paralysis'. While good ideas are important and innovation will definitely be the driving force to grow any company, Taobao's philosophy is that this should only be secondary to that of execution first. The CEO's view is that the company itself should move from being managed as an 'organization' to being trained as an '*animal of execution*' (the italics are mine).

Some Tailpieces

Phenomenal Growth of Mobile Internet in China

As of November there were 192 million mobile Internet users in China. China's 3G licenses issued earlier this year provide a good opportunity for developing the country's mobile Internet user base. An iPhone Developers Association launched recently.

Korea's Continued Ascendancy in Mobile Handset Market Share

The combined marketshare of Samsung Electronics and LG Electronics in the mobile handsets market went over 30% for the first time.

e-Readers and e-Books May Take Off in 2010

China, India, Brazil, and the EU are likely to propel global growth in 2010, according to Forrester, but the U.S. will still be the biggest market. While the U.S. is the biggest market for e-readers and e-books, the rest of the world will start to catch up. Experts predict that at least five new e-readers will launch in China, likely distributed through China Mobile. There could be opportunities for UK partnerships in this space.

TV Markets Vibrant

Asia is probably the world's fastest growing region for entertainment content. Examples of developments include: new channel launches, an increase in international co-productions, more liberalisation and the emergence of new platforms.

Educational Software and e-Learning Opportunities

Across the Region, significant opportunities continue to exist for UK exports of education equipment and software, including educational games. The combination of the strong aspiration of Asians to learn English, the very large international and local school sectors, together with the UK as a role model/magnet for education makes the Asian market very attractive.

Final Word

To conclude this *tour d'horizon* of some recent highlights in Asia's digital content markets:

The world started the year on a very tough note. 2009 is concluding with renewed optimism conveying the growing importance of Asia as a market for financing, production, buying and selling of content across an increasing range of platforms and devices.

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10th December 2009

Levering Ltd provides companies with strategic advisory services. Comments invited.