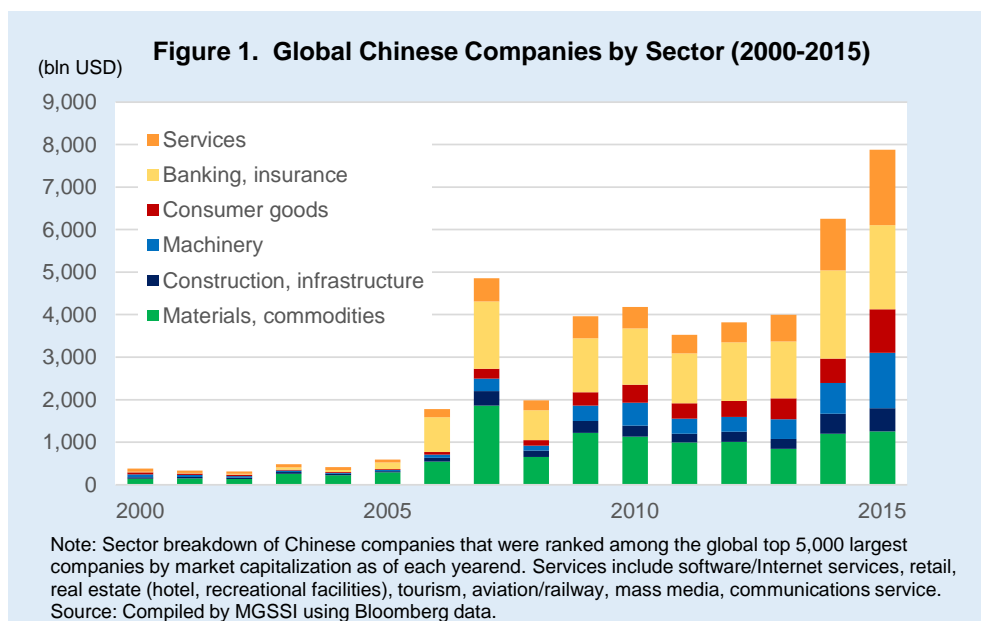


CHINA'S THRIVING SERVICE INDUSTRY LED BY LOCAL INNOVATIVE COMPANIES

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GROWTH OF CHINESE COMPANIES IN SERVICE SECTOR

Among the top 5,000 companies worldwide by market capitalization as of 2015 end, Chinese (excluding Hong Kong) companies account for 1,107, a significant rise from 326 back in 2000. The share of these Chinese companies' aggregate value out of those 5,000 firms also grew from 1.3% to 13.6% during the same period. By industry, in 2000, the major players were companies from



resources and materials industries such as oil and metals, and after the mid-2000s, they shifted to financial businesses, for which the Chinese government made privatization efforts (Figure 1). By the end of 2015, various Chinese service providers have appeared, from real estate, retail, digital contents/media/advertising, recreation to education, and the Internet-related service companies particularly increased their presence, following Alibaba's IPO in the previous year (Figure 2).

The rapid growth of the Chinese service industry can be attributed to its huge market of 1.3 billion people, and also to its fast-growing economy and wage level. China's GDP per capita reached \$14,000¹ in 2015 from \$4,000 or less in 2000, while auto sales rose to 24.6 million from 2.09 million, and retail sales increased to 30.1 trillion yuan from 6.7 trillion² during the same period. The growth of the service industry is proven by the upsurge in movie attendance (1.26 billion in 2015, grew by 7.9 times in a decade) or the number of domestic tourists (4 billion in 2015, a 5.4-fold increase in fifteen years).

The government policy is also a driver of the Chinese service industry growth. While the government restricted market entry of foreign capital firms in various industries, including retail, logistics, entertainment facilities, visual or game contents, indigenous service providers made a great leap, represented by e-commerce giant Alibaba, or conglomerate Dalian Wanda Group, which also runs commercial properties like movie theaters. In addition, in the 2000s, the government phased in measures to bolster the ICT industry and developed communications infrastructure, resulting in the explosion of Internet service businesses. Helped by the spread of mobile devices,

the penetration rate of Internet usage exceeded 50% in 2015, amounting to 688.3 million users, and that was only 22.5 million in 2000. Also, the government censorship on Google or Facebook turned out to provide a boost to search engine Baidu or SNS operator Tencent.

Figure 2. Top 30 Chinese Service Companies by Market Capitalization (2015)

Ranking		Company name	Business	Market capitalization (bln USD)			
China	World			'00-end	'05-end	'10-end	'15-end
3	21	Alibaba Group	E-commerce				201.2
4	27	Tencent Holdings	SNS, game		1.9	39.9	185.0
12	139	Baidu	Search engine		0.3	33.6	65.3
19	217	JD.com	E-commerce				44.6
22	250	Vanke Group	Real estate				40.5
24	273	China Telecom	Communications service		29.7	42.4	38.0
29	355	Greenland Holdings	Real estate	0.4	0.1	0.5	30.6
33	379	China Unicom	Communications service	19.2	10.2	33.7	29.2
40	437	Dalian Wanda Commercial Properties	Real estate				26.4
45	490	China Merchants Industrial Zone Holdings	Real estate				23.8
46	492	NetEase	Internet service	0.1	1.8	4.7	23.7
55	571	Wanda Cinema Line *	Movie theater				20.7
59	594	China United Network Communications	Communications service		7.3	17.2	20.2
67	682	Poly Real Estate	Real estate			8.8	17.6
68	683	Ctrip.com International	Travel site		0.9	6.0	17.6
72	710	Leshi Holding (Beijing) [LeEco]	Video streaming			1.0	16.8
83	803	Suning Commercial Group	Retail, household appliances		0.8	13.9	15.3
84	822	East Money Information	Financial information service			1.1	14.9
85	823	Air China	Aviation			22.4	14.9
98	961	China Eastern Airlines	Aviation	2.5	1.2	9.5	12.6
99	967	Shanghai Lujiazui Finance & Trade Zone Dev.	Real estate	2.8	1.3	4.3	12.6
101	987	Evergreen Real Estate	Real estate			7.3	12.3
113	1,055	China Southern Airlines	Aviation	1.0	1.4	12.1	11.4
119	1,119	Shanghai Chengtou Holding	Real estate	2.0	1.2	2.8	10.7
125	1,177	Shenzhen Overseas Chinese Town	Recreational facilities	0.7	1.8	5.7	10.0
133	1,238	Gemdale Group	Real estate			4.2	9.6
135	1,253	JSCN	Mass media				9.5
138	1,263	Qihoo360	Internet service				9.4
140	1,278	Country Garden Holdings	Real estate			6.4	9.3
142	1,291	58.com	E-commerce				9.2
Total (30 companies)				28.7	60.0	277.5	963.0
of those Internet-related				0.1	4.9	86.3	587.8
Share (%)				0.3	8.1	31.1	61.0

Note: Internet-related companies are highlighted. (*) indicates affiliates of Wanda Group (unlisted).

Source: Compiled by MGSSI by using Bloomberg data

RISE OF CHINESE ENTREPRENEURSHIP

In addition to economic development and successful government policies, the emergence of unique Chinese-born entrepreneurs also helped the service business boom in China. Early entrepreneurs appeared back in the 1980s, in the manufacturing and real estate sectors, irrespective of their academic or business backgrounds. Zhang Ruimin³ (born 1949), the founder of electrical appliance manufacturer, Haier, used to be the deputy manager of the Household Appliance Division of the Qingdao municipal government and was then promoted to Director of the Qingdao Refrigerator Factory⁴ in 1984 to rebuild the ailing company and made it into a global major home appliances brand. Another pioneering entrepreneur is Wang Jianlin (born 1954), the founder of the aforementioned Wanda Group. After 16 years in the People's Liberation Army, he made his real estate business into the multinational conglomerate, and he himself was named the richest person in Asia in 2016 by Forbes. Having acquired the US theater chain AMC in 2012, the group has become the world largest theater operator,

and is also made inroads into the movie production business. The group also owns resort facilities and theme park businesses, widely ranging from hotels, shopping centers, golf courses, ski resorts, to theaters and hospitals.

Chinese entrepreneurs in the 90s are mostly represented by former government officials or academics, inspired by Deng Xiaoping's famous southern tour. Former English professor at Beijing University, Yu Minhong (born 1962) founded New Oriental Education & Technology Group in 1993, an English school focusing mainly on TOEFL preparation. With 3.6 million students studying at 748 sites across the country, the group is now the largest cram school operator in China.

Compared with those pioneers, Chinese entrepreneurs around 2000 tended to target overseas development of their business in the early stages. China's WTO accession in 2001 is one of the major factors that changed their mindset toward global operation. Typical examples are found in Internet businesses, including those of Pony Ma (born 1971) of Tencent (founded in 1998), Jack Ma (1964) of Alibaba (1999), and Robin Li (1968) of Baidu (2000). Although only a few of those entrepreneurs studied in the US or worked abroad, they actively recruit experienced businesspersons from the US and elsewhere as their company executives, and gain business know-how.

Since the mid-2000s, the number of business startups in the Internet/mobile service sector in China has increased ever faster. Given the growing number of tertiary education participants and those who study abroad, entrepreneurship seems to have been cultivated in China. As of 2013, the number of students at higher educational institutes reached 34 million (enrollment 30%), which reflects a five-fold increase in just thirteen years, while the number of Chinese students studying abroad exceeded 700,000⁵ during the same period, similarly a five-fold increase.

FROM IMITATING BUSINESS MODEL TO CREATING INNOVATION

Most of such service businesses have emulated successful business models in the United States and evolved themselves in China. In addition to those mentioned above, many local providers of lifestyle or entertainment services (many are equivalent to the existing models in the West) are enjoying remarkable growth; namely, Youku (Chinese-equivalent of YouTube, acquired by Alibaba in 2015), Didi Chuxing (Uber), LeEco (Netflix), Ctrip (Expedia), Tujia (Airbnb), Dianping (Yelp, 20% ownership by Tencent).

Their business models are often said to be copied from the US companies, but some are successfully offering distinctive services of their own. For example, Alibaba's annual Singles Day event brought it 91.2 billion yuan in sales in one day in 2015. Prior to Facebook, Tencent succeeded in connecting its messaging application with various lifestyle services such as games, e-commerce, taxis, delivery, and payment, thereby creating social infrastructure of 900 million consumers. Neck-and-neck competition between Alibaba and Tencent over incorporating payment application with financial services such as asset management, loans, insurance products, resulted in the world's highest number of Internet financial service users, over 500 million in China.

In the meantime, a Silicon Valley-like system of encouraging entrepreneurship is being developed in China. In the US Silicon Valley, a network of supporting entrepreneurs has been established together with the help of academic or research institutes, excellent human resources with technological expertise, venture capitalists, and angel investors. Also, once they have succeeded, entrepreneurs often come back to Silicon Valley as investors. In China, successful entrepreneurs are encouraging entrepreneurship of younger generation, major

players such as Alibaba and Tencent support startups, and a Silicon Valley-like network is taking root not only in major cities like Beijing and Shanghai, but also Shenzhen, where Tencent is headquartered.

According to OECD (Organisation for Economic Co-operation and Development), China's R&D spending in its industrial sector reached USD 248.8 billion (PPP, nominal) in 2013, approaching that of America, USD 278.1 billion. As the scale of R&D is also on the rise, in China, and more startups emerge in the areas where consumer needs cannot be met only via the Internet, such as the healthcare and entertainment sectors, it is expected to accelerate upgrading of China's industrial structure and also spread Chinese innovation worldwide.

- ¹ GDP based on PPP per capita GDP, current international dollar, 2015
- ² Adjusted by current prices of 2015
- ³ Mr. Zhang earned his MBA degree at University of Technology and Science of China in 1995.
- ⁴ A predecessor of Haier, founded in the 1920's
- ⁵ UNESCO statistics