ARE CHINA'S DIGITAL COMPANIES READY TO GO GLOBAL?

By François Candelon, Fangqi Yang, and Daniel Wu

To get a sense of how thoroughly the global digital economy is dominated by the US and China, look no further than a recent list of the world's most valuable internet-based companies. Eleven of the top 20 are from the US; the remainder are based in China.

When it comes to global recognition, however, there is a wide gap. Virtually every US internet titan is a household name in much of the world, starting with the big five—Apple, Amazon, Microsoft, Google/Alphabet, and Facebook—and continuing with companies such as Netflix, PayPal, Uber, and Airbnb. Among Chinese companies, Alibaba and Tencent are perhaps the best known globally, even though few consumers outside China and its neighboring countries interact directly with them. The names farther down the list—such as Didi Chuxing, Meituan-Dianping, and ByteDance—are more obscure beyond China. (See Exhibit 1.)

There is a reason for this recognition gap: the larger global presence of the US companies. Even though some of the Chinese players may be bigger in their sectors, they still concentrate overwhelmingly on their immense home market. International operations accounted for only 5% of the 2018 revenue of Chinese digital companies. The contrast is just as striking when we compare companies in the same space. Around 30% of Amazon's 2018 revenue came from outside the US, for example, while only 8% of Alibaba's revenue last year was from outside China. Google and Facebook earned more than 50% of their revenue overseas. That compares with less than 1% for Baidu and 3% for Tencent.

This situation may be changing, however. About 40% of Chinese digital companies report at least some overseas revenue. What's more, nearly 60% of the 150 executives we interviewed at Chinese digital companies said they regard international expansion as a priority that's equal to or higher than domestic expansion.

Drawing on our interviews with executives, we have developed a globalization framework for Chinese digital companies. It al-

EXHIBIT 1 | The 20 Most Valuable Internet-Based Companies Are All from the US and China

1 Apple	6 Alibaba	11 Salesforce.com	16 Didi Chuxing
2 Amazon	7 Tencent	12 Booking Holdings	17 JD.com
3 Microsoft	8 Netflix	13 ByteDance	18 Meituan-Dianping
4 Google/Alphabet	9 Ant Financial	14 Uber[1]	19 Xiaomi
5 Facebook	10 Paypal	15 Baidu	20 eBay

US China

Sources: CB Insights; Reuters; BCG analysis.
Note: The ranking is based on market capitalization. Market capitalizations for publicly listed companies are as of April 8, 2019; valuations of private companies are estimates.
[1]Based on market estimate prior to Uber's IPO, on May 10, 2019. Uber's ranking may have changed owing to market fluctuations.

lows us to identify approaches to overseas development for various sectors—and helps other companies understand the type of Chinese competition they are likely to face. In areas like e-commerce and online payments, Chinese market leaders have the expertise to add considerable value to new markets and can afford to acquire or invest in local players. In sectors such as gaming and video sharing, Chinese digital companies can successfully compete on the strength of their innovative offerings.

Why Chinese Digital Players Are Going Global

Globalization is attractive to China's digital companies for two fundamental reasons. First, China's domestic market has grown fiercely competitive. While a high percentage of market leaders cite this concern, it is especially relevant to new entrants. In gaming, for example, new developers often must rely on bigger companies, such as Tencent, for distribution. The investment required to build a user base in China has become so high that such companies must consider other markets. Of the Chinese executives we interviewed from digital companies that are not market leaders, 85% cited intense domestic competition as a key reason for going abroad.

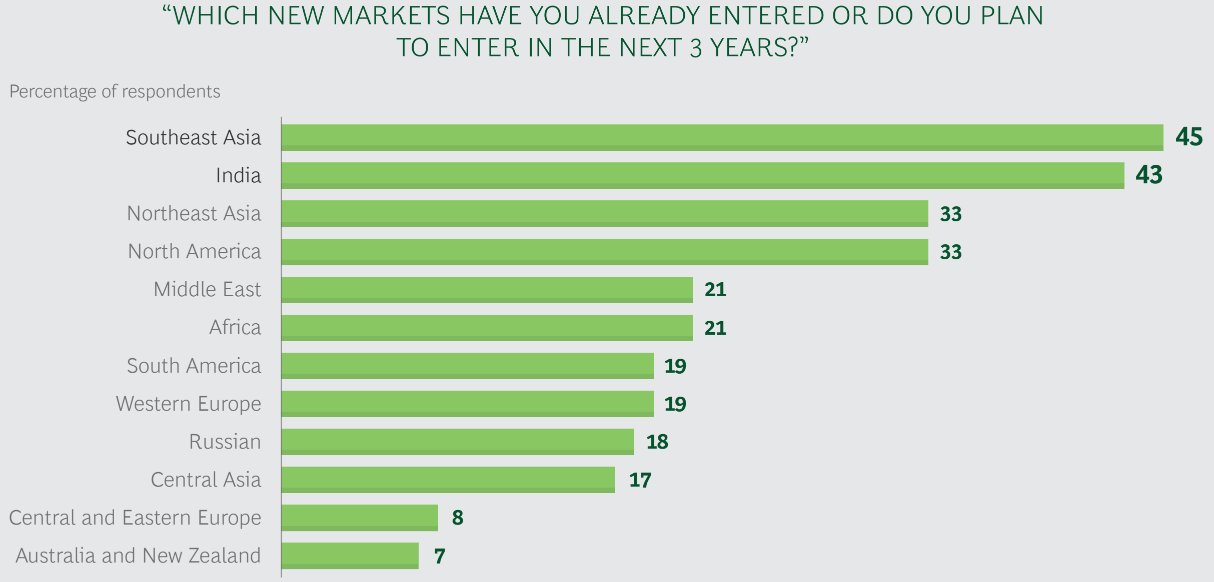
Second, the overseas success of some Chinese digital companies is boosting the confidence of others in their ability to venture abroad as well. For example, TikTok, an app for sharing short videos, was one of the most downloaded apps in the US and Europe in 2018, surpassing YouTube, Instagram, and Snapchat. Bigo Live, a live-streaming platform launched in Singapore by David Li, the Chinese entrepreneur who founded the video-based social media platform YY, is popular across Southeast Asia, the Indian subcontinent, Saudi Arabia, and New Zealand.

These successes show that there are two pathways for China's digital companies to go abroad. The traditional path followed by pioneers such as Alibaba and Tencent has been to win in China first and then venture abroad. The other is to go international immediately. This new path emerged as more Chinese companies saw opportunities for higher returns overseas—and recognized that they had the digital capabilities to succeed globally.

Where China's Digital Companies Are Competing

The top foreign destinations for China's digital companies currently are India and Southeast Asia—the emerging markets with the greatest growth potential, closest cultural fit, and most developed digital infrastructure. Forty-five percent of executives we interviewed said their companies have already expanded in Southeast Asia or plan to do so in the next three years; 43% said they have expanded or plan to in India. That compares with 33% citing North America and 19% citing Western Europe as destinations. (See Exhibit 2.)

EXHIBIT 2 | Southeast Asia and India Are the Top Destinations for China's Digital Companies



Sources: China Digital Globalization Survey (150 executives of Chinese digital companies); BCG analysis.

In many cases, Chinese and US companies are competing head-to-head in India and Southeast Asia, leaving little room for local players. The US tech giants have a head start in video sharing and social media. Facebook's WhatsApp messaging service and YouTube have the most users in both regions. But Chinese companies are building a presence by investing in leading home-grown competitors in these segments. Indian social messaging app Hike, for example, received funding from Tencent in 2016.

In other areas, China is gaining the upper hand. In e-commerce, payments, transportation, and gaming, China's digital titans have been expanding their market share and in some cases have surged ahead of companies such as Amazon, eBay, and Uber. In payments, Alibaba-backed payments app Paytm has captured up to 70% of the Indian market. In transportation, Ola Cabs, an e-hailing company backed by Tencent, competes head-on with market leader Uber India.

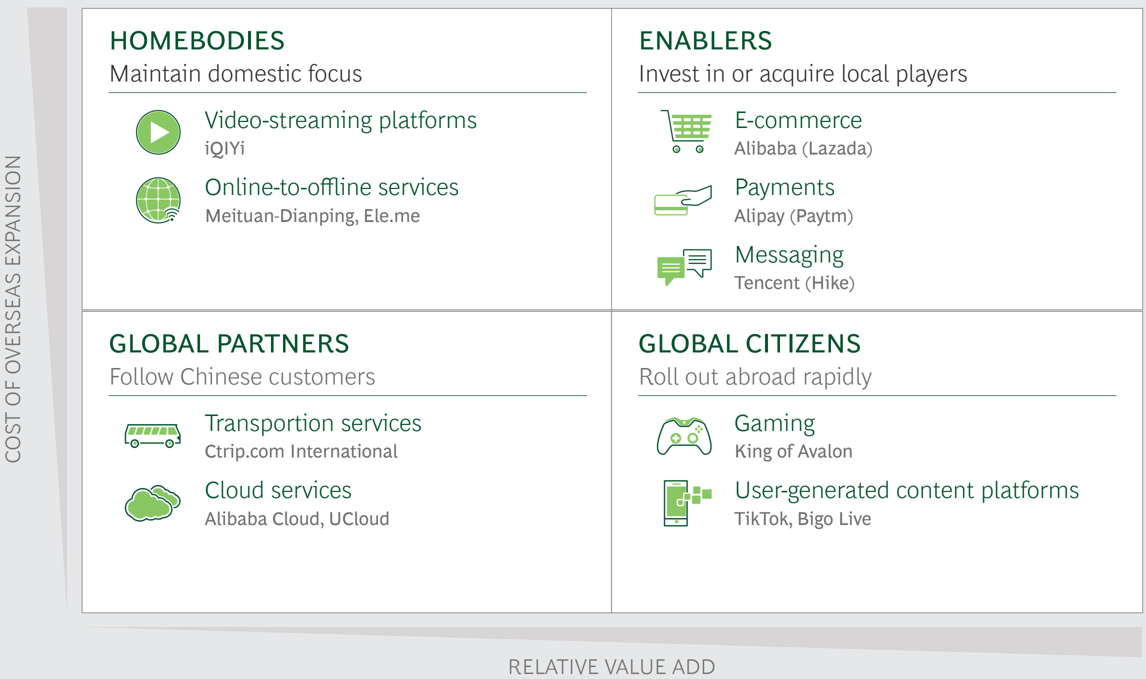
The digital giants of China and the US are taking very different approaches to entering new markets. Leading US companies tend to leverage their global brands and technological strengths. They focus on building scale at home and then offer similar products and solutions overseas. China's digital titans, by contrast, tend to use more customer-centric business models to tailor their offerings to local and even personal tastes. Given their digitally savvy and demanding customer base, this should not be surprising. Chinese users expect an ultraconvenient, hyper-engaging experience that is entertaining, social, and highly personalized. Chinese companies strive to solve each hurdle along the customer journey in order to provide a seamless experience. Their platforms capture data from various touchpoints, such as searches and social interactions, and use artificial-intelligence-based analytics to give customers a curated, personalized service. This positions them as natural frontrunners in the integration of online and offline commerce.

What Models Do the Chinese Companies Follow?

To identify globalization models, we plotted different sectors along two axes. (See Exhibit 3.)

On the x-axis, we assess the level of value that the Chinese competitors bring to their

EXHIBIT 3 | A Framework for Chinese Digital Globalization



Source: BCG Henderson Institute analysis.

sector in a new market. For instance, Chinese digital companies are usually strong in the mobile internet and in developing businesses that combine online and brick-and-mortar value chains. They are also expert at customization and solving difficult logistical and payment challenges in developing economies. The y-axis weighs the cost of overseas success, which varies by sector, the level of physical integration required, the regulatory context, and the degree of customization needed to build a local user base.

We segmented Chinese internet-based companies into four groups on the basis of their approaches to overseas expansion: enablers, global citizens, global partners, and homebodies.

Enablers. Chinese companies in this category identify emerging or successful players in the local market and acquire or invest in them. Because access to the local market is essential, enablers appreciate the fact that home-grown companies know how to deal with the intricacies of local regulations and customer habits. In return, the digital giants add a lot of value through their experience. Often, local companies need help overcoming roadblocks similar to those the Chinese companies have encountered and surmounted at home. The enablers then tailor their expertise, advanced tools, and solutions to that country, often helping their new affiliates achieve amazing transformations.

A good example of an enabler strategy is Alibaba's role in turning Southeast Asian online marketplace Lazada into a "shoppertainment ecosystem," a platform that blends shopping and entertainment. Even though it was already the region's largest e-commerce company, Lazada had struggled to expand in an e-commerce market with low penetration of online payments and scattered logistical support.

Alibaba has invested $4 billion in Lazada, helping to resolve the company's logistical challenges by integrating the platform into the smart logistics network of Cainiao, an Alibaba affiliate, and building several hubs. The enhanced network has enabled Lazada to develop new partnerships, such as with lifestyle and fashion companies, and to deepen its integration with other companies offline. Lazada's platform remains local, however, and the company remains in control of customer touchpoints in Southeast Asia. US e-commerce companies that have entered the region are in fewer countries and are offering a one-click shopping service similar to what they provide in the US.

Ant Financial enabled a similar transformation with the Indian online payment company Paytm. Ant Financial taught Paytm to deploy the QR barcode in its mobile payment app to overcome challenges in transacting payments at retail stores in India, where many consumers lack bank accounts and wireless internet connections are slow. Six months after Ant Financial bought a large stake in the company, Paytm had increased its share of Indian electronic payments to more than 70%, becoming the world's third-largest e-wallet, after Alipay and WeChat Wallet. The company has since expanded into wealth management services with the launch of Digital Gold, which allows consumers to buy, store, and sell gold digitally. The idea was influenced by Yu'e Bao, Ant Financial's money market fund.

Global Citizens. In some areas, Chinese companies have developed unique products that they rapidly roll out overseas. This works especially well in asset-light sectors, such as social networking.

TikTok, the pioneering video platform, is one such global citizen. TikTok has positioned itself as an interactive content hub rather than as simply a video-sharing app. The platform hooks users by constantly offering "challenges" that encourage social interaction, such as a competition to create the most innovative video about Christmas. TikTok is owned by ByteDance, the Chinese company that launched the Douyin video-sharing app. Development costs were low because Douyin and TikTok share technology, such as the artificial-intelligence-based algorithm that enables the TikTok platform to optimize and curate content and make personalized recommendations for users. TikTok's model has proven to be highly replicable: its service is used in 150 countries and has been translated into 75 languages.

The live-streaming platform Bigo Live is another example of a Chinese-backed digital company that went global with an innovative offering. David Li started Bigo in Singapore; the company has since become popular across the region. Bigo illustrates another trait that distinguishes Chinese global citizens from most US digital giants: rather than try to maintain a consistent global brand, they tend to keep their international identities distinct from their Chinese identities by customizing their offerings and gaining a deep understanding of local markets.

Bigo achieved its highest traffic in India by introducing Bigo Ludo—a version of a popular game traditionally played during Diwali. Tencent's WeChat famously used a similar strategy in 2014, when it attracted millions of users over the Chinese New Year by digitizing the ancient custom of giving money away during the holiday season.

Global Partners. Some Chinese digital companies go global by following their Chinese customers. This approach is low cost because the company is simply extending its value proposition to its own customer base. In the business-to-consumer realm, Ctrip.com International, China's largest online travel agency, established an international presence primarily to help Chinese customers book accommodations and transportation while traveling abroad. Only later did Ctrip.com acquire Trip.com, in order to serve an international audience. Chinese cloud computing companies are pursuing global partner strategies in the B2B space. For example, UCloud, a Chinese provider of cloud computing infrastructure and services, has positioned itself as a "courier station" for Chinese companies going overseas.

Homebodies. This group of Chinese digital companies remains focused on China. There is not enough of a business case for going global to justify the high cost, nor do these companies believe they have a unique value proposition to offer abroad. The homebodies believe they will make a higher return by protecting and strengthening their position in China. The Chinese video streaming giant iQIYi, for example, has stated that it intends to remain focused on its home market. While it has succeeded by offering original content suited to the tastes of Chinese audiences, it has little advantage that would help it compete with giants such as Netflix and Amazon in foreign markets.

Some Chinese homebodies are accumulating immense data and expertise that can give them advantages overseas and could enable them to become enablers. Meituan-Dianping, for example, may be a candidate for becoming an enabler. The company has stated that it will focus on the domestic market in part because of the fierce competition in its core business—a platform that includes grocery delivery and restaurant ratings—from Alibaba affiliate Ele.me. But Meituan-Dianping has transformed itself into a lifestyle service delivery platform by integrating a Chinese bicycle sharing company and hospitality services. The company could use this experience to add value in foreign markets by helping advance the integration of online and offline retail.

How Far Will China's Digital Giants Go?

The traditional constraint for Chinese companies wishing to go global was the old belief that they were weak in innovation. But China's digital titans clearly are in the global vanguard when it comes to innovation that's based on customer insights, what Boston Consulting Group calls customer-to-business innovation. They are better at this than most of their Western rivals and have access to far more data through their massive platforms, which combine social media and e-commerce.

China is also fueling the innovation engine with huge investments in new technology. It has already surpassed the EU in total R&D spending and is close to catching up with the US. In key fields such as artificial intelligence, China has gone from a fringe player to a global leader in fundamental research in less than two decades.

While its capabilities continue to surge, however, China's digital sector is at a crossroads of sorts. Given the geopolitical headwinds, two critical questions need to be answered. One is whether Chinese companies will be able to gain international trust. The other is whether the digital champions will maintain their appetite for globalization given the costs of establishing themselves in foreign markets.

Winning trust is essential in an era when foreign governments worry about cybersecurity, consumers worry about protection of their personal data, and incumbents in foreign markets worry about the impact of Chinese competition on domestic industries. One way Chinese digital companies can build trust is through strategic partnerships with local businesses and governments that help develop digital infrastructure and create economic opportunity. They can accomplish this by nurturing local digital ecosystems that will enable workers and small businesses to reach global markets through their platforms.

Alibaba is a pioneer in creating mutually beneficial initiatives overseas. The company is leading an international effort to establish an Electronic World Trade Platform (eWTP), a global e-commerce network that would reduce friction in transactions. Alibaba's vision is to build infrastructure and logistics hubs that will enable small and midsized enterprises to engage in international e-commerce. It is encouraging governments to create virtual free trade zones for small businesses and allow them to sell to foreign customers with low import duties and speedy customs clearance.

In Malaysia, Alibaba is developing an "e-hub" as part of the eWTP that will act as a central clearance, warehousing, and fulfillment facility that would help SMEs reach overseas markets. The initiative supports a Malaysian government goal of doubling the economic contribution of e-commerce to $50 billion by 2020. In Thailand, Alibaba's affiliate Lazada is working with the national customs service to establish a logistics hub and e-commerce park in the Eastern Economic Corridor that will have links to Cambodia, Laos, Myanmar, and Vietnam. The initiative will offer e-commerce training to 30,000 SMEs. Belgium and Rwanda have also agreed to be partners in eWTP.

Such trust-building initiatives are very expensive, however. Chinese entrepreneurs are pragmatic. Many Chinese companies may decide that the return on investment needed to overcome such challenges in foreign markets may not be worth it—especially considering the opportunities at home. E-commerce revenues in China have risen by an average of 34% annually for the past three years. And there is plenty of headroom for growth: 40% of China's population is still not connected to the internet, compared with 30% in the US and 20% in the EU.

Trust should come eventually, however, if Chinese digital companies stick with their winning strategies and demonstrate a willingness to allay local concerns. If these companies create value not only for themselves but also for their partners and customers, and for small enterprises in the markets they enter, foreign companies and governments could increasingly view China's digital titans as positive contributors to their economies.

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