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# Tencent: A Case Study on Expanding Through Micro-Innovation and Strategic Partnerships

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## Abstract

Tencent is a Chinese IT company that offers a wide variety of products in the e-commerce, online advertising, online games and social network markets. Most of these services are centered around the central hubs of QQ and Weixin/WeChat. This allows for a spillover of users and a brand name that can be used for a variety of products. Most of Tencent's software products are free to use, but allow users to buy small cosmetic upgrades. For Tencent, these value-added services are the main source of income. This differentiates the company from most of its competitors, which still rely mostly on online advertisements to monetize users of free services. Tencent focuses on 'micro-innovation', taking a proven concept and adjusting it to the Chinese market. The company is very strong in the domestic market, but has had trouble in foreign markets. More recently, Tencent started strategic partnerships with companies in segments where the company cannot become market leader on its own. Perhaps the company could also use this strategy for foreign market entry.

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## 1 Introduction

Since the introduction of the World Wide Web in China in 1994, the user base has grown exponentially. By 2008, there were 253 million internet users in China, making it the largest internet market in the world (Zhang 2008). During the last survey of the China Internet Network Information Center in July 2013, this count was up to 591 million (CNNIC 2013). It will come as no surprise then, that there is a lot of money to be made in this market by companies who know how to approach

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it. Chinese internet-based companies, such as Baidu, Alibaba, and Tencent, have grown quickly and their founders have become billionaires.

Like many of its Western counterparts, Tencent started as a small company founded by a few friends and with little money. Since then, it has grown to become one of the largest internet companies worldwide, and has a revenue that is higher than Western giants such as Facebook. The company offers a variety of services to its customers, mostly centered on their hub of qq.com. Services include instant messaging programs, social networks, online video games and e-commerce, both on PC and mobile platforms. The instant messaging program QQ was at the start of Tencent's success and is the largest such service in China. At the end of 2013, Tencent's instant messaging services had 808 million monthly active accounts and their WhatsApp-like Weixin and WeChat protocols had a combined monthly active user count of 355 million (Tencent 2014e). Unlike most of Tencent's competitors, the company does not monetize this enormous user base with online advertising. Instead, the company concentrates on 'value-added services', small cosmetic features that a user can buy for a small fee. It is hard to find a Chinese PC that does not contain a product from Tencent, and the company is also growing in the mobile market.

So far, Tencent has gotten the vast majority of its revenue from the Chinese market. The company is, however, also looking to expand into various international markets. It already opened offices in South Korea and the USA. Tencent has also invested in a variety of companies in countries such as the USA, South Korea, Thailand, and India. While Tencent has yet to get a firm foothold in any market outside of the domestic one, the company is not planning on giving up anytime soon. One of its long-term goals is to make their services popular in select foreign markets. In this analysis, we will examine Tencent's profile, rise, and expected developments.

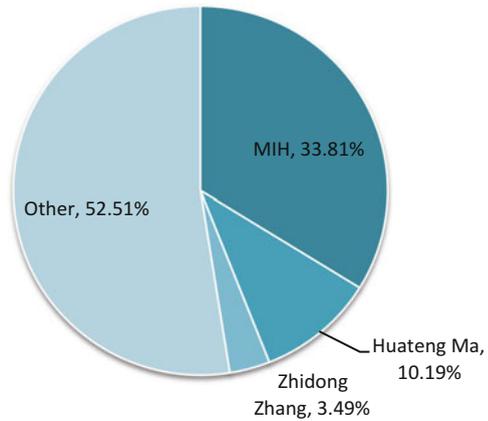
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## 2 Company Profile

### 2.1 History

Tencent was founded in November of 1998 by Huateng Ma (or Pony Ma, as he likes to call himself in English) in Shenzhen, Guangdong, China. Originally the company was called OICQ and it developed an instant messenger service of the same name aimed specifically at the Chinese market. The motivation was the deal of AOL, who bought the Israeli developed instant messenger ICQ for 407 million US\$ earlier in 1998 (Businessweek 2011). The instant messenger, renamed QQ after complaints by AOL, would quickly grow to become the most popular Chinese instant messenger system. After the launch of QQ, the company (by then renamed Tencent) would diversify its business while still staying focused on the internet market. Between 1999 and 2006, Tencent launched, amongst other things, mobile and telecommunication value-added services, internet value-added services, web portals, casual (computer) games, a social networking service, and an online payment platform

**Fig. 1** Substantial shareholders of Tencent as of Q1, 2014 (Tencent 2014a)



(Tencent 2014a). Initially, it was hard for the company to find investors. These problems seemed solved when, in 2001, MIH, a holding company connected to South African media group Naspers, paid 32 million US\$ for a 47 % share in Tencent (Businessweek 2011). MIH has stayed a major shareholder until this day, with 33.81 % of the shares by early 2014. Other major shareholders are Huateng Ma himself (10.19 %) and Tencent co-founder Zhidong Zhang (3.49 %) (Fig. 1). In June of 2004, Tencent would be listed on the Hong Kong stock Exchange and in June of 2008, the company also became a constituent of the Hong Kong's Hang Seng Index (Tencent 2014a).

## 2.2 The Founders

The main founder of Tencent is Huateng Ma. Forbes lists him as the fifth richest Chinese citizen (Forbes 2014a). Ma is a native of Chaoyang, in Guangdong. He graduated from Shenzhen University with a bachelor degree in computer science in 1993 (Sun and Quan 2009). Afterwards he started working for China Motion, a telecommunications company. In 1996, he was sent to the US by this company, for training at a telecom equipment company in Melbourne. This was where he first discovered the possibilities of the web (Businessweek 2011). Compared to some other Chinese internet billionaires, Ma chooses to keep a relatively low profile. He dislikes public speaking and does not talk with the press often. Internally at Tencent, however, Ma is known as a perfectionist and micromanager (Businessweek 2011). Currently, he is Executive Chairman of the Board and Chief Executive Officer at Tencent.

Tencent cofounder Zhidong Zhang stays away from publicity even more so than Ma. He also, is listed on the Forbes list of richest Chinese, at place 25 (Forbes 2014a). Zhang holds a bachelor degree in computer science from Shenzhen University and a master degree in computer application and system structure from the South China University of Technology. Before he founded Tencent together with

Ma, he worked at the Li Ming Network Group. On March 18, 2014, Tencent announced that Zhang would resign from his position at the board of directors immediately and from his position as chief technology officer after September 20 for “personal reasons” (Forbes 2014b). He will, however, stay connected with the company in an advisory role.

### 2.3 Employees

As of the end of 2013, Tencent had almost 27,000 employees (Google finance 2014). According to the company, more than 50 % of these employees are R&D staff (Tencent 2014b). Most of Tencent’s employees work in China, but Tencent also has offices in South Korea and in the USA. Both of these foreign offices are relatively small though. The South Korean office now employs a little over 20 people, and the office in the USA is “small and nimble” according to Tencent (Tencent Careers 2014). Not much else is disclosed by the company, but their official website offers some insight in the corporate culture of the company. Since Tencent is a leading internet company with a huge R&D department, it would seem reasonable that its employees are mostly highly educated with backgrounds in fields such as computer science.

In recent years, Tencent tried to achieve a more positive and open image. Their vision is to be “the most respected internet company” and one of the ways to achieve this is to “earn the respect of employees by continuously improving our corporate reputation so that Tencent is a company employees are proud to work for”. At the same time, Tencent stresses the importance of integrity (going as far as having a separate page for “whistleblowers” on their official site) and innovation (Tencent 2014c). It seems that most of these points are responses to several controversies that have hurt the company’s image. We will discuss these controversies further on in this analysis.

### 2.4 Product Range

Tencent has a very wide product range (Fig. 2). After the launch of the QQ instant messenger, Tencent started mobile and telecommunication value-added services, internet value-added services, the mini casual games portal QQ game, the webportal qq.com, several (casual) games, the multimedia networking service QZone, the C2C (consumer-to-consumer) platform paipai.com, the online payment platform Tenpay, the mobile instant messenger Weixin, the video portal v.qq.com, the e-commerce platform buy.qq.com, and mobile game centers. It developed a search engine (SoSo) and several video games in-house (both casual games and massively multiplayer online games), but also outsources some of the development work. Most of these development companies are South Korean, but Tencent also invested in the American game developers Riot Games and Epic Games. Tencent also offers e-commerce services. The products were traditionally aimed at the PC

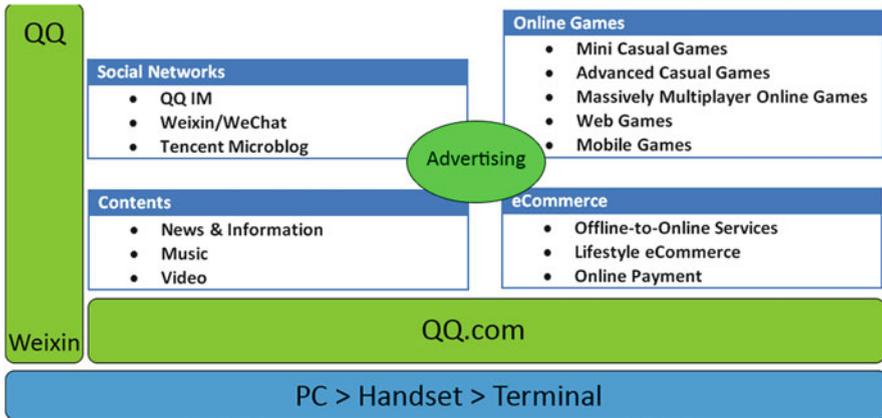


Fig. 2 Tencent’s product range (Based on Tencent 2014d)

market, but nowadays Tencent is also very active on the mobile market. Aside from offering the mentioned products, Tencent has invested in many companies and products, including internet companies active on the Chinese, Russian, and Thai markets (Tencent 2014d).

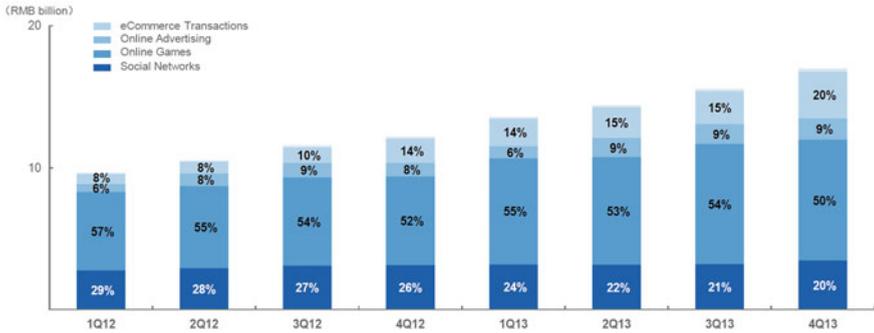
According to the investor factsheet, Tencent “uses technology to enrich the lives of internet users”. Apparently, Tencent has been very successful in this ambition, since its products are very popular on the Chinese market. By March 2010, the QQ instant messenger service had reached the milestone of having 100 million user accounts online simultaneously. The Weixin/WeChat messenger had over 300 million registered users in January 2013 and qq.com has been one of the most popular web portals in China since 2006 (Tencent 2014a). As of April 2014, qq.com is the second most visited website in China, according to Alexa. Globally, it ranks seventh (Alexa 2014).

## 2.5 Revenues

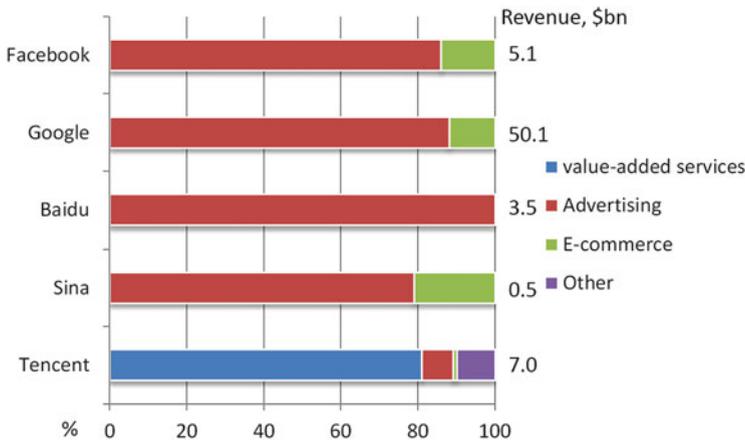
The revenue of Tencent can be broken down into four categories: e-commerce transactions, online advertising, online games, and social networks. Over the past two years, revenue on all these categories has increased, but there has also been a remarkable change in its composition. The revenue from online games is still the biggest, but revenue from e-commerce transactions has increased from 8 % of the total in Q1 of 2012 to 20 % of the total by Q4 2013. In the same period, the percentage of social networks decreased from 29 % to 20 % and that of online games from 57 % to 50 %. The fourth category, online advertising, slightly increased from 6 % to 9 %.

The low percentage of online advertising in Tencent’s revenue breakdown is remarkable. Most internet companies rely on advertising for the vast majority of

**Revenue Breakdown**



**Fig. 3** Tencent’s revenue breakdown (Tencent 2014a)



**Fig. 4** Internet firms’ revenue by source, 2012, % of total (Based on Economist 2013)

their revenue (see Fig. 4). Tencent makes most of its money by value-added services, such as micro transactions in their computer games and social networks. The value-added services revenue is the total of the online games and social networks categories of Fig. 3. The value-added services strategy has been instrumental in Tencent’s rise. While Tencent is active overseas (such as with the popular American online game League of Legends), most of its revenue still comes from the home market in China. As can be seen in Fig. 4, Tencent’s revenue is higher than that of Facebook. The company’s shareholder total return was even the highest of any large firm from 2008 to 2012 (Economist 2013).

## 2.6 Business (Success) Strategies

The business strategy of Tencent has been highly controversial. Originally the company seemed to mostly copy proven products from competitors and optimize them for the Chinese market. The QQ messenger, the development of which led to the founding of Tencent, used to be called OICQ and was a copy of the (at that time) popular ICQ messenger. Other companies criticized Tencent for its practices, including Sohu.com's Charles Zhang: "Tencent is a copycat. It's a company that doesn't create anything." Tencent itself calls it "micro-innovation", adding small details to a product and localizing it (Businessweek 2011).

In 2011, Tencent started their "open platform strategy" as a response to criticism of their restricted platforms. It should allow easier access to Tencent platforms for third parties. This, together with the "corporate culture" pointers, are examples of how Tencent tries to improve its public image.

The other part of Tencent's strategy is focusing on making revenue from value-added services instead of from advertising. The company offers its products, such as games or messenger software for free, but for a small fee users can buy extras to improve their experience. In the case of games, this can be clothing or weapons, and in their messenger software or social networks, it could be customized avatars and other cosmetic features. Most of Tencent's competitors also offer their products to users for free, but try to monetize them with advertisements. So far, Tencent's business model has worked very well for the company and there are no signs of change, even though the share of e-commerce related revenue is increasing.

While Tencent has invested in many foreign markets, the company has trouble getting footholds. This is an effect of Tencent's overall business strategy: localizing proven concepts for the Chinese market. The company understands the Chinese market well, but doesn't manage to provide competitive products for the international market. The international investments are also not always meant to enter those markets. For example, the main objective of the investment in US developer Riot Games was to localize their online game League of Legends for the Chinese market, not to get a foothold in the US market (Businessweek 2011). Tencent does not want to give up on the international market just yet though. According to the outlook and strategies for 2014 of the Tencent 2013 annual results, the company states that it will "continue investing heavily in certain long-term projects we deem strategic, including, [...] marketing and popularizing our WeChat service in selected international markets" (Tencent 2014e).

## 2.7 Quality and Innovation of Product Range

As mentioned before, Tencent is not known for innovation, despite its huge R&D facilities. But because Tencent runs with what works, its products are of high quality, as is evidenced by their popularity in China. The company also continues to invest in other companies and has started strategic partnerships with various parties in order to improve products. An example would be the strategic partnership

with Sogou, a company that specializes in search engines. Tencent wants to merge their own search engine SoSo with this company (Economist 2013). Basically, Tencent either buys or copies quality. But the company also has the ambition to keep developing products by themselves. In their annual report for 2013, Tencent mentioned an interest in developing O2O (Online-to-Offline) services, a relatively new business model that seeks to combine online shopping with front line transactions (ChinaAbout 2013). Whether this development will be done through innovation or “micro-innovation” remains to be seen.

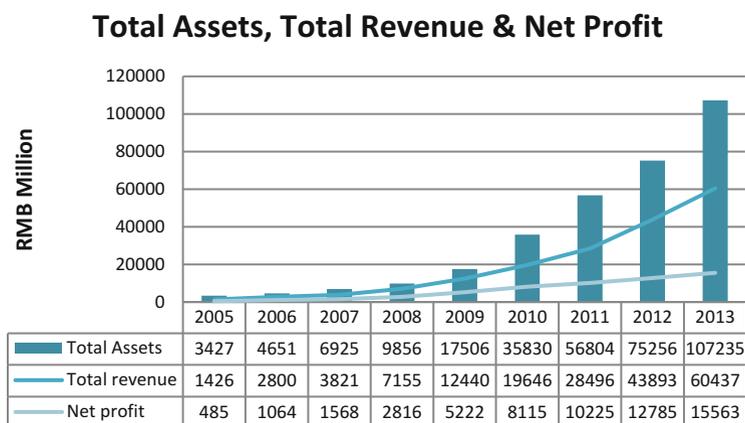
### 3 The Rise of the Company

#### 3.1 Growth Development

Tencent, both as a company and in the amount of users of its products, has grown tremendously since its founding. The company was unprofitable until 2000 but has seen a steady increase in assets, revenue, and net profit since then (Tencent 2010) (Fig. 5).

The financial crisis of 2008 had no visible impact on Tencent’s development, which has been growing steadily, probably because of its focus on the Chinese internet market. The total assets and total revenue show an exponential growth, while the net profit rises more evenly.

During the first 11 years of its existence, Tencent mostly launched new products and services, but since 2010 the company has increased its amount of investments in other companies, both in China and abroad. This shows how the company has not only grown financially, but also in its strategies. In November 2013, Moody’s changed Tencent’s outlook from stable to positive, stating the progress of the



**Fig. 5** Tencent total assets, total revenue and net profit 2005–2013 in RMB million (Tencent 2014f)

“Open Platform” strategy as one of the reasons. The rating bureau praises Tencent for its ability to keep a healthy balance sheet, despite the expansion of its business scope (Moody’s 2013). In June of the same year, Standard & Poor’s upgraded the long-term corporate credit rating from BBB+ to A– “to reflect the company’s stronger competitive position and improved financial strength. A strong growth in business scale, an expanding user base, and improving service diversity underpin the improvement in Tencent’s competitive position” (S&P 2013).

In conclusion, it can be observed that Tencent’s growth is based on an ever-expanding business and diversification of services in a growing market. Originally, this was achieved with products developed by Tencent itself. In later years, the company started investing in other companies to expand its business, and allowed access to its platforms to third parties. This has resulted in a steady growth of the company and financial stability.

### 3.2 Becoming a Brand?

While the name Tencent is well known in China, the company’s strongest brand is without a doubt QQ. QQ has grown to become much more than just an instant message service. Most of Tencent’s PC-based services are built around qq.com, the company’s web portal. For instance, Tencent’s video portal can be accessed through v.qq.com, while the open e-commerce platform is accessed via buy.qq.com. The company considers QQ to be its flagship service and has been working to change it from a PC-centered service to a primary smartphone experience, showing how important the brand still is for Tencent (Tencent 2014e).

Internationally, Tencent chooses a different approach. QQ can hardly be called an international brand, and apparently Tencent does not try to make it one. A successful international product of Tencent is WeChat, the international version of its mobile instant messenger Weixin. Tencent is trying to push WeChat as a brand with a big marketing campaign. In 2013, the company started a world-wide ad campaign featuring the famous football player Lionel Messi. It also partnered with other brands by offering relationships. According to VALUE2020, the app has been mostly successful in Asia, but there is a growing user base on basically all continents. The local marketing is only aimed at Asia for the moment, but the app also increased its user base on the other continents (VALUE2020 2013). Still, WeChat is far from an international house-hold brand. There remains work to be done in this field for Tencent. The company realizes this and states that WeChat international expansion is one of their key objectives in order to expand their position on the mobile market (Tencent 2014e).

With QQ at home and WeChat abroad, Tencent has potentially two strong brands. Where QQ was built up slowly, by integrating more services under the same name, Tencent seems to choose a more aggressive approach, with the intention of creating a multi-functional platform out of the brand, with WeChat. So far, however, WeChat is only one product and the name of Tencent is not

necessarily associated with it. It remains to be seen how far WeChat, both as a product and a brand, will grow.

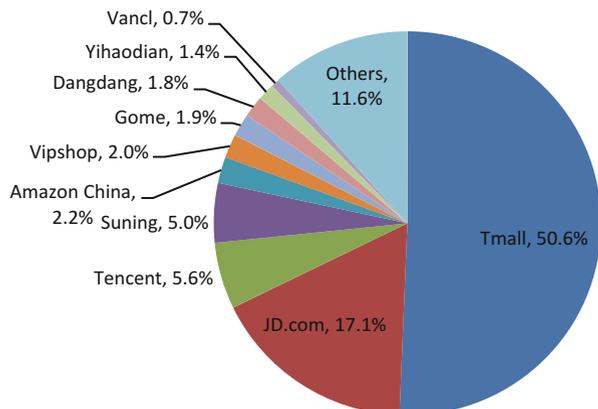
### 3.3 Position in the Home Market

Because Tencent's services and products are so diverse, it is hard to compare the company to others in terms of overall market share. Therefore, we will concentrate on what Tencent itself identifies as its three main streams of revenue: online advertising, e-commerce transactions, and value-added services.

Online advertisement has traditionally been the most important way to monetize in the internet industry. As we have seen before, Tencent chooses a different approach (see Fig. 4). It still considers online advertising as one of its main revenue streams though, and is the fourth largest in this field in China with a market share of 5.2 % in Q3 2013. The top three at that moment were Baidu (30.8 %), Alibaba (15.9 %) and Google China (5.5 %) (China Internet Watch 2013). While a share of 5.2 % is not much compared to the two leading companies in this field, it is still quite high considering the limited importance of the market for Tencent's total revenue. Compare this to Google China's 5.5 % as a company for which online advertising is very important. In this sense, Tencent performs quite well.

The e-commerce market can be divided in B2C (business-to-consumer) and C2C (consumer-to-consumer). Tencent is active in both segments. In the B2C segment, Tencent had a third place of 5.6 % after Alibaba's Tmall (50.6 %) and JD.com (17.1 %) in Q2 2013 (iResearch 2013) (Fig. 6). It should be noted that in March 2014, Tencent started a strategic partnership with JD.com in this field. JD.com will take on several of Tencents e-commerce activities (Reuters 2014a). In the C2C market, the field looks quite different. As of Q3 2012, this market is completely dominated by Alibaba owned Taobao (94.53 %). Tencent's paipai has a share of only 5.46 %. This share has, however, been growing (iResearch 2012).

**Fig. 6** Share of Chinese B2C websites by GMV in Q2 2013 (iResearch 2013)



In the market of value-added services, still the most important one for Tencent, the company is strong. Because of the growing importance of the mobile market, Tencent wants to concentrate in this area. It wants to achieve this by migrating the QQ service to mobile platforms and by enhancing the Weixin/WeChat app, which it claims is market leading (Tencent 2014e). To give an example of Tencents dominance in this field, in 2010, 73 % of all daily active social network services users in China were using Tencent products (Focke 2011).

Tencent is trying to strengthen its position in the domestic market by starting strategic partnerships with key companies who are active in diverse markets. By teaming up with these companies, Tencent hopes to increase its share. Examples are Sogou (search engine) and the aforementioned JD.com.

### 3.4 Position in the Global Market

Tencent has almost exclusively focused on the domestic market. After all, its expertise is optimizing products for the Chinese market. However, the company has increasingly tried to get a foothold in international markets. The company launched its QQ instant messenger for the international market on its English language portal imqq.com. It is marketed as being “the most popular personal communications app in history: over 1,000,000,000 registered users across 80+ countries” and cites its built-in translator as one of its main features. It is also connected to the social network QZone, although the international version can only be accessed through QQ and does not have all the features of the Chinese version. The amount of international user accounts should also be taken with a grain of salt, since the vast majority of these accounts are Chinese. In a 2011 interview, Tencent’s CEO Ma remarks that the Japanese and American versions of QQ “weren’t competitive and those markets were already dominated by big US companies” (Businessweek 2011). It seems that Tencent has met with more success in markets that are not as saturated. The Weixin/WeChat app has already been mentioned, which is very popular in Asia.

In online gaming, Tencent has also gone global. The American Tencent office developed social network games for Facebook under the name of Ice Break Games (but that name does not seem to be in use anymore). It acquired a majority share in US developer Riot Games in 2011 and a 40 % share in Epic Games, also from the USA, in 2012. According to Tencent, Riot Games’ League of Legends increased the income from international markets and was important in sustaining growth in the company’s online gaming activities during 2013 (Tencent 2014e). League of Legends is a good fit for Tencent, since it is a free to play game that is monetized by micro transactions, the same business model Tencent has used for its own online games. Still, when looking at the official annual results and outlooks of the past years, the company remains focused mainly on the Chinese market. There is word of “continue[ing] to explore opportunities in international markets” in the 2012

overview, but in 2013 the outlook for the next year only mentioned the internationalization of Weixin/WeChat.

When compared to other internet companies, Tencent is one of the biggest firms globally. According to Statista, Tencent ranked fourth world wide in 2013 in terms of market value, behind Ebay, Amazon, and Google, but in front of the likes of Facebook and Chinese competitor Baidu (Statista 2014). The other Chinese juggernaut, Alibaba, is missing in this list, because it is not a publicly listed company. Tencent is a huge company with a diverse portfolio of products that certainly have international potential. The company also wants to expand abroad, but does not seem sure yet with what long term strategy.

### 3.5 Triple Helix

Many Chinese companies have benefited from the triple helix system of government, business, and education. The Chinese internet industry as a whole has certainly benefited from the educational system and the government. The first internet users in China were mostly academics, and the first Chinese web pages were developed by a Chinese professor. The pioneers of commercial activities in this field were also mostly highly-educated academics, some of whom had experience in the USA (Zhang 2008). Does Tencent fit into this? Obviously Tencent's founders and most of its employees have been educated in China, and the Chinese government created a barrier of restrictions for foreign companies that is often complained about. However, Tencent's main strength is its knowledge of the Chinese market which is focused more on entertainment and mobile phones than most foreign companies realize (NY Times 2007).

In fact, Tencent has actually had a few incidents with the Chinese government. At the end of 2010, Tencent and Qihoo, a developer of security software, had a dispute that escalated enough that the Chinese minister of information technology called both companies immoral and irresponsible (Businessweek 2011). The strong regulation of the Chinese government might benefit Chinese companies in favor of foreign firms, but it can also work against a business. In March 2014, the People's Bank of China demanded that both Tencent and Alibaba halt their new virtual credit cards, which would allow users to make payments by scanning QR codes. While this is a temporary halt so that the People's Bank of China can examine the product and make sure it is safe, some say it is the result of growing tensions between traditional banking institutions and the new internet companies which are developing more e-commerce products (Reuters 2014b).

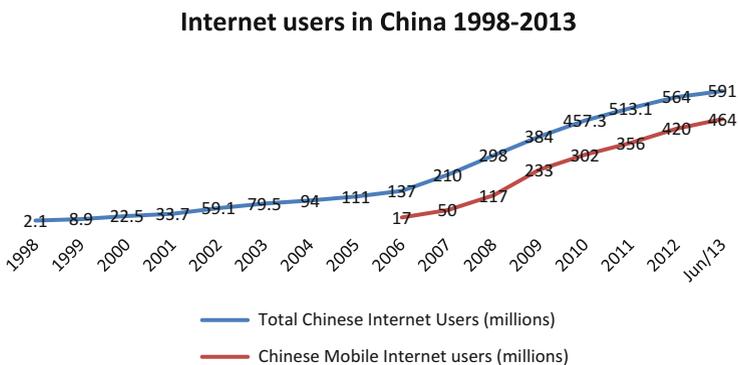
## 4 Future Developments

### 4.1 Future Challenges and Problems at Home

The main challenge for Tencent in the domestic market is that the amount of internet users in China is leveling off. Since Tencent's founding in 1998, the amount of Chinese internet users has grown exponentially, but in more recent years this growth is decreasing.

While the internet penetration rate is still only 46 % (in June 2013), the exponential growth seems to have stopped. This is mainly due to the large regional differences in China. The rural areas of China are still lagging behind in penetration rate compared to the urban areas. In June 2013, 72.1 % of the Chinese internet users were urban, while only 27.9 % were rural (CNNIC 2013). However, even with this stabilization, there is still a healthy growth in new internet users.

Another challenge, which Tencent is already addressing, is the shift of internet users from PC to mobile. As can be seen in Fig. 7, the amount of mobile internet users has grown very fast. The majority of Chinese internet users, 78.5 %, now access the internet using a mobile phone (CNNIC 2013). For the traditionally PC centered Tencent, this meant an important shift. The aforementioned migration of QQ from PC to mobile fits in this trend, as does the expansion surrounding the Weixin/WeChat app. In 2013, Tencent launched a game center for the mobile version of QQ, building on their strength and knowledge in the online gaming market to achieve better results in the mobile segment. However, in the 2013 annual report, the company remarks that "The weakness in our VAS subscription services continued in 2013. This was primarily due to rapid adoption of smart phones by users, whereas our paid subscription services are traditionally focused on PC or feature phones. [...] To better align our VAS subscription services with the mobile internet opportunities, we unified the product teams and product experiences between PC and smart phones, and introduced smart phone-oriented subscription



**Fig. 7** Amount of Internet users in China 1998–2013 (June) (Source: author, data from NMG 2012; CIW 2013; CNNIC 2013)

services, such as Super VIP” (Tencent 2014e). Throughout the entire report it is clear that the company realizes the importance of the mobile market. One of the key points for the 2014 strategy is to “build a prosperous ecosystem for O2O and mobile eCommerce activities”, showing the growing importance of both the mobile market and e-commerce for Tencent.

Because of Tencent’s realization of and the shift to the mobile market and their strategic partnerships with key players in important Chinese market segments, the future of the company in the domestic market seems bright. It is well underway to solving the problems and challenges it faces at this moment and has managed to stay one of the biggest players in a still expanding market. The partnerships in segments such as search engines (Sogou) and e-commerce (JD.com) will allow the company to keep expanding in these markets, while also concentrating on its own core strength of VAS and online gaming.

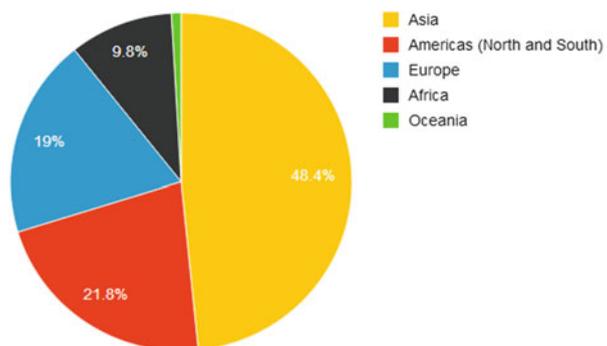
## 4.2 Future Challenges and Problems Abroad

In the international market, Tencent seems to concentrate itself on the Asian market. This is wise for several reasons. In amount of users, for instance, the Asian internet market is by far the largest worldwide.

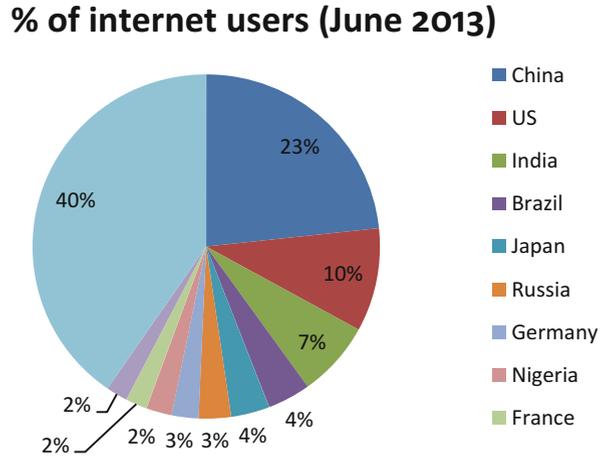
Almost half of all internet users are from Asia (see Fig. 8). Perhaps even more importantly, the penetration rate of some key Asian countries is still low and likely to grow. India, for instance, is already the third largest internet market (in terms of users) at this moment with 7 % (Fig. 9). The Indian penetration rate however, is only 16 % (Internet Live Stats 2014). With the growing prosperity of the country, there is a huge potential in this market. Of course, India itself also houses a lot of high tech companies, so a good knowledge of the market will be necessary to become successful. Already in 2008, Tencent launched a joint venture with its important share holder MIH to invest in Ibibo, an Indian online travel company.

While the European and (North) American internet markets are also very large and house a lot of wealthy customers, they are already quite saturated and therefore it is hard for companies that are new to these markets to get a foothold. Tencent’s

**Fig. 8** Percentage of internet users per continent (June 2013) (Internet Live Stats 2014)



**Fig. 9** Percentage of internet users per country (June 2013)  
(Internet Live Stats 2014)



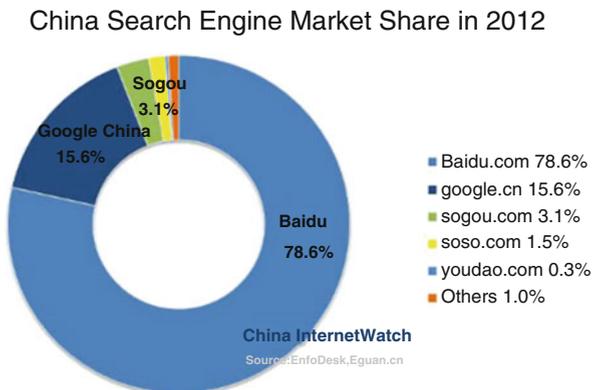
launch of a US version of QQ was already mentioned. Tencent's main strength in its domestic market (the knowledge of that specific market), seems to have been a weak point in the US market, where the product was not competitive enough. The investment in US developer Riot Games seems to have been a good one, though, with the continuing popularity of its online League of Legends game, both in China and internationally. Perhaps the company should keep investing in these free online games with value-added services, since they remain popular worldwide. As the Riot Games investment, as well as those in various South Korean developers, show, the best course of action for Tencent here is to keep developing in-house for the Chinese markets, while also licensing internationally popular titles. The VAS segment is one that Tencent knows like no other, and which has had proven success in the international market.

Tencent is also expanding its Weixin/WeChat app internationally. This expansion is mostly concentrated on the Asian market, as we have seen before. In 2014 and beyond, the company wants to keep following this strategy (Tencent 2014e). Together with the broadening of WeChat into a brand that houses a lot of different services, this is a good way of entering the international (Asian) market in various segments which Tencent has already demonstrated domestic success. The partnerships with local companies do not only help Tencent with brand building, but can also yield valuable advice on the local markets in order to prevent the US QQ scenario. The first priority for Tencent, however, seems to lie on simply popularizing WeChat.

### 4.3 Competition

Since Tencent is active in so many segments of the internet market, they face competition from a wide variety of companies. There are, however, two main

**Fig. 10** China's search engine market share in 2012 (China Internet Watch 2014a)



competitors on the Chinese market: Baidu and Alibaba. Both of these companies are big internet firms that offer a variety of services, often in direct competition with products and services of Tencent. In terms of market value, Tencent (74 billion US\$) is bigger than Baidu (46 billion US\$) (Statista 2014). Alibaba is a privately held company, but its worth is estimated between 55 billion US\$ and 120 billion US\$ (Economist 2014). So depending on the actual worth of Alibaba, Tencent would rank first or second. Baidu's main activity is its search engine. In 2012, it held a market share of 78.6 % in this field. During the same year, Tencent's SoSo had a share of 1.5 % while Sogou (who became a strategic partner of Tencent in September 2013) had 3.1 % (China Internet Watch 2014a) (Fig. 10). It will be hard for any single company to compete against such figures. Since the strategic partnership of Tencent and Sogou is very recent, it remains to be seen how it will impact the Chinese search engine market. However, we can see that Tencent's recent strategy to strengthen its weaker services is to team up with another competitor of the market leader. Baidu's other products include news services and one of the biggest Chinese online encyclopedias. It is also active in another core market of Tencent: e-commerce. Baidu's own e-commerce platform is called Youa, but it has been unable to compete with Alibaba's and Tencent's services. Therefore, it first bought a majority share of RenRen's Nuomi and then bought the site completely in early 2014 (Tech in Asia 2014). This move was most likely made in the hopes of catching up with Alibaba and Tencent in the important e-commerce market.

The other big Tencent competitor, Alibaba, is mainly active in the e-commerce business. We already analyzed how Alibaba's B2C service Tmall had a share of 50.6 %, while its C2C service Taobao had an enormous 94.53 % share. But the company is also a major player in B2B (business-to-business) e-commerce. In 2013, Alibaba had a share of 46.4 %, miles ahead of number two, Global Sources, with 8.2 % (China Internet Watch 2014b). Tencent bundled its powers with JD.com in March 2014 in order to compete more successfully against Alibaba in the B2C segment. In theory, in both this case and the Tencent-Sogou strategic partnership,

this will allow the specialized JD.com to work with the support of the enormous Tencent. Again, because the partnerships are very recent, it will be hard to predict in what way it will allow Tencent to become more competitive compared to Baidu and Alibaba. But the potential is certainly there. Sogou and JD.com have the knowledge, and Tencent has many resources.

In the international market, Tencent faces competition from the big US internet companies such as Google and Facebook. Tencent has trouble reaching the Western market and Western companies have trouble reaching the Chinese market. Both are also trying to expand in the wider Asian market. This can mean both competition and also opportunities should Tencent choose to enter partnerships as it has done on the home market. It has already some experience with these sort of international relationships due to their majority share in Riot Games and minor share in Epic Games, both US companies.

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## 5 Conclusions

### 5.1 Why Did This Company Become So Successful?

In its founding days, Tencent profited from the young and quickly growing Chinese internet market. It introduced new products made specifically for the Chinese market that would quickly become popular. Said products were not made through Tencent's own innovation, but by taking a proven idea from a (often Western) competitor and adjusting it so that it would be able to compete on the Chinese market. The company calls this "micro-innovation". Judging by the fact that the majority of Tencent's employees work in the R&D department, this is still an important strategy. This does not mean that Tencent is a shady company that can only copy competitors. The products of the company could not have been as successful as they were if this was the case. Tencent knows very well what (Chinese) users want and has built a very successful business model around this knowledge. The quick boom of mobile internet in China led to some initial problems. By now, however, the company is well underway in its mobile services and has migrated many of its products from PC to smartphones.

Tencent also quickly started diversifying its products and services, while keeping them centered around the central hub of QQ. This allowed for a spillover of users and a brand name that could be used for a variety of products. Most of Tencent's software products are free to use, but allow users to buy small cosmetic upgrades. For Tencent, these value-added services are the main source of income. This differentiates the company from most of its competitors, who still rely mostly on online advertisements to monetize users of free services.

More recently, Tencent has started strategic partnerships with some of its competitors. These partnerships follow a similar pattern: in a certain market segment, the Tencent product has been unable to become the market leader. A partnership is made with another smaller competitor. This smaller competitor can now concentrate on this segment with the huge financial backings of Tencent. In

this way, Tencent tries to create a bigger market share in segments such as search engines or e-commerce. Similar to this strategy is the strategy of select investments in other companies. For example, since Tencent makes a lot of its revenue from free to play online video games, it invested in some South Korean developers of said games, as well as in a US game developer.

## 5.2 Is It Likely This Company Will Become a World Brand?

In China, QQ is certainly a strong brand. While there is also an international version of QQ, Tencent has had trouble getting a share in foreign markets. It is a long-standing ambition of Tencent to also become a big player on the international market. Initially it tried to enter the highly saturated US and Japanese markets with localized versions of the QQ instant messenger. However, its products were simply unable to compete. The company has been more successful in the international market for online games. The Facebook games made by the US Tencent office under the name of Ice Break Games did well, and US developer Riot Games (who are now owned almost completely by Tencent) has a worldwide hit with their free to play game League of Legends. However, in both these cases, the name Tencent is not used, and in the case of Riot Games, the company is mostly allowed to do its own thing, without too much interference from Tencent. So, while these international investments seem to be profitable, they will not lead to building a worldwide brand out of the Tencent name.

After the initial failures in the US and Japanese markets, Tencent has chosen a different approach to its international expansion. The company now tries to expand through the international version of its Weixin smartphone instant messenger, WeChat. It started an international ad campaign featuring famous football player Lionel Messi and has a more specific strategy for some key national Asian markets. In these select markets, Tencent starts partnerships with local companies in order to build up their brand. These partners often have well-known brands themselves and in this way Tencent tries to build the WeChat brand by association.

If Tencent wants to build a truly international brand out of WeChat, it should learn from its own past. Regional preferences are vastly different on the internet market. Therefore, it will be necessary to build up partnerships with regional partners who know their home markets. In this way, Tencent can build products specifically for certain markets, just like it did in its own home market. While WeChat faces heavy competition from similar products like WhatsApp, there is certainly potential, especially if Tencent tries to turn WeChat into a sort of hub with diversified services, like it did with QQ. Again, cooperation with regional partners will be crucial for this.

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