Platform Competition in the Online Video Industry: a Comparison Between the United States and Chinese Markets

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ABSTRACT

Along with the popularity of broadband, online websites are transforming to complex multiple-side platforms (MSPs), bearing many kinds of products and services. The MSP format enables online websites not merely works as media between content producers and end users, but aggregates multiple parties together to create new values and leads. With vast amount of UGC (User Generated Content) and different methods of making revenue, YouTube and Hulu from the U.S. are leading online websites' platform transformation. Meanwhile, Youku, LeTV and Tudou, the imitators of YouTube and Hulu in China, are exploring their own "Chinese Style" to strive for success in China's huge online video market.

Given the basic MSP model, this case study explores the critical factors that forge Chinese online platforms, by comparing administrative restraints, strategic operations, and revenue models of YouTube and Hulu. A general comparison of mechanisms between the U.S. online video platforms and Chinese platforms will be processed in terms of their initiative methods and growing strategies.

Furthermore, several typical Chinese leading online video platforms are discussed and analyzed from aspects of their core strategies, operations, and targeted customers. We will use real transaction data, business contracts, and recorded interviews to figure out how they achieved their market position, in which area the company invested, and what their developing direction would be in the next couple of years.

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PLATFORM COMPETITION IN THE ONLINE VIDEO INDUSTRY: A COMPARISON BETWEEN THE UNITED STATES AND CHINESE MARKETS

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The transformation of online video websites to media platform

Big data, cloud computing, e-commerce, video chatting, web 2.0, multiple-side platform, etc.— all of these words were created and spread rapidly in recent years. Internet is gradually changing people's modes of communication, entertainment, and work. Online video has been around since the early days of the Internet. However, because the technological approaches were not mature enough to support massive and scale public application, people rarely used this operation to satisfy their production or entertainment needs. But thanks to its nature of direct communication, online video was never abandoned because some people believed that this way is the optimal way to transmit information through the Internet. Compared with text and picture, video delivers more information and has a greater ability to connect emotionally to an audience. More importantly, video is more natural and intuitive. In other words, there is not much difference between television of the 1960s and online video of the present. People spend their time sitting in front of televisions in families and groups but stare at their screens individually. 20 years of booming development make the Internet so popular in most countries that you can find LCD screens or monitors connected with each other either on Beijing's CPC Military Museum exhibition wall or on Tokyo's automatic vending machines.

Although North America ranks quite high in Internet penetration rates at 78.6%, Asia is still the biggest Internet market with more than 1 billion Internet users. Asia makes up almost half of total Internet users. Asia has a very healthy Internet user growth rate at 841% from 2000 to 2012, ranking third and only following Africa and Latin America, 3606% and 1310% respectively (Internet World Stats, 2013). Among the Asian region, China, the world economic engine with a population of more than 1 billion half of which are Internet users, plays a dictating role in online video. There are several basic reasons for the accelerated growth of Internet video:

- Technology push. Innovation pushes society to develop and change in a profound way. In the past 20 years, the Internet, telecom, and new media has given us myriad advances reforming people's life and work. New techniques such as online video streaming or live online broadcasting will likely overtake the traditional observation methods.
- User demand. Users demand multiple ways of receiving information as well as new delivery methods, which are necessary for the success websites that offer merchandise or entertainment. People not only want to know the information, but also want to enjoy engaging with it.
- Cost reduction. For online video companies the biggest part of its operation expense is bandwidth. They use much more bandwidth than traditional ICPs, such as Yahoo! and Sina.com, because multiple users watching online videos simultaneously cause their servers to suffer huge accessing and transferring pressure, leading to crashes, lags, and package

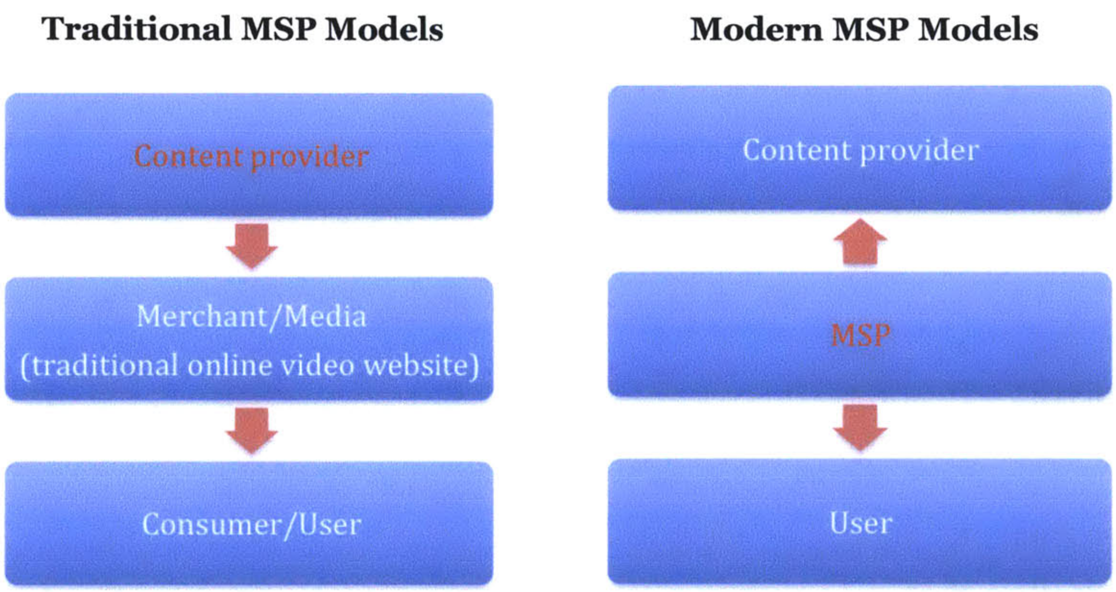
loss. Fortunately, telecommunication instruments manufacturers, led by Huawei and ZTE, and telecom carriers, such as China Telecom and China Unicom, have had diminishing bandwidth prices over the past ten years. But China's bandwidth price is still four times as expensive as America's. This critical issue will be discussed later on.

The external reasons above offer an explanation for how online video could develop so fast in the last ten years. However, we also need to understand as much as possible about how internal elements drive this industry. First, online video is ubiquitous and multi-functional allowing it penetrate into many aspects of people's daily lives. According to IDC and Gartner's reports in 2011, the number of China's PC consumers, which was 67.8 million but at 10.8% growth rate, will exceed the number of America's PC consumers, which is 71.7 million or one-fifth of the world's PC consumers. China will have become the world's largest PC consumer country by the 3rd quarter of 2012. Additionally, we have handheld devices such as smartphones and tablets. According to the advisory of Flurry Analytics, there are 231 million smartphones and tablets activated and used in domestic U.S. by February 2013 and 246 million in China, who became the world biggest smartphone market for the first time. (IDC, 2013) Although most institutions forecast that there will be a deceleration in the growth rate of smartphones, of the growth of tablets will continue increasing consistently for the next three years. This is optimistic for the online video industry because people are inclined to watch video through bigger screen devices with stronger battery life. Second, internet video is quite flexible in format. Compared with television program producers, video makers could control the content by themselves without the oversight of networks concerned with investment, audience and advertisers. Thus, online video is the best format to fit people's fragmented internet habits. Third, internet video works well in cooperation with television advertisement. Contrary to common television ads, which are widespread and roughly pushing out to all the audience, internet video has strong ability to target specific customer group by implementing other technologies such as cookies, folksonomy, and intelligent networks. Last, internet video has a very intense scale merit nature so that if a company could use internet video as its main business development tool, big marketing and cost benefits will result. As bandwidth marginal expense is decreasing, marginal revenue is increasing.

Based on all these components, companies of certain size can grow to become platform leaders. They already have the proven ability to figure out several key challenges both from technical side and business side, such as the right architecture, designing interfaces, disclosing intellectual property selectively, facilitating third parties' provision of complements and introducing incentives for third parties to create innovations (Gawer & Cusumano, 2008).

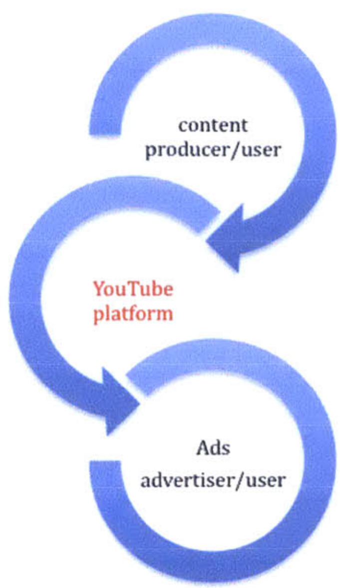
American original online video websites

Thanks to its relatively long period evolution and large scale of users, a few American online video websites grew to multiple-sided platforms, the most famous of which are YouTube and Hulu. They initiatially got rid of the traditional "merchant" characteristic that purely transmitting information from goods or services provider to buyers, turned into the model of positioning in the center of information integration. Let's look at how they re-position their economic foundation. (Hagiu & Eisenmann, 2007)



YouTube

YouTube's MSP model is just a variation of standard MSP model listed above. However, YouTube's characteristic of "self-media" is expressed by endowing users freedom to create their own content.



That's why the arrowed circle rolling towards common users from content producers. The only criterion is video quality. YouTube's "self-media" strengthens and relies on the user side of the "Catch-22" issue, accumulating a huge amount of users so that advertisers and professional media want to join this platform. Referring to the flowchart, YouTube could increase the size each small circle such as "producer-user circle" and "advertiser-user circle," thus making the entire platform running towards better and bigger.

For most people, YouTube is practically synonymous with online video, although it is not the earliest or most innovative online video platform in the world. This video-sharing website, created by three former PayPal employees in February 2005, allows users can upload, view and share videos. The company is based in San Bruno, California, and uses Adobe Flash Video and HTML5 technology to display a wide variety of user-generated video content, including movie clips, TV clips, and music videos, as well as amateur content such as video blogging, short original videos, and educational videos. Most of the content on YouTube has been uploaded by individuals for nonprofit purposes, although media corporations including CBS, the BBC, Vevo, Hulu, and other organizations offer some of their material via the site, as part of the YouTube partnership program. Unregistered users can watch videos, while registered users can upload an unlimited number of videos. Videos considered to contain potentially offensive content are available only to registered users who are at least 18 years of age. In November 2006, YouTube, LLC was bought by Google for US$1.65 billion, and now operates as a subsidiary of Google. (Wikipedia, 2013)

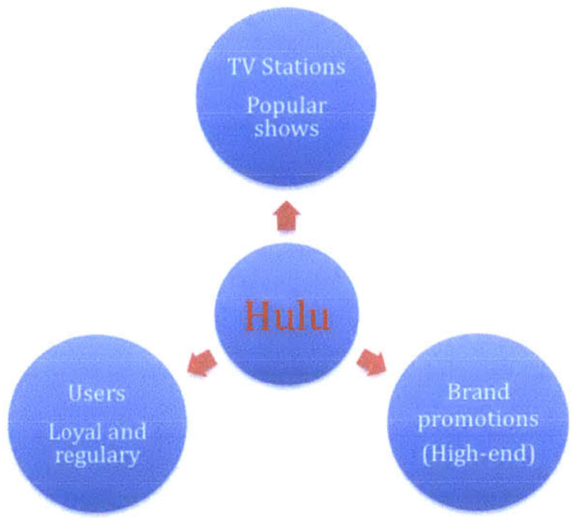
Since its establishment, YouTube has never been profitable until the 2012. According to its announcement 4th quarter 2012, YouTube gained $2.4 billion revenue for Google. The majority of its revenue comes from ads. What makes YouTube different from Hulu and other video websites is that users generate all the content and YouTube doesn't purchase movie or TV series.

YouTube is an idol to other online video websites who don't have money or access to offer licensed commercial contents, such as TV shows, movies and other programs. It concentrates on UGC and creates the best platform for common people to share the joys and sadness of their lives.

Focusing on free, UGC and large volume, YouTube's MSP strategy is working as a self-producing—self-consuming circle increasing its effects and penetration. The ultimate revenue source is advertisement. However, America's open internet policies and loose censorship create a perfect environment for YouTube's strategies to be successful.

Hulu

Hulu's model is at the opposite extreme from YouTube. There is almost no grassroots user-made content on this site and all the programs you watch from this site could be seen on television or other media. So why does Hulu still build up such a platform to play homogenization on Internet? How could it be so successful? The way Hulu works is so special we can call it "Hulu Model."



In terms of Hulu's case, MSP works as bridging TV networks and internet users by repacking and optimizing those TV shows better fit for online video watchers. They have more flexible revenue methods and control two sides firmly—professional content maker and royal paid user. Additionally, advertisers show more willingness to deliver high quality advertisements on those high quality programs. The high-end platform that Hulu delivers will not harm their brand reputation.

As important as they play in YouTube's case, America's market natures significantly help Hulu build their MSP in a short time. Many TV/movie producers supply fair priced programs to Hulu, then highly educated users are willing to pay reasonable fee (or free) for services. Hulu worked hard to acquire quality, professionally-produced content with significant upfront investment in copyright purchase and advertisement marketing. They decided to start by figuring out merchant side of "Catch-22" issue and attracting users with genuine TV shows and popular movies, then complementing by a fee service, Hulu Plus.

First, Hulu spent tons of money on copyright purchases and TV network alignment to acquire as many as possible programs and shows (upside circle in the model). No one should underestimate the power of a precious vault with more than 1000 TV series and 500 movies. Hulu knows TV has obvious time sensitivity so that they made all the programs available anytime rather than set times on television. Doing so not only avoids cannibalization with TV networks but also increases ad sales.

Second, Hulu redefines what internet advertisement should be (right circle). Users can decide by themselves which ad category to play before enjoying the main course, cellphone or car commercial. There are also many interactive ads that were designed as small games on Hulu's webpages, leading young users to click and associating a fun experience with a product. Hulu tries to make the advertising time less annoying and more relaxed. Users like this kind of consideration. According to Hulu's own statistics, more than one-quarter of customers would like to participate interactively with ads.

Third, as a joint venture between NBC, Fox and ABC, Hulu is more than a dependent website offering video clips, rather, it is a content creator. This role gives Hulu diverse resources to make revenue instead of solely relying on ad income. They can retail programs to other video websites, or distribute whole series to NBC and Fox themselves. This aspect creates huge influence to both internet and media fields because all the other producers and distributors see Hulu as their peer and partner rather than a pure competitor.

Last, Hulu is the first video website who seriously cares about users' watching experience (left circle). A bunch of R&D budget was put into web art design, UI enhancement and habit research. When you were suffering from those ugly and massive layouts on YouTube, Hulu users were discussing why they think the pale green and deep grey mixture makes them relaxed. Meanwhile, advertisers will feel safe that there is no homemade, violent, and/or vulgar video content binding to their products' promotion to impact their brands. This strategy allows Hulu to own almost all the premium and high-end customers that advertisers are seeking.

Chinese online video industry and market

Market volume and growth rate

Since the first online video website emerged ten years ago, the whole industry in China gradually changed from initial exposure, valley and going public tide, to current sector reforming and upgrading period. The online video sector has been one of the most significant areas in internet applications, with characteristics such as booming user scale and nonstop rising coverage. According to CNNIC 2011 report, there are 325 million online video users in China mainland and the penetrating rate was 63.4%, with compound growth rate at 14.6% (CNNIC, 2012). Since that time, online video has become, in a real sense, the most important channel to acquire digital content such as news, entertainment, movie and TV shows. Not only the number of users, but also the market value of online video sector has kept rising at high speed. IResearch, a mainstream internet data analysis company, claims that the online video market size in 2011 was more than 6 billion CNY and will be 16 billion plus in 2014.

Besides the market size itself, online video advertising market volume is going up at an impressive rate as well. In 2012, total advertisement revenue of online videos in China was 8.82 billion CNY, 87.2% higher than revenue in 2011 (Enfodesk, 2012). That incredible growth rate shows how much potential this market has in the future. There are several factors contributing to this rapid revenue growth rate of online video in China.

First, users are getting used to new type advertisements. Traditional pre-video ads are too old-fashioned to attract advertisers who have embraced new media. They believe that only multimedia tricks could make users wait for more than 3 seconds in front of that small screen. Fortunately, PC is the best place to test whether a new flash ad works or not. Three years ago Youku and Ku6 started to cooperate with some small game companies in ad production. They paid modest amount of money to customize some small specific ad themed flash games and inserted these games into video clips. Compared to non-interactive ads, users prefer move their wrists and eyes. Abundance of ads brought significant inventory for video websites thus they can enrich their product line and sales strategies.

Second, overseas copyright fights became fiercer and harder for some online video providers so that they started to create their own content such as short TV episodes or micro-movies. These products are relatively easier to insert advertisements and branding promotions without much expense. In other words, more ad space was created. Based on entire mass of customers, video websites have a huge amount of data and statistics allowing them to figure out what kind of shows people would like to watch or which joke would be the most popular one a couple of weeks later.

Third, wide usage of multiple terminals gives online advertisement different and bigger platforms to penetrate. As was mentioned in the introduction, palm devices are replacing traditional desktop computers at a fast rate. Moreover, these smart devices generate millions of hours of fragmentation time for all users and indirectly reduce hours people spend on desktop PCs. In order to educate customer habit and raise branding awareness, advertisers start to develop multi-platform ads including living room, tablet, and smartphones. This strategy increases ad revenue significantly.

Industrial development stage

Being listed on the NYSE is a very impressive symbol that indicates that online video companies' development is stepping into another stage. They started to stand up in the front of public, leaving those undercurrent images far behind. They are eager to become mainstream and don't want to stay at grey area anymore. Before the introduction of the relevant provisions comes out, “everyone in online video sector is operating illegally, during a quite long time”, said Mark Natkin, executive director of Marbridge Consulting Beijing. “But government didn’t give a heavy hit on this industry, rather than sitting by and watching its growth and strengthen. After all government doesn’t want to strangle entire sector.... they only wish troubles were not aroused and let the sleeping dog lie.”

But it not so easy for independent online video companies in China because they need to handle all-round competition from different parties. In the light, Youku need to fight with network departments of large media groups such as CCTV, Xinhua News and China Movie Channel, and online video units of big internet companies such as Sina, Netease and Sohu. In the dark, they need to combat with the rampant piracy black market in China – online or offline. For instance, people can get most up-to-date DVDs at newsstands, often even before the public release of that movie. Also, people might assemble illegal satellite antenna at home by professional cable companies to enjoy unlimited programs at very low prices. All the international movies have subtitles and are transmitted over the Internet by streaming or P2P technology. Users just pay a one-off installation fee and a cheap annual fee like dozens of dollars, that’s all. In this world, content is almost free without any limits.

All the online video companies claim that they have more freedom to create fashionable and favorable programs for users than traditional TV stations. Meanwhile, they are not reluctant to admit that they are under some of the strictest content censorship in the whole world, which could result in the end of business. The consequences of disrupting the bottom line of the Chinese government will be very serious.

Fanfou, the first Twitter-like website in China, was very popular within a short amount of time. After two years of operation and development, Fanfou was the biggest and most popular micro blog website with more than 1 million users. However, things changed on July, 7, 2009. Along with a vicious riot stirred up by East Turkistan Islamic radicals that happened in Urumchi, China on July 5th, Fanfou became the platform for people spreading relevant news and comments since it's fast and far-reaching. Many forums and BBS were temporarily closed or under enforced maintenance on July 7th. Some of them recovered a short period of time afterwards but Fanfou never did.

Just like all the other public internet platform services in China, online video is very sensitive for the government and CPC itself. "Walking on thin ice" is the best description for those seemingly versatile and energetic entrepreneurs.

China has the biggest internet user base and the fastest penetration rate of any country. Of course that is good online video platforms, However, some other economic and non-economic elements are playing very critical roles as well making the Chinese online video market much more complicated than America's. Open and free internet environment, loose censorship, plenty content resource, educated users, and market-oriented telecom foundations, all these necessary factors for healthy online video platform building are missing at this stage of Chinese internet industry. Instead, we have ridiculously expensive bandwidths, tight content censorship from government, and unqualified programs. The worst point is that the Chinese online video market is just beginning to enter people's lives, many of whom have never paid for Internet services since China began internet use 15 years ago. This means that Chinese companies need to solve the "chicken-egg problem" even more effectively than the American predecessors.

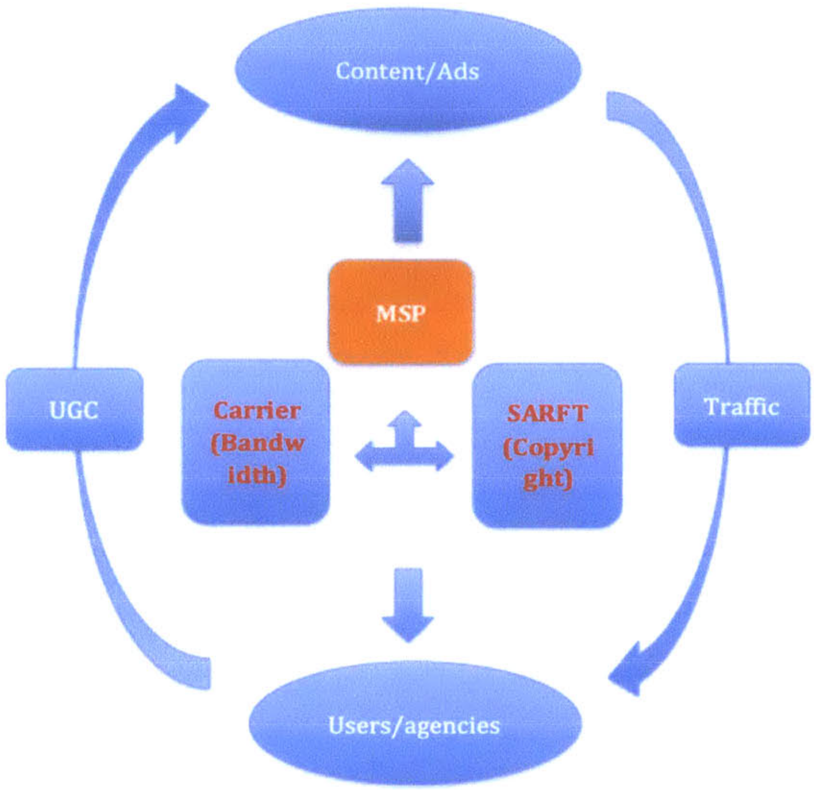
Part II, Chinese Particular Online Video MSP and Internet industrial key characteristics

Chinese Online Video MSP model

The Chicken-Egg problem, or Catch-22, is one of the biggest issues in multiple-sided markets that companies must figure out or work through: "Prospective users on each side will avoid the platform until they are confident that the other side will have enough users to make it worth their while. Who's going to sign up for a new type of credit card if no merchants accept it? And what merchant will accept the card if no customer s carry it?" (Hagiu, 2009)

To conquer this obstacle and to acquire that huge potential market, Chinese online video companies are exploring and aggregating as many resources as they can from either the governmental side or the content provider side or even both. This is to develop a new MSP model with Chinese characteristics to observe and analyze how those platform leaders find their own way to win the battle and what their ongoing developing strategies are like. These factors are fundamental for laying out the Chinese MSP model, thus very worth our while to break them down and analyze them.

- Governmental regulation/relationship (SARFT)
- Bandwidth costs (Carrier relationship)
- Content generation and protection
- Copyright advantage (SARFT)
- User retention



Not as open and free as America's, the Chinese internet market is highly restricted and censored by the Chinese government and its press and publication ministries. China is experiencing a growth period that incubated many successful internet companies such as Youku, iQIYI and Tudou, because China has a great and innovative idol, the U.S., who has already explored and moved a lot. There are both positive and negative aspects to the factors that exist in this second biggest internet market affecting the online video market. Although the major players are doing fairly well both within China and globally, ironically, everybody is paying more attention on the negative side because they believe these factors will put a lot weight on Chinese online video market ongoing development in the future.

Government regulation

Market economies deal with critical elements such as regulation and openness. Developed economies like the U.S. and Japan have healthy regulations and guidance in commercial activities. Governments operate by laws, meanwhile firms act lawfully and hopefully consciously. In China, however, the internet industry faces many administrative restraints and marketing interventions such as sensitive topics, regulatory filings, and information interruptions. Under the present laws, more than 20 approvals are required from several governmental sectors to establish a mid-sized website in China. Furthermore, regulation overlaps, different standards, and frequent censorships lead to a very difficult and weird situation where most of the internet companies are operating illegally or under violations, normally.

This sick condition makes those internet companies live in a sicker condition: people think illegal or irregular is necessary for getting advanced in Chinese market. CEOs don't consider market atmosphere relevant and follow those who play tricky and low, which drags market ethos into an endlessly fallen loop. Apparently, it will end up with high opportunity cost on both the government side and the enterprise side. Government has no ability to turn around this situation by small adjustments and abiding. Moral companies need to pay quite high indirect market expenses to compete with those who are not.

There is a perfect case that exemplifies how serious outcomes are from this vicious competition. In 2010, the two biggest Internet companies in China, Tencent and 360, sued each other that the opponent violated user's privacy protection law and competed with unfair benefits. As the initiative party, 360, the biggest information security player in Chinese software market, encourage users to install its software that could detect and prevent Tencent software and announced that Tencent was stealing user's information from backdoors. As counter fight, Tencent hold an expression conference and said no computer with 360's software could launch Tencent software, such as QQ, which is the most popular and necessary IM in the Chinese world. Basically, 360 developed brand new desktop manager software and wanted more market share and excluded its opponent out of PC desktop market. In China, success in such a huge market is dependent on heavy promotion and other marketing strategies. The only way they could do is making another competitor disreputable and "evil looking." Due to the fact that both 360 and Tencent have hundreds of million users and their products could affect many users' habits, more and more internet and software companies were involved in this battle reluctantly, such as Baidu, Kingsoft and Maxthon, etc. As a victim, I would like to say all these practices brought common users into a very annoying situation, which means we need to be forced quit one frequently used software for using another one. That harms the nature and spirit of the Internet—openness and freedom. More immediately, many advertisers, paid users, and employees were shocked financially so they clamored to get their investments back and receive compensation. Almost three months later, the Chinese government intervened in this case and forced 360 and Tencent to stop hurting user's legal benefits, stop preventing each other's product, and initiate the legal process. In the end, 360 was sentenced to pay 400 thousand Yuan to Tencent, though we know this amount of money is just symbolic. Though it is hard to forecast business operations in big companies, especially of high tech and internet industry, we still need fast and concrete legal regulation to guide this market.

China needs to implement some serious principles to specify which sector actually needs to take the responsibility to supervise internet businesses and management. The regulations and laws should be explicit and accurate defined. Some violators will need to be punished strictly to inform the rest that enforcement will be taken seriously. Right now, the Chinese government deals with violation cases only after they happened and made enormous social impact or significant economic damage. Since we know MSPs are relying on complete regulations in different sectors such as media, Internet, copyright and public relationship, MSPs need do extra work forming relationships with government institutions while preparing for malicious attacks from competitors.

User habit and market positioning

In China, most of the websites don't have their individual iconic characteristic. That is another Chinese characteristic in many industries, people incline to follow what others did and imitate every factor from the original. Even in online video market, you can tell the difference only between several very famous online video websites but not the other 5000. Homogenization makes it so that users couldn't tell which online website he or she used in last week for the newest Qing Dynasty fantastic episode. This makes it so that almost no user agglutinant exists. Not only the content lacks differentiation, but also the UI design and website structure are lacking significant brand identification. Several objective reasons have lead to this Chinese phenomenon.

Reason No.1, most of the websites are in the early stage of business. According to some authentic investigation, 80% of current online video websites have less than 2 years of operation in China but their aggregate volume is less than the combination of 2 biggest, Youku and Tudou. Users will show their loyalty only to content, instead of website or brand. Unfortunately, those young and small websites don't have any distinguished and unique content to educate and incubate their own users. They need time and money to modify web architecture, purchase valued content, and promote their brands.

Reason No.2, Chinese users rely on search engines such as Baidu, Sogou and Google. It is kind of hard to remember which exact online video website was opened after enjoying desired video clips. All the attention is paid to the searching frame and search engine itself, instead of the real platform that carries videos. Reluctant to admit it, most of the website owners know that they can't make it without help from Baidu since 80% plus visits and volumes are brought by them. They don't have any other revenue source but only volume transaction and unique visits. This reality makes different companies have different strategies and relationships in cooperation with search engines. We will discuss this point later on.

Reason No.3, user habit has no constant pattern to follow, meaning that in China, contingency is quite obvious behavior for those video watchers. According to research done by iResearch, 70% of the online video websites users would like to keep logged in to the same site to watch videos and the average of UV per user of most websites is only 5. A major problem will be raised if users drifting among different websites without any concentration because advertisers will feel unsafe about their advertisement effectiveness when they invest money on one of these websites with low user retention.

Aside the reasons already mentioned, Chinese users have a very bad habit that is fatal for mature online video MSPs, which is they don't pay for the services at all. How could the MSPs make through the tough situation without any direct income from main users? Fortunately each of them has unique approach to work this early stage out.

Content innovation/acquirement

We know that in the TV/movie area, TV series content could contribute a lot on audience rating and same condition applies in online video area. In China, people haven't been habituated to record their daily lives or to create homemade videos as a profession or just for fun. Based on CNNIC's report, movie and TV series are the top 2 favorable categories of all online video content. In 2010, 92.6% and 87.2% users claim they've watched movies and TV series through the Internet, respectively (CNNIC, 2012). Because of the lack of original creativite content on all the Chinese video websites, regardless of the website appearance, they started to pursue movie and TV show copyrights to acquire users. All these websites were competing with each other over TV networks and filmmakers to purchase as many as possible episodes, but this content is limited and often exclusive. This competition drove up the price so much that by mid-2011 the TV show single episode average price was pushed up to almost half a million China Yuan. When I did interviews with several CEOs or COOs of Ku6, Youku, and LeTV in Beijing this winter, all these industry leaders said they were reluctant to pay such high prices, but they had to, otherwise users will run away in weeks.

Mr. Kun Wang, ex-operation manager of Ku6, the first internet video company going public in China, gave me a very detailed list about how these major players spend their money from VC. In 2010, Ku6 spend about RMB 300 million on copyright purchases. The number of TV series is more than 90% of total available TV plays that year. Meanwhile, Qiyi spent RMB 220 million on copyright purchases as well. This tells us that over 60% of the genuine content on these two websites are overlapped! Sohu.com also used 200 million to acquire 23 of the top 30 audience-rated TV shows domestically; as did as LeTV and others. For Chinese online video websites, TV shows and movies are sort of the "standard service" and industrial barrier. Lack of innovation and self-creativity make those players throw themselves into a massive fight over copyrights and overlapped content, pushing up operation expenses and dragging down their own branding.

Intellectual property protection/Copyright transaction

Intellectual property protection and copyright transaction is another important topic for Chinese online video websites. IPP relates to many problems of multiple layers and aspects such as governance, culture, enterprise management, private right and even national diplomacy. We were very happy to see how the Internet developed through free-sharing and openness in the past decades. However, as time goes by more and more people notice that as a platform, the Internet is creating more value to different participants, such as content producer, information integrator, and service distributor. Thus, IPP is makes sure each role gets paid fairly based on their contribution. But in online video area, IPP becomes more complicated than in traditional publishing and broadcasting areas.

First, some IPP infringement doesn't necessarily copy or steal your video or creation itself, but it might "hotlink" the videos to some other pages taking advantage from resources that were not produced by the online video website. For example, hot linkers build a fake but similar website that exhibits many stolen video links and import all the web consumption to its own servers to get advertiser's interested and sell its space to another hot linker. Usually users cannot tell which video was originally from which website. Indirectly, the online video websites' reputation and awareness are severely harmed.

Second, when TV shows are hosted by different websites, internet broadcasting rights are independent from common broadcasting rights of TV stations and channels, meaning websites need to negotiate with the TV shows' producers, and possibly others, to ensure their legitimacy won't be harmed. The cost of time, money and all the other property issues will put more pressure on those website short of capital. To avoid this part of expense, several leading websites try to produce their own TV shows or movies with much lower costs and much more implanted advertising. This will be discussed more thoroughly later.

Third, disclaimers might not apply to most of cheating cases. It is quite common on the Internet that when you search for one movie's name, another completely different video clip jumps up. However, if you click it, you will find it is still the one you looking for. This is a very popular trick to get away from censorship and piracy punishment in internet publishing areas. Vice versa, sometimes you think you got the right video but surprisingly find it was just an advertisement or useless stupid clip. You feel annoyed and time is wasted, but the website already earned one or two clicks from you, which could transfer to real money to their pocket. To some extent, websites are purposefully adopting these illegal methods because they benefit by doing so.

Bandwidth costs

Mr. Liu Dele, CFO of Youku, told me that according to international research firm ComScore's report, Chinese internet companies have to pay 4 times the price for bandwidth that American companies like YouTube and Hulu pay. It is another Chinese characteristic is responsible for this situation. There are only two main telecom carriers have the authority and capacity to offer scale bandwidth service, the blood of online video industry. There are three tiers we need to dive down one by one to understand this issue.

Tier1, monopolistic state-owned enterprises (SOE) raise bandwidth price as a high position and they control the supply tightly. In the area of Chinese communication and the Internet, you can never ignore two big names—China Telecom and China Unicom, both are large national holding companies. The larger company, China Telecom, controls 70% of the international portal bandwidth of China. In recent years, the EU and the U.S. frequently criticize China as a non-market economy because the government and SOE did too much to incubate an adequate/sufficient competing context. China will need to change its policies to correct this problem in order to enable Chinese online video website to compete in the global market. Since all the ICPs and ISPs could only purchase large amount of bandwidth from those two SEOs, bandwidth price is not market sensitive as other commodities in this area. Even more interesting is that in China, 21 southern provinces' telecommunication market is mainly controlled by China Telecom and 10 northern provinces' market is mainly controlled by China Unicom. The Yangzi River is their rough boundary. It makes even worse for those internet companies who want to serve north China users but located in the south because they need to travel half of China to discuss and make deals with local carriers. The same goes for northern companies.

Tier2, due to some historical reasons, China Telecom and China Unicom have terrible interconnectivity. Most ICPs such as Youku and Baidu have to duplicate acquisition bandwidths from both of them to guarantee that all Chinese users can access the same qualified video no matter they are using CT broadband in south China or using CU broadband in north China. Victor Koo, the founder and CEO of Chinese biggest online video company Youku, said if interconnectivity problem could be solved or even diminished, they will make a much better investment portfolio and improve pricing optimization, Hence, both investors and Youku themselves could be release from much financial pressure.

From 2011 3rd quarter earnings results of Youku, we find the bandwidth costs are 92.4 million China Yuan and net deficit is about 47.5 million CNY, 11% lower than the corresponding period the following year (NYSE:YOKU, 2012). Assuming China's bandwidth prices reach the same level as American bandwidth price, one-quarter of what it is now, Youku could reduce half of its net loss. That would be a big boon for an internet entrepreneurial company, even though it is the largest one in China.

Tier3, 2nd and 3rd level carriers do not have the right and approach to build same quality bandwidth to compete with China Telecom and China Unicom, instead their only choice is to purchase bandwidth and distribute it as secondhand resources. To control customers directly and build concrete relationship with them, China Telecom and China Unicom usually give out very high wholesale price to those 2nd carriers like 21Vianet, ChinaCache, and CNLink, etc. This is an unreasonable position for most business models that need wholesalers and distributors to cover different customers of different levels.

When I was the chief client manager of China Telecom, my major customers included Youku, Tudou, Ku6 and some other video websites in Mainland China. To maintain and enhance our customer relationship, and passively avoid them turning to other carriers to purchase bandwidth, we gave them a good offer that was much lower than the indicated price, which was about 100,000 CNY/GB per month. Meanwhile, we charged 21Vianet, one successful private telecom carrier located in Beijing, 160,000 CNY/GB per month, even though it was our downstream distributor and lives on our feed. It is almost impossible for 21Vianet to acquire big customers by that price, even if they add 0 CNY on packaging, service and delivery. For 21Vianet and other private/2nd tier carriers, they could never compete with China Telecom with high value and big scale customers such as Baidu, Youku and Sohu.com. This is not a privilege of only China Telecom; China Unicom has similar policies as well.

Professor Kan Kaili is the first student sponsored by Chinese government in 20th century to be admitted into Stanford University. Also, he was special counselor of the World Bank and manager of Pacific Bell Telecom Company. As Dean of School of Economics and Management, BUPT and my thesis advisor, he has rich experience and deep perception about the Chinese telecom market. He said monopolies such as China Telecom and China Unicom are controlling the entire industrial chain from upstream to downstream. That is a big threat for all the competitors. All the participants in this sector need to ingratiate the two big carriers to get portion of the business. This even applies in IDC construction and server procurement because without bandwidth IDC is no more than a real estate property. "We know there are many small sized carriers in China but they are nothing comparing with them (China Telecom and China Unicom). ChinaCache, listed in NASDAQ, is even smaller than one of their dozens of local branches. But in the U.S., uncountable telecom companies compete with each other on a public unified standard enacted by the state and they have built very ubiquitous and solid communication infrastructure. Furthermore, any one of the U.S. carriers has the right to acquire international bandwidth portals in order to implement their service in different countries overseas. None of them has such a dominant power as China Telecom in China to make it the only top dog."

Part III, Strategies and practices implemented by different major MSPs

In spite of all the negative features of the Chinese internet sector, China is still the most exciting potential market for every entrepreneur who wants to create great value and explore attractive, virgin territory. The big booming phenomenon is happening not only within the internet area but also in online video sub-industry. On December 8, 2010, Youku, the biggest online video website in China, successfully went public on the New York Security Exchange and raised 203 million USD. Its share price increased by 166% on the first day of trading, making Youku the best performing stock on the NYSE since 2005. Nine months later, Tudou.com, Youku's major competitor in China, also listed on NASDAQ for better growth and larger public funding. With these two companies listed in the U.S., many consulting firms who pay attention to the Internet and new media expressed their optimal expectation, foreseeing that both Youku and Tudou.com have the potential to grow into large international media groups covering networks and TV channels.

This massive potential is why online video business is so attractive even though the path of development hasn't been very clear yet. Five years on, a bunch of VCs swarmed into this niche market because they knew it would happen. According to insider assumptions, capital accumulated in this area in China has been more than 1.5 billion USD thus far. Since February 2010, China overtook the U.S. in the number of internet users and three-quarters of the total 420 million users have watched videos online, with an annual growth rate at over 36.3% (Internet World Stats, 2011).

The huge user base is not the only reason to explain why online video is so popular in China. Another important reason is that China doesn't have such an open and diverse TV program/movie supply as the U.S. has. Contrary to TV programs, online videos are easier to skip over censorship and deletion. Users are relatively free to choose what they want to watch and when to watch it. This is very special in China.

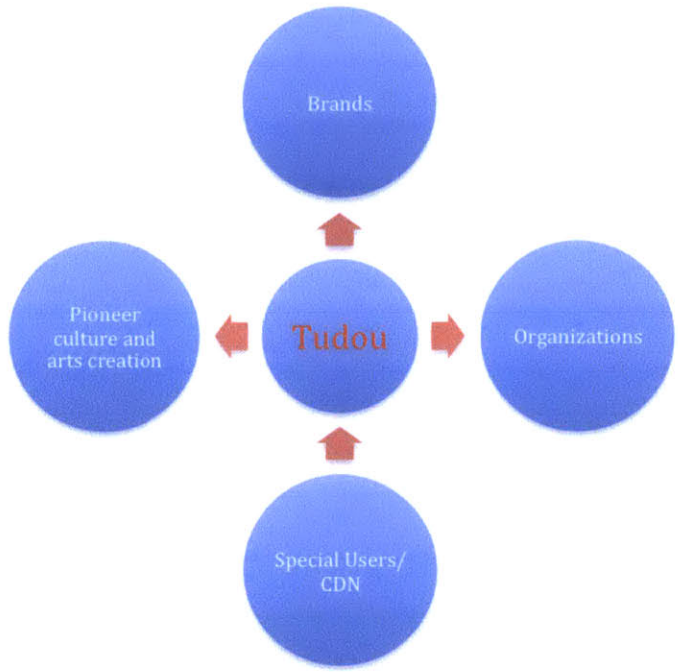
Although every party in this sector is looking forward to getting lucrative return, like investors, advertisers, and entrepreneurs, the pressure of proving their ability to earn profit for

Youku is overwhelming. Online video websites need to find the right methods to survive and then stand out from this complex battlefield. They need to deal with traditional TV stations cleverly to obtain proper content. They also need to build their own unique business models that could bring the best benefits.

"However, questions about the online video market remain. What will ultimately become of all the wheeling and dealing in the online video market? What are the most important technologies needed to expand online video? Can online video startups find viable business models? And aren't all parties simply hedging their bets since it's unclear which online video distribution models will win out?" (Fader, 2006) Peter Fader, professor of Wharton in marketing, asked everyone he met in the Wharton Customer Analytics Initiative.

When these questions come to the Chinese-specific context, they look even more complicated. How do these top Chinese sites create new value, micro-innovations, and their business models suitable for the Chinese market? How do they balance and lay down their investment and resources to accomplish their goals? How do they take advantage from partners such as telecom carriers and movie/TV royalty agencies? These questions are critical if we want to truly understand this topic and find out right direction for Chinese online video websites.

Tudou



Tudou went online on April 15, 2005, even earlier than YouTube. It is one of the pioneers in the online video industry. Its name comes from an English slang: coach potato, which means people who sit on the couch with a TV remote in their hands. Mr. Wang Wei, founder of Tudou, has lived in U.S. for ten years and chose to use this word to remind people of the effects brought by TV and videos. Tudou's slogan is "everyone is the director of life." Just as this concept, Tudou encourage users to produce interesting and creative content. On August 20, 2010, Tudou was acquired by Youku, its former rival and biggest player in the online video market in China, and continued operating separately from Youku. Meanwhile, Todou delisted from NASDAQ and every stock conversed to 1.595 Youku American depositary receipts.

Early entry is a very important advantage of Tudou, especially in the developing China online video market. Telecom carriers have never had this kind of customer before. Even Sina.com, the biggest portal website in the Chinese world, could not use up 1GB bandwidth per month because that is a big volume and there is not much content to carry. Furthermore, 1GB bandwidth per month cost about 500,000 CNY at that time. According to public investor information disclosed by Tudou, in December 2005, IDG gave them 500,000 USD as the first round venture capital. At currency rate of USD to CNY then, Tudou can't hold on for 6 months if there is no more VC or other types of investment. Fortunately, online video, as the newest way to browse the Internet, was well accepted by most of the artistic youth so that Tudou became a hot topic at that moment. VCs suddenly realized online video would be the next battlefield with high return and unlimited opportunities and followed up investment urgently. 5 months later, Tudou received second round investment of 8.5 million USD, a big amount of money at that time from IDG, GGV and JAFCO Asia. Contrary to those online video companies who suffer from stingy investors 2 or 3 years afterwards, Tudou started with a perfect opening since it painted a perfect future for them.

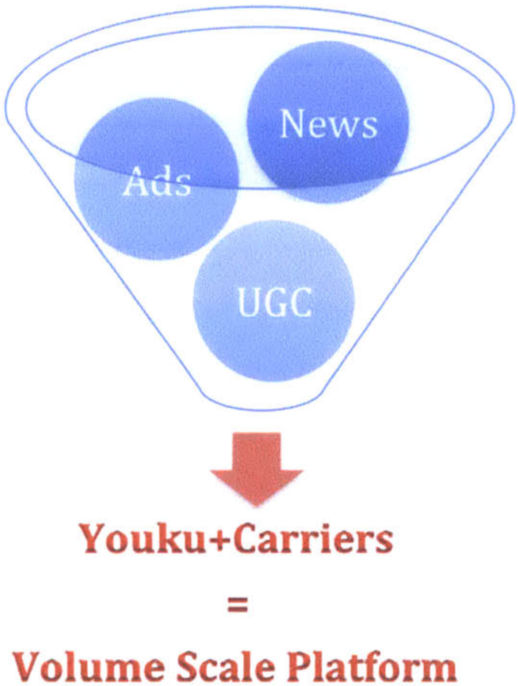
On the other hand, Tudou built a very delicate relationship with carriers in terms of bandwidth procurement and cabinet rent. Technically, bandwidth is not the major cost of telecom carriers but cabinet is; since bandwidth is reusable and has few marginal expense however cabinets need vast electricity for driving and cooling down hundreds of servers. And room rental is another big pressure for IDC. As an online video producer, Tudou also needs much more bandwidth than normal ICPs but much less cabinets, say merely one tenth of common ICP's, which is favorable for telecom carriers. Since then, online video company was listed as a high net worth client within telecom industry and Tudou got a experimental contract with China Telecom. That is, gradient pricing and bandwidth plans were introduced by Tudou because they were the first online video service provider in China.

Gradient pricing, as the name implies, is offering several tiers of bandwidth prices corresponding with Tudou's monthly usage. Using more makes unit price going down but total revenue going up, vice versa. This pricing model allowed Tudou freedom to choose tge development pace they were inclined to take, at the same time carriers could balance bandwidth price control with its revenue KPI. Bandwidth plan is another great contribution Tudou made for entire online video market. It means Tudou and the carrier worked together to design a package with a specific amount of bandwidth and cabinet portfolio, which depends on Tudou's annual budget and business status. We already said that online video companies need relatively few cabinets but huge amount of bandwidth if they did well or had many users. But it also depends on their own operation strategy, whether they concentrate on a few IDCs or spreading to many small/middle sized spots. It's quite complex and crucial to have reasonable network architecture to minimize Tudou's expenses. And these two revolutionary solutions took Tudou to the No.2 position for several years. Even now Tudou still has the advantage of flexible and relatively low procurement channels with telecom carriers. (See Exhibit 1)

Being good at art creation and marketing promotion/planning could also explain why Tudou held a big portion of market share through these hard times. Of all the other early period online video service providers, Tudou was obviously different in website structure. Every user has his or her own homepage instead of a boring universal login page. Tudou wants "netizens" (network citizens) who have an individual space to show their imagination and creativity, no matter the quality. This is the most important element in the cyber world, creating and sharing. Internet and online video give common people a way to express themselves, to show themselves, and to reflect themselves. Tudou seized the origin of networking from the very beginning, letting it stand very close to grassroots artistic youth and enterprises eager to expose themselves in a new way. Tudou Video Festival and Orange Box are special activities that invite many original authors compete in video production and micro-filmmaking. Tudou connects producers, advertisers, and internet users together and guarantees that each party is enjoying the fruits. For example, the 2013 Tudou Video Festival invites Mr. Gao Qunshu, Mr. Ning Caishen and Mr. Luo Yonghao, famous film industry professionals, as the judging panel. Also invited were hundreds of independent filmmakers and their teams, favored by many senior netizens. If you think Tudou will pay for all the costs, you are wrong. Colgate and Budweiser are major sponsors to the 2013 Tudou Video Festival so that they will cover most of the expenses in administration and operation. Return for the sponsors are attractive as well, not only because Tudou has millions of users to perceive their brands and products, but also some artists will make theme films for them directly. That is very smart way to promote a brand in an organic way. This lets Tudou entirely get around any IPP violation problems while creating more value for advertisers.

Technology is another strength of Tudou. Although Tudou has deep relationship with telecom carriers to avoid paying too much for bandwidth, they still need to find another way to improve data transportation efficiency for such a huge user base. Because of China's extremely special networking issue caused by bad interconnectivity between China Telecom and China Unicom, Tudou also needs to implement another mechanism to guarantee most users could browse its webpage regardless of their location or ISP. Tudou was the first major online video company in China to implement CDN technology to solve this problem. Michael Zhao, one of my friends in the internet industry, used to be the first CTO of Tudou and he conducted Tudou's CDN construction and maintenance. We had a casual interview in January in Beijing about the reason Tudou put a lot of money to build this CDN at that time. He said they had to, otherwise bandwidth cost in the long run will nibble up all the venture capitals we have. CDN might cost a lot at beginning period in local bandwidth purchase and network construction, but it could enhance the performance and stability of video streaming at a low price level. Following after Tudou, Youku and iQiyi started to deploy their own content distribution network soon after.

Youku



Youku started with the accumulation of users and providing a better experience of its services. The trade off was Youku spent a bunch of money on bandwidth purchase, servers purchase, and hardware construction. (See Exhibit 2 & 3) Also Youku is a total hodgepodge including news, TV shows, self-made clips, and art creations. This is quite dangerous but it works very well for Chinese users because people don't like to wait and don't care what is on the show. Although Youku is acknowledged the biggest and most developed online video website in China, frankly it was a total imitation of YouTube; you can see this point even from its name. In its early stage, Youku almost copied every line of codes from YouTube, making its color scheme look exactly the same as YouTube's–red and blue combination surrounded by white background. This is very smart in the Chinese internet sector, especially when you are not certain which way is right to pursue. Following a successful ancestor could at least let you not lose so badly. Since

Youku has chosen such a "special way" to grow itself, the business model is set down as same as YouTube's in the first 3 years. Millions of UGC video clips, many pirate TV plays and shows, low quality homemade videos, all of these makes Youku the biggest but messiest place on the Internet. But that is also why Youku was growing so fast among China's urban areas and suburban areas. People could find most of the original Youtube videos from Youku, with Chinese subtitles! Look at the funnel model of Youku, it is the same as YouTube's strategy—big and complete.

Victor Koo's capital management is the first thing I want to discuss about Youku. An MBA from Stanford, former Bain consultant and VC Richina Group Vice-president, Victor Koo knows plenty about how to raise an internet company like Youku and how to arrange all the resources around him. Capacity to control the entire enterprise operation is the biggest factor that differentiates Victor from other online video bosses such as Wang of Tudou and Li Shanyou of Ku6. Victor still has 34.8% of the listed company (NYSE:YOKU) share even after three rounds of VC investments, promising he can steer the wheel by himself (IT XINWEN.COM, 2011). Of course, world class VC supported Youku significantly in its development and going public in the past 6 years. Youku's institutional investors include Sutter Hill Ventures, experienced VC from Silicon Valley, Farallon Capital, and Chengwei Ventures, the one and only evergreen fund. All the investors are proud of their rich fund and vision, which are essential to push Youku forward steadily. That's why Youku has the money to expand to every province in China while its rivals suffer from poor funding. Online video is a game of burning money, the longer you persist means bigger opportunity you win. We can see Youku's input comparing with other competitors' quite clearly from exhibit 2. Another thing worth mentioning is that the period when Youku began collaboration with many local VC/PEs is the period when the Chinese VC/PE sector became highly developed. In some sense, they complete each other.

Operation strategy makes Youku big and complete. According to my interview with Hui Zhao, executive director of operation department, Youku has become the top online video website in terms of user experiences in fluidity and resolution. With these numbers below, you can tell that Youku is not bluffing at all. (Interview with Zhaohui, 2013)

- 60% of Youku's crew is specialized networking engineers, including user experience (UE) engineers and user interface (UI) engineers.
- Youku is consuming more than 400 GB bandwidth domestically in total, about ¼ of entire bandwidth consumption of all internet companies in China. (Exhibit 2)
- Youku has more than 40 database server nodes in China, including all the tier 1 cities such as Beijing, Shanghai, Guangzhou and most of the tier2/tier3 cities such as Huizhou, Chengdu, Dongguan, and Shenyang, etc.
- Youku works so well with telecom carriers that they collaborated together to build a monitoring system that can precisely count and analyze each node's Internet volume.

Device coverage and industrial alliance make Youku a mainstream media terminal nowadays because it's the only online video company that has ability to cover multiple devices such as smart TV, theatre, and smartphones. Multi-platform has been Youku's highest-level strategic frame as long as most people would admit there is no constraint in content vector. Ming Wei, senior VP of operation at Youku, said: "In our lives all the movies are for presenting in cinema and all TV plays are for TV sets. Now we online video producers are creating everything for devices that can be online! As long as there is a network, there is our program shows." Youku has always been aware of the ubiquitous future of internet information streaming so that they never stop exploring new territory. According to China Telecom's survey, more than 50% of shipped smartphones in 2011 have installed a Youku app, giving new phone owners the convenience to watch online videos right after they get the phone (Chinatelecom, 2012). Youku's iPad app also kept placing at No.1 on free app chart in Mainland China for 7 weeks; consolidating Youku's leading position in market share.

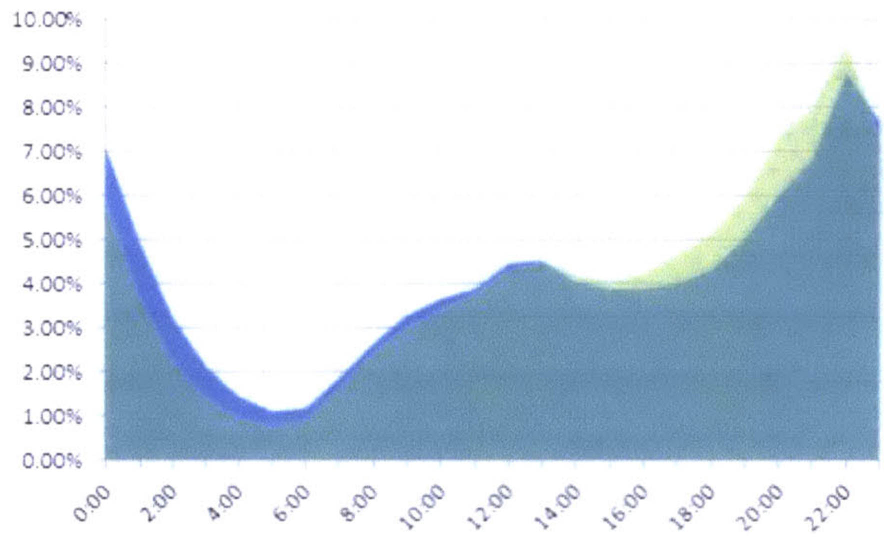
Industrial chain value-added project is another approach Youku is trying to implement for broader cooperation with professional video producers. There are several reasons to make this move.

- Since online video is still a very sensitive area in Mainland China, Youku needed to establish friendly relationship with every party that possibly takes part in media sector, such as SARFT (the State Administration of Radio Film and Television), MIIT (Ministry of Industry and Information Technology) and CFGC (China Film Group Corporation), etc. To cooperate with those administrative bureaus, Youku takes the responsibility of building a well-functioned news website. People could check almost all the TV news and what was happening from Youku.com without turning on their TV sets or waiting until they were back home.

- Talent resources are quite important for Youku as well. As a private company supported mainly only by ad revenue, Youku doesn't have strong confidence to hire top actors/actresses and famous directors who can create quality content for it. What they have is broad platform and millions of users, which is what actors need. This is a typical win-win situation. Youku doesn't only have technical specialists, but also all other video professionals such as actors and artists.
- Advertisement has been the most effective business model for the entire media industry for more than 100 years. This is no exception with online video sector. Industrial chain integration would help Youku to prove how new media affect customers' perception and what evolution it will bring to traditional ads (IResearch, 2013). From Exhibit 1, we could know the advertisement market sharing of Chinese online video industry till 2013 3rd quarter. Youku is firmly holding the first position by more then 20% of the entire revenue.

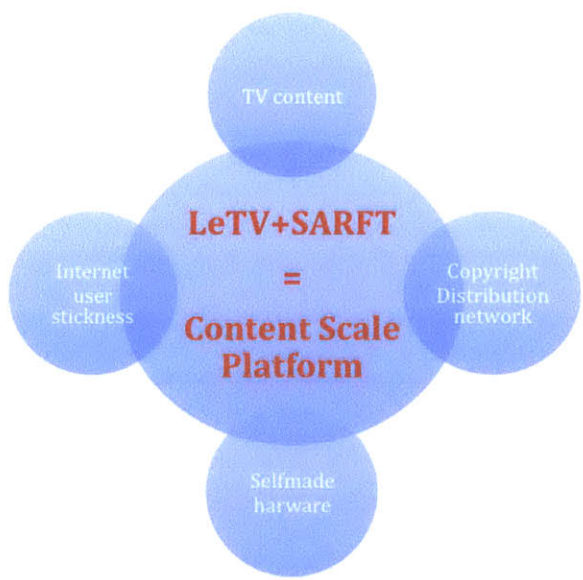
LeTV

When tons of online video websites were bruised and battered, struggling with copyright issues, LeTV was enjoying all the benefits brought by "copyright buyout." LeTV, the one and the only video company listed on "most investment value 50 firms chart 2009" operated by Zero2IPO, authority investment consulting firm in Mainland China, is still relatively young for other major players such as Youku, Ku6 and Sohu. From its very beginning, LeTV insists on a professional content path and doesn't accept any personal, homemade video upload. Its business model is quite easy, too—paid membership and film/TV publishing.



According to PPTV's (a major Chinese P2P online video service provider) monitoring and analysis, in China online video viewing rating distributes as the chart above, quite similar to traditional TV audience rating. LeTV decided to go in the direction of online genuine TV shows and episodes.

Given this information, it is very reasonable that LeTV promotes its internet set-top box, similar to Apple TV. In China, permission to develop IP TV is closely controlled by SARFT, the state administration of radio film and television. It is almost impossible for LeTV to operate an individual SARFT IP TV platform, since it needs significant infrastructural investment and policy support from government. Fortunately, LeTV has strong connection with CNTV, the official Internet online home site of CCTV because of its film and TV series producer background. Now though this channel, LeTV's MSP strategy is very aggressive because it is the first one who invades traditional cable TV service providers, which are seen as the mainstream media forever.



Facts prove that this strategy is perfect designed for LeTV and makes it one of the biggest internet film and television play issuing institution, with more than 20,000 hours of programs in total. Monitoring data from iResearch in 2012 shows that LeTV ranked first among all the online video website in single page view (SPV) length per capita (IResearch, 2013). How has LeTV been so successful and solved those "Chinese characteristics"?

Well understanding the power of SARFT, LeTV seized most of the *Guanxi* with local TV stations, who have TV shows productivity and wholesale privilege by setting up its own studio. Original contents are LeTV's well-deserved ace card.

According to Hong Liu, COO of LeTV's comments, online video websites primarily compete on content and user experience. But every company is starting to input a lot on hit shows and hot movies, making all website content very homogenized and indistinguishable. To stand out in the user experience index, video quality, download speed, and complete inventory would play a critical role. Only a combination of these three could increase users' stickiness and educate growing users. LeTV has purchased 50%-60% of all the hit films and TV shows copyrights of 2012 **exclusively** and will pursue 40%-50% of them in 2013. Mr. Liu said they have gone farther than any other competitor in this industry. 209 TV series and 6000 plus episodes, LeTV's exclusive video contents are more than twice of all the rest together. To transfer such a large amount of programs, LeTV invested lot money on their own CDN. (See Exhibit 4)

Apparently this is the most effective way to counter piracy and imitation of Chinese internet industry. If the content were stolen, LeTV has absolute right to sue and ask for compensation. This also helps the Chinese government to improve its regulation because experts and administrators need lively cases to set the standard and implement enforcement. Another reason LeTV paid such a high price for content was to squeeze out other competitors in this market for more royal users. During 2009 to 2012, these several websites fought intensively for limited copyrights and sued each other for piracy and violation. In 2011, Tudou was sued 587 times for IPP violation during that one year due to its unauthorized playing and copying, therefore Tudou was fined more than 1 million CNY (Chinanews, 2011). For its long run consideration, LeTV decided to choose a "genuine and premium" model as their basic development strategy. In 2011, LeTV paid 20 million CNY for the exclusive internet copyright of "The Tale of Zhenhuan," a very popular TV series in the last three years. Surprisingly, this TV show brought in 100 million in monetary profit and 3.6 billion PV increase in webpage volume, silencing all skeptics. Following this trend, LeTV paid another 50 million CNY for the most eye-attracting TV show in 2013. They have plenty of confidence to achieve a new revenue summit (Interview with Wuyazhou).

Controling the content means controling the initiative of broadcasting. Copyright distribution is a unique weapon that only LeTV has successfully wielded in China so far. This practice gives LeTV the best position in the online video market in China. However, to avoid becoming pure Internet channel provider, LeTV needs to have their own IP in TV/movie industry, even if they do not produce the content by itself. Otherwise, their high expense on bandwidth and other infrastructure will only exchange very cheap basic channel rental, just like what telecom carriers suffering currently.

Under the big picture of the financial crisis in 2008, most of the online video websites were suffering from "broken money chain." At the same time, LeTV accumulated 70 million revenue and 30 million profits as LeTV's first year performance, making it stand out of the entire internet industry. Thanks to LeTV's "genuine content + copyright distribution" business model, multiple local VC/PEs expressed strong interests in LeTV, such as Huijin Lifang, Nanhai Growth fund, and Shenzhen Innovation Investment. Mr. Jia Yueting, founder and chairman of LeTV, told me, "Even before we started our company, we've made our own forecast to the internet industry. As total bandwidth volume rises globally and its price goes down, internet publishing will definitely replace the position of traditional AV issuing. That's why we determined to go this path, simultaneously focusing on both online video playing and TV/movie online distributing. Thus we can form a closed business circle and self build by feeding our own products."

Part IV, Conclusions and market trends

After aggregating the context, policies, and strategies previously discussed, we could make some reasonable conclusions to explain the differences between the U.S. online video market and the Chinese one.

- In the U.S., online video platforms such as YouTube and Hulu have more flexibility on content production. No matter if you are an individual video lover or professional moviemaker, there is almost no restriction on what kind of content you cannot create.
- In China, online platforms are under tight surveillance, which is in order to prohibit sensitive or political expressions, forcing them to compete fiercely on content purchases and imported program imitation.
- In the U.S., internet bandwidth cost is modest and startups don't worry too much about their expense side but focus on the revenue side. Online video platforms have options to choose a preferred carrier to build up their framework.
- In China, two giant companies, China Telecom and China Unicom, are controlling the bandwidth resources intensively and the price is very high for those VC/PE sponsored online video websites.
- In the U.S., internet users are used to paying for some premium services or some programs with copyrights, not only for avoiding the punishment but also showing their respects to the originator. Therefore, online video platforms could get income from the relatively earlier stages. Even very modest revenue could show the platform's business model and earning ability to an investor. Also, the management team could independently determine the company's operation themselves, without being bothered by others.

- In China, video platforms will face such an extremely embarrassing situation as the more users they have, the more money they lose. This results because Chinese users don't pay, but bandwidth consumption is increasing dramatically as the number of users grows. The online platforms would like to integrate more third parties to create income by ads, traffic exchange, and agent business.

In the future, those major online video platforms will likely carrying out two totally different developing directions. One way will be focused on relatively small screens and mobile devices, in which Youku and Tudou as the leader of desktop traditional online video websites will go.

PCs and smartphones/tablets encourage people to interact with each other more, comment more and create more. People need to be prepared for contributing their intelligence anytime anywhere.

UGC and short videos are more suitable for those platforms because smaller screen could reduce the risk brought by bad video quality and limited network capacity. Meanwhile users would like to use those devices only if they were idle for short while, for example work break or lunch time. Short videos are very casual and flexible to enjoy.

Smartphones and laptops are much more convenient for those who want to create something by themselves, which is helpful to establish a UGC environment. Imagine that scene, you see a extraordinarily intense street basketball game and take out your iPhone, snapped a 50 seconds essential clip and uploaded on Youku by tapping twice. Two minutes later all your friends who are crazy about basketball can watch this video clip on their phones. This is how people share information and message now and it will only increase in the near future.

Finally, Chinese bandwidth price is going down, although slowly, due to the technology development and more open competition among carriers. Youku and Tudou will have the ability to enhance the video quality, transmitting speed and additional services. High definition videos are becoming popular as 4G and WIFI access spreads in China.

Apparently, according to its strategy, LeTV is concentrating on another way, which is occupying people's living rooms. Big screen, high-definition TV sets are their ultimate goal. For decades, TV has been the main method people acquire information and entertainment. In the past ten years, TV lost the battle with computer because TV has not that many program options and it was not interactive. But now things are changing. "Smart TV" or we can call it big screens with operation system and internet access, will control most of the families again. Comfortable couch, superior visual effect, variety of programs, and X-box could get your friends and family together. That's why LeTV is striving for all the 2nd and 3rd tier cities market. Compared with TV advertisement revenue, online advertisement is still a small piece of cake.

As a real online video platform, LeTV even could install 3rd party apps, such as Weibo.com (Chinese Twitter) and Meican.com (online food delivery service) in their smart TV to go farther in business units' aggregation, which will contribute significantly to LeTV's ecosystem and income sources.

Additionally, it's more acceptable for people to pay for the "Internet cable" TV fees. They value professionally made programs more than those homemade video clips, and thet value family time together more than their own personal time.

After all, no matter how those online video platforms will choose their strategic solution to make it through, the most important thing is always finding the appropriate business model. Both Youku and LeTV models seem to work well in the Web 2.0 environment.

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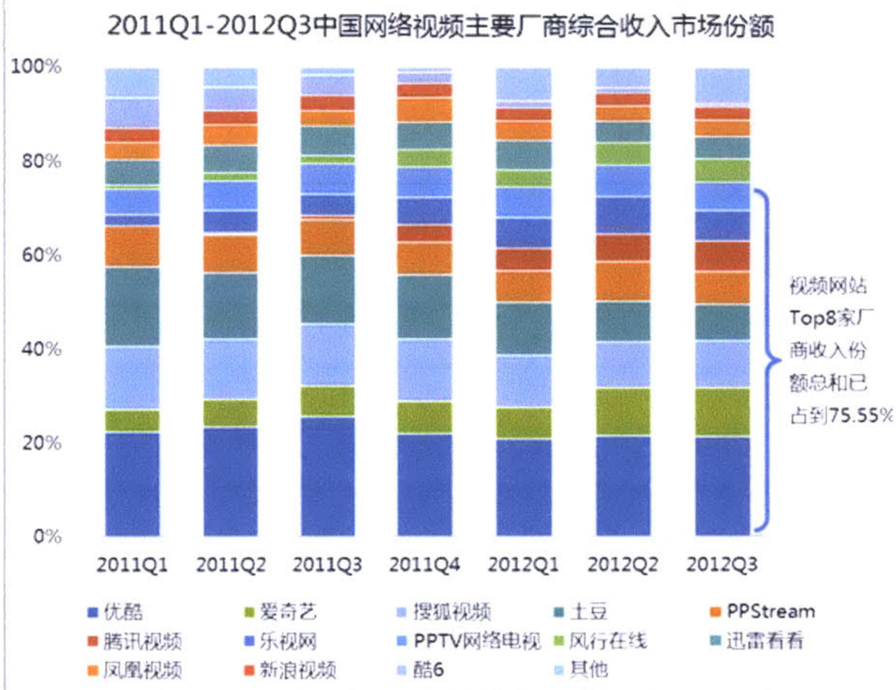
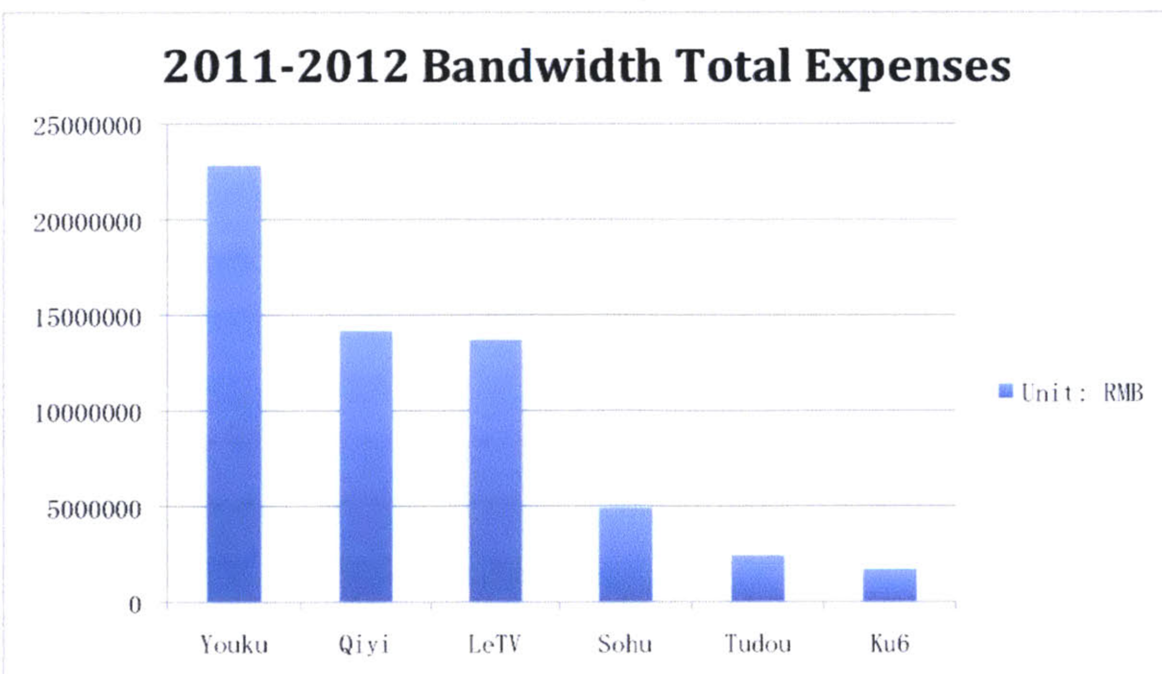
Exhibit 1:

2011-2012 Overall Ads Revenue Share of Major Online Websites in China
(Biggest Blue part is Youku, following Qiyi and Sohu and Tudou)



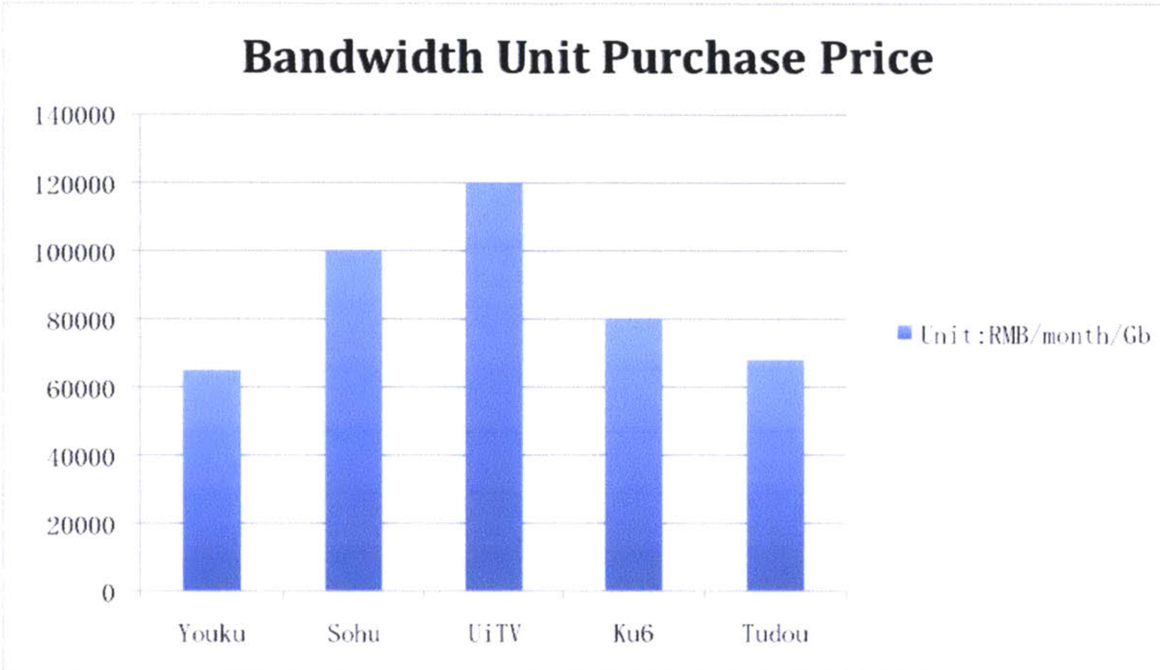
Source: http://tech.163.com/12/1121/15/8GRIGB5V000915BF.html

Exhibit 2



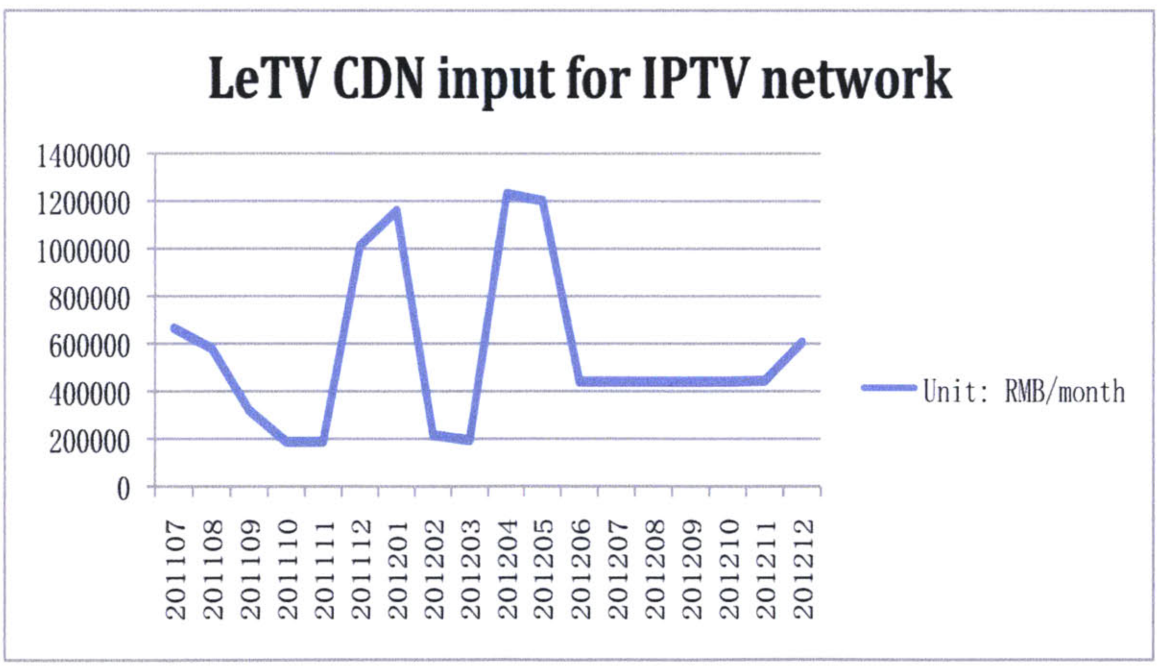
Source: inside transactional information of China Telecom 2009-2012

Exhibit 3



Source: inside transactional information of China Telecom 2009-2012

Exhibit 4



Source: inside transactional information of China Telecom 2009-2012

Exhibit 5

Client Name	Contract#	Total contract value (10KRMB)	Monthly income (10KRMB)	Contract signed date	Contract starts date	Contract ends date
CCTV6	IDC1	18.954	6.318	2009.4.1	2009.4.1	2010.3
Ku6	IDC1		-3.8	2009.2.2	2009.2	2010.2.2
KUWO	IDC1	37.2	3.1	2009.4.10	2009.4.10	2010.4
Ku6	IDC2	70.8	11.8	2009.06.01	2009.6	2010.1.31
Ku6	IDC3	24	2	2009.09.9	2009.9.9	2010.01.31
CCTV	IDC1		-13.8	2009.12.10	2009.12.10	2010.12.10
Ku6	IDC4	24	2	2009.12.10	2009.12.10	2010.01
JOY	CDN1	20	1.67	2010.01.08	2010.01.08	2010.01.08
JOY	CDN1	240	20	2010.02.08	2010.02.08	2011.02.07
Ku6	CDN1	144	12	2010.02.09	2010.02.09	2011.01.03
YOUKU	IDC1	218.4	18.2	2010.12.01	2010.12.01	2010.11
TUDOU	IDC1	96	8	2010.02.01	2010.02.01	2011.01
UITV	IDC1	42	3.5	2010.05.10	2010.05.10	2011.05
UITV	IDC2	126	10.5	2010.05.01	2010.05.01	2011.05
LETV	IDC1	66	5.5	2010.05.24	2010.05.24	2011.05.23
QIYI	CDN1	107.8	107.8	2010.12.01	2010.12.01	2011.11
QIYI	IDC1	240	20	2011.01.01	2011.01.01	2011.12
LETV	CDN1	960	80	2011.01.01	2011.01.01	2011.12
KU6	IDC5	169.2	14.1	2011.02.01	2011.02.01	2012.01
YOUKU	IDC2	1272	106	2011.08.01	2011.08.01	2012.07.31
LETV	CDN2	3.12	0.26	2011.07.01	2011.07.01	2012.06.30
QIYI	IDC3	13.2	1.1	2011.08.01	2011.08.01	2012.07.31
LETV	CDN3	528	44	2012.04.16	2012.04.16	2013.04.16
KU6	IDC6	169.2	14.1	2011.09.01	2011.09.01	2012.08.31
LETV	IDC2	736.8	61.4	2011.05.24	2011.05.24	2012.05.23
TUDOU	IDC2	0	0	2011.08.01	2011.08.01	2012.07.31
SOHU	CDN1	132	22	2012.01.01	2012.01.01	2012.12.31
SOHU	IDC1	488.16	40.68	2012.04.01	2012.04.01	2013.03.31
ZDWS	IDC1	36.42	3.04	2012.07.02	2012.07.02	2013.07.02
SOHU	CDN1	60	10	2012.09.27	2012.09.27	2013.03.27
WBSJ	IDC1	15	1.5	2012.09.04	2012.09.04	2013.09.04

Source: inside transactional information of China Telecom 2009-2012