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# FROM WECHAT TO WE FIGHT: TENCENT AND CHINA MOBILE'S DILEMMA

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## Abstract

*With the coming of mobile internet era, Giants in the different industry begin to compete face by face. This teaching case presents the event of charging for WeChat in China context to delineate the new challenges that Online Service Provider and Mobile Network Operator will face. The case describes the origin of the event, development of WeChat from inception to today, the impact of WeChat on China Mobile growth, current dilemma and disputes that all stakeholders involved. This case can help students gain more insights on the current debate around Net Neutrality.*

*Keywords: Net neutrality, WeChat, Tencent, China Mobile*

# 1 INTRODUCTION

For many years, the Chinese lunar New Year usually witnesses two records: the world's most watched television gala show, and its busiest telecommunications network. Rather than visiting families and friends and passing on good wishes in person on the first day of the lunar New Year, the Chinese have grown used to sending greetings from their mobile phones. China Mobile, the country's biggest telecom operator, announced that more than several hundred million text messages were sent on the eve of the Chinese lunar New Year. However, while media once dubbed China Mobile the biggest money-maker on New Year's Eve, the heyday for the short message service (SMS) and multimedia message service (MMS) may have passed. WeChat, a popular Smartphone application that allows text and voice messages and more creatively edited greetings, because of its convenience and low cost, became a trend in 2013 sending new year greetings. A survey run by Sootoo.com, a website monitoring the Chinese Internet industry, showed that about one fourth of 7,854 respondents said before the Spring Festival that they would prefer using WeChat to send greetings rather than traditional text based messaging services.

This phenomenon has given rise to substantial impact on the Chinese telecom industry. A latest report from the Ministry of Industry and Information Technology of China (MIIT) said the Chinese sent 897 billion SMS messages in 2012, up by only 2.1 percent from 2011, whereas the number of mobile users increased about 11 percent to 1.1 billion. China now has 564 million netizens, about 75 percent of whom can access the Internet from their cell phones. Because the function of WeChat is very similar to the text messaging and voice call services that are provided by telecom carriers, from 2008 to 2012 the number of minutes used by customers of China Mobile voice service dropped by more than 380 billion, even though the number of subscribers has increased by 226 million. More recently, with the fast expansion of WeChat users, the short message services (SMS) of China Mobile saw much slower growth in the first two months of 2013.

## 1.1 Charging for WeChat Controversy

Since March 2013, rumors have arisen from the online community in China that China Mobile along with other two telecom service providers have been meeting with the Ministry of Industry and Information Technology (MIIT) to work out a way to charge for Tencent's WeChat service. Those rumors took on new weight when Miao Wei, the head of MIIT, was quoted by Chinese media as saying that it was possible that a small charge would be added. Although MIIT declined to comment on the report and has so far made no mention of any potential charges for WeChat on its website, meanwhile Tencent has signaled that it has no plans to charge users for the service. This event helped push Tencent's shares down 1.5% on 1st April and drew almost universal outrage from users on China's other popular social media service, Sina Corp.'s Weibo. An informal poll by Southern Metropolitan Daily on Weibo on 1st April showed 86% of more than 2,000 respondents would stop using WeChat if they were forced to pay for it. A Chinese famous blogger even alleged that charging for WeChat would be the most serious battle in the history of the Chinese Internet. WeChat has taken the country by storm, but all of this is just the beginning.....

# 2 BACKGROUND

## 2.1 Tencent and Its Success in the PC Internet Era

Founded in November 1998, Tencent Inc. has grown into one of China's largest and most used Internet service portals. Since its establishment over the last decade, Tencent has maintained steady growth under its user-oriented operating strategies. On June 16, 2004, Tencent Holdings Limited (SEHK 700) went public on the main board of the Hong Kong Stock Exchange.

Tencent's mission is to enhance the quality of human life through Internet services. Presently, Tencent is providing value-added Internet, mobile and telecom services and online advertising under the strategic goal of providing users with "one-stop online lifestyle services". Tencent's four leading Internet platforms in

China – QQ (QQ Instant Messenger), QQ.com, QQ Games, QQ Space– have brought together China's largest Internet community, to meet the various needs of Internet users including communication, information, entertainment, e-commerce and others. As of Sep 30, 2011, the active QQ users accounts for QQ IM amounted to 711.7 million while its peak concurrent users reached 145.4 million.

A brief history of Tencent’s development is illustrated in Figure 1.

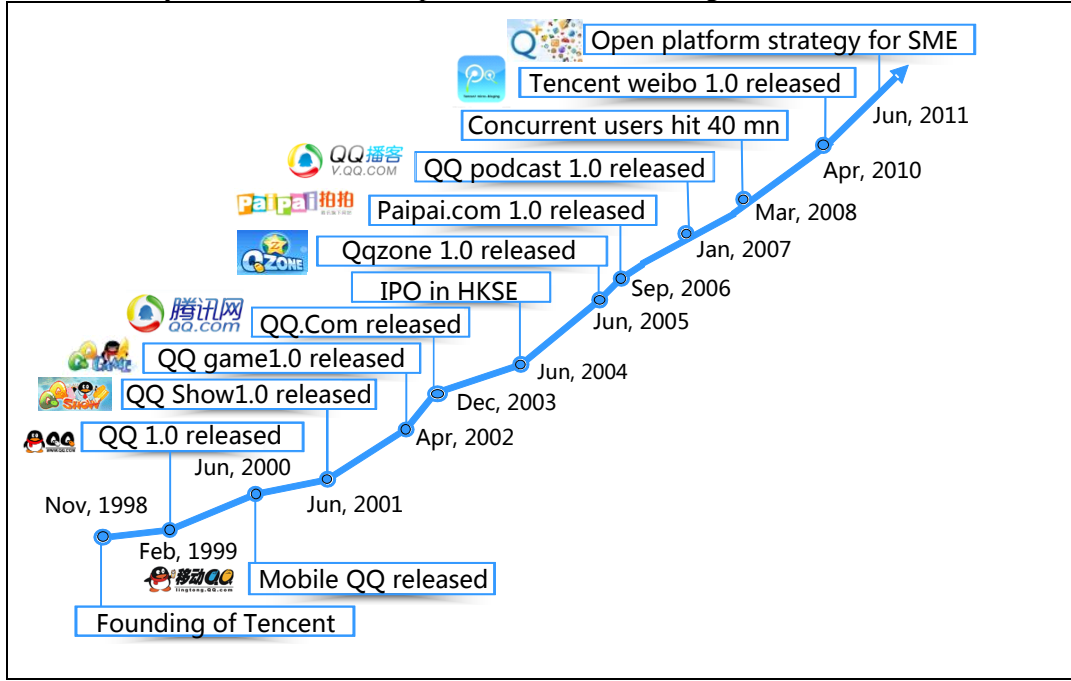


Figure 1. Tencent’s development roadmap

Starting from the QQ chat software, Tencent has spent over 10 years to successfully build a network with Tencent QQ, QQ Game, QQ space and Pet Network as the core platform, and has the highest growth for the domestic market capitalization of Internet companies. In 2011, Tencent ranked as No. 1 among TOP 100 internet companies in China with annual revenue of 4.5 billion US \$ and 45% growth rate per annum. The revenue structure change of Tencent between 2004 and 2010 is shown in Figure. 2.

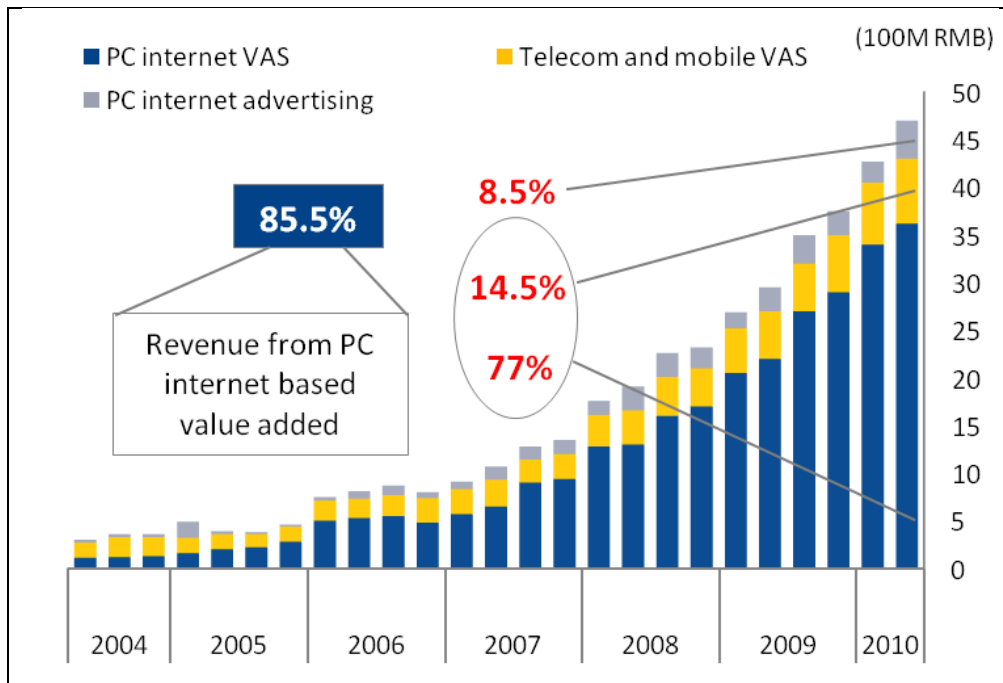


Figure 2. Changes in Tencent's revenue structure from 2004 to 2010

It can be seen from figure 2 that Tencent has made rapid growth in the past 7 years. Nevertheless, most of its revenue came from the value added services which based on PC internet. With the move from PC internet to mobile internet, Tencent hopes to develop cutting edge apps to continue its predominant leader status and sustain its business in the new era.

## 2.2 The Rise of WeChat: Tencent's Hope in the Mobile Internet Era

WeChat is a mobile communication and private social networking app which provides text messaging, hold-to-talk voice messaging, broadcast (one-to-many) messaging, photo/video sharing, location sharing, and contact information exchange. To some extent, it is a mobile app with the features of Facebook, Twitter, and Instagram all in one, mixed with Skype and a walkie-talkie. The evolution trajectory of WeChat is shown below:

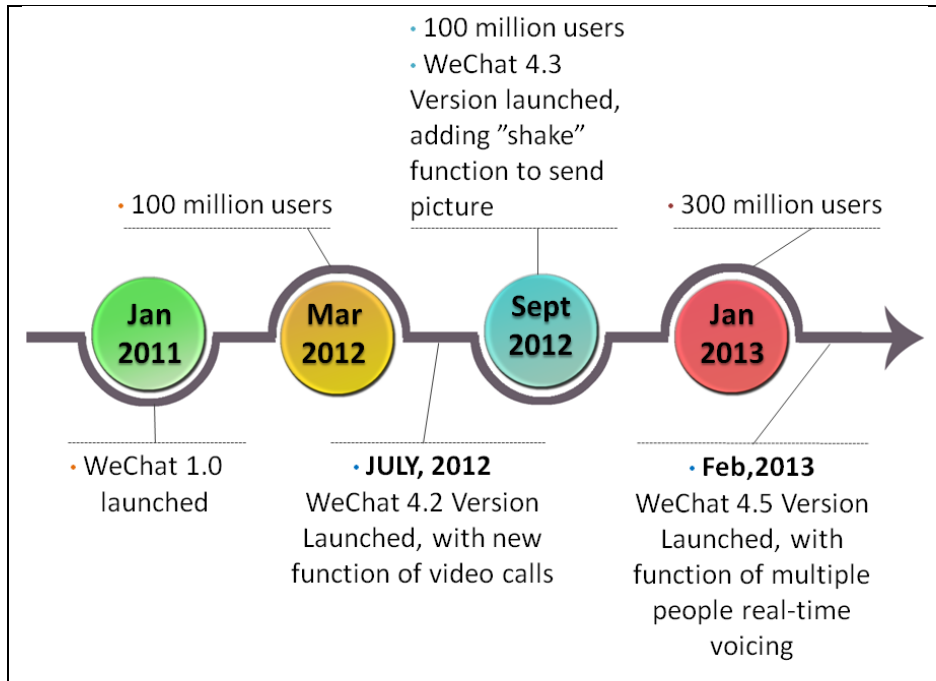


Figure 3. Tencent's WeChat evolution

WeChat, Tencent's secret weapon, was launched on Jan 12, 2011, and took more than a year to draw 100 million users. By September 2012, it had reached the 200 million mark. By January 2013, it had hit 300 million in less than two years since the service was released. According to the forecast from iResearch Consulting Group, a local market research company in China, WeChat is "very likely" to gain another 100 million users over the next 12 months if the number of mobile Internet users continues to expand at the current speed. Such success has attracted a lot of attention within the mobile and internet industries in China. As a result, everyone is trying to figure out why Tencent's WeChat is so successful. According to a report released by Goldman Sachs, at least 2 reasons can answer the question:

1. Unique product features.

Key features	WeChat	Fetion
Voice messaging	√	√
Photo sharing	√	√
Video chat	√	√
QR code scanning	√	√
Group chat	√	√
Synchronize contact numbers	√	√
"Drifting bottles"	√	×
Friend shake	√	×
Music sharing	√	×

Table 1. Comparison of WeChat and Fetion functional features

Like the world's most popular smartphone applications, such as Facebook and Twitter, WeChat has evolved into a full fledged social network to fulfill the social demand of users. Compared with Fetion, WeChat has more functional features, which are listed in detail in Table 4.

WeChat has created some unique features. One feature that was a nice attempt at capturing serendipity was their message in a bottle feature. Users can choose to create or retrieve a message (text or audio note) in a bottle to find new friends. Another feature was group chat. People can send multimedia messaging (e.g. photos, audio recordings, videos, etc.) to a group of people without charge. This especially addresses real needs of the Chinese market (e.g. by working very well on 2-2.5G mobile networks). In addition, WeChat's rich communication service features include: (1) Portability of mobile devices put WeChat into work during the timeslots that QQ desktop cannot penetrate. Users are enabled to socialize while engaging with offline activities, ranging from commuting to waiting for elevators, (2) Handwriting input method (potentially upgraded with voice recognition) eases the technical barrier of mobile texting, and (3) WeChat allows users to make new acquaintance through location-based features (e.g. friend shake).

## 2. Comprehensive online-offline social link

In the U.S., smartphone apps succeed often because they either enhance the users' social experience, or leverage the mobile or location-based data into accomplishing offline tasks. In China, WeChat has emerged as the potential dominant player which achieves both. Many people view WeChat as a game-changing innovation from QQ Mobile, as WeChat has blurred the boundary between QQ (784 million active accounts)'s virtual name-based online network, and users' real-name contacts in offline social circles, oftentimes stored in cell phone contact books, creating a comprehensive social graph centered on each WeChat user. A major reason of this feature may be that weChat enables a new friend to be added either by his or her QQ number or by Cell phone number. Figure 5 further gives more details.

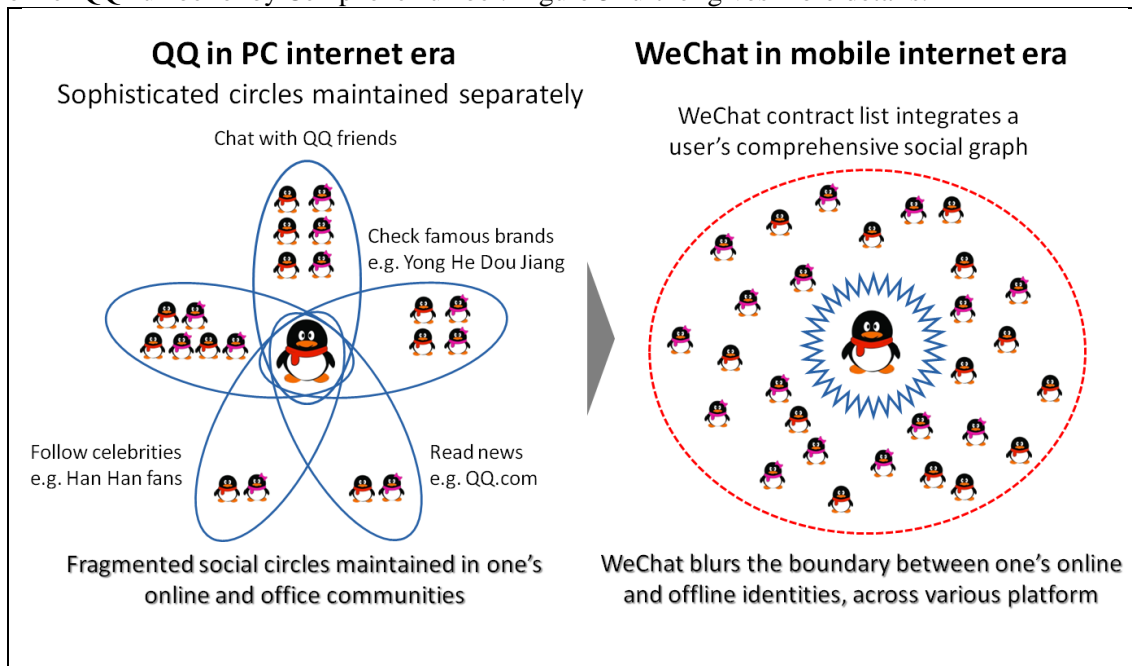


Figure 4. Comparison of Tencent's QQ and WeChat social features

In a word, WeChat is fundamentally altering China users' communication and social experience on smart devices. WeChat's success is not directly due to its product features, rather it successfully leveraged Tencent's large base of QQ users (who have now grown up and own a smartphone) to reach a critical mass and eventually ubiquity.

### 2.3 China Mobile and Its Great Challenge

China Mobile Limited was incorporated in Hong Kong on September 3, 1997. The Company was listed on the New York Stock Exchange ("NYSE") and The Stock Exchange of Hong Kong Limited ("HKEx" or the "Stock Exchange") on October 22, 1997 and October 23, 1997, respectively. It was also admitted as a constituent stock of the Hang Seng Index in Hong Kong on January 27, 1998. As the leading mobile services provider in China, the Company owns the world's largest GSM mobile network and the world's largest mobile customer base. The business makes money from its voice-based services and other value-added services such as SMS text, mobile e-mail and similar services. In 2012, the Company's operating revenue maintained stable growth, reaching US\$90 billion, up 6.1% over 2011. Its total customer base reached 710 million, including 87.93 million 3G customers. It can be observed in Figure. 6 that China Mobile relies too much on traditional service, such as voice service and SMS & MMS service (over 70% contribution to total operation revenue). That means China Mobile might face intense challenges and development pressures since the emergence of new internet technologies and businesses magnified the impact and substitution effect on the traditional communications sector.

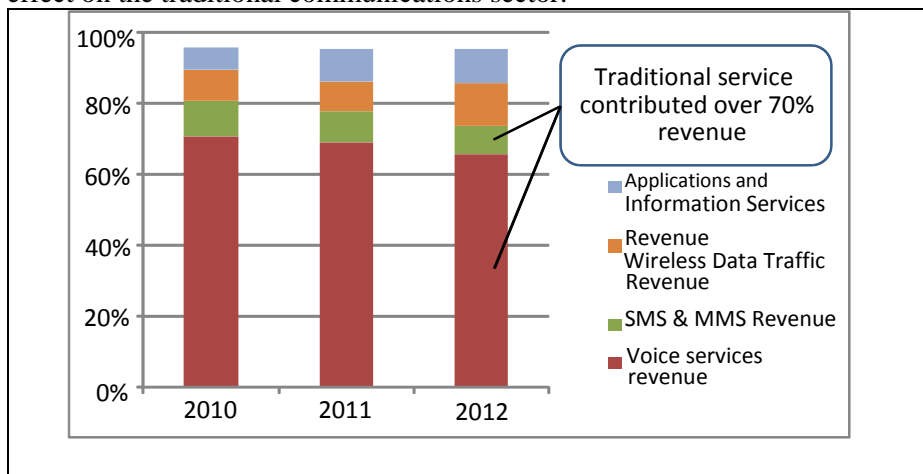


Figure 5. China Mobile's revenue structure change between 2010 and 2012

On the other hand, although China Mobile had built the world's largest GSM network which adopted the mature 2.5 generation technology, China's home-grown mobile technology is a few years behind that of its international competitors since it was having problems with handsets. Essentially 3G technology was lagging behind. Part of the problem was the choice to swap to TD-SCDMA's network which many would consider inferior to the 3G technology offered by European and American alternatives (which their competitors have decided to adopt).

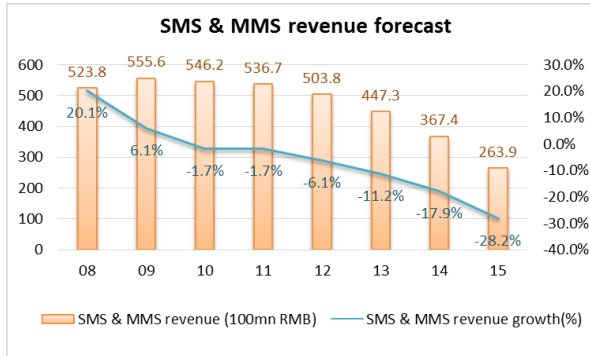
### 2.4 Impact of WeChat on China Mobile Revenue Growth

Both China Mobile and Tencent are dominant players in China. Over the years, each of them has focused on their own domain and made rapid progress independently of each other. With the convergence of information and communications technology, the Mobile Internet era has emerged. In January of 2011, Tencent released a mobile app named WeChat which became very popular and acquired a customer base of nearly 300 million users within 2 years. The rise in popularity of Tencent's WeChat application totally subverts the mobile carriers' text and multimedia message plans. Tencent has made the WeChat application available to mobile users at no cost. Users only pay a very small amount for using WeChat compared to the traditional short message (SM) service provided by mobile carriers. The challenges faced by China Mobile can be illustrated as follows:



Example: user want to send 1000 SMS and 33 MMS

	China Mobile SMS Revenue	China Mobile data plan
Traditional SM service provided by China Mobile	¥70 (¥ 60-SMS; ¥ 10-MMS)	0.06¥ /item for SMS 0.3¥ /item for MMS
WeChat service provided by Tencent	¥ 0.167(SMS and MMS)	20 ¥ /120M data traffic
User benefit a lot but mobile carrier lost huge revenue !!!		



China Mobile SMS & MMS revenue have decreased since 2010 and forecast to be declined over 50% than the year 2010.<sup>4</sup>

Figure 6. Impact of WeChat on China Mobile message services revenue

### 3 DISPUTES FOR THE STAKEHOLDERS INVOLVED IN THE EVENT

#### 3.1 China Mobile

The high popularity and usage of apps such as WeChat is creating a technological challenge to China Mobile. Due to the shortage and limitations of bandwidth through the 2.5 generation mobile network infrastructure, the popularity of WeChat and similar apps available on the mobile platform is creating a burden on the data transfer speed. China Mobile has incurred huge capital expenditures and is experiencing pressure to resolve this issue because its revenue growth is affected. To resolve this problem, China Mobile is considering two possible courses of action — (i) charging Tencent for the WeChat app, or (ii) improving the functionality of China Mobile’s home-grown app, Fetion — a WeChat-like app — to roll out to its subscribers. This creates two dilemmas. First, if China Mobile charges Tencent for this and similar services, it would violate the principle of Network Neutrality and become a ‘head-on’ rival in the Internet industry. However, if it decides not to charge Tencent, WeChat will likely continue to grow rapidly and become a dominant force in China's mobile market. Tencent will grow so large that it can take market share away from China Mobile in potentially every value-added service, including content, advertising, online games and video services. WeChat will dominate; as a matter of fact, that is exactly what is already happening. Second, if China Mobile improves Fetion to become a strong rival of WeChat, Fetion will cannibalize China Mobile’s traditional services in SMS and MMS, and jeopardize its revenue stream from these services. On the other hand, if China Mobile abandons Fetion, WeChat will dominate the SMS and MMS domain and erode voice services in the coming years.

### **3.2 Tencent**

Tencent announced that the principle of Network Neutrality will be violated if China Mobile is to charge users or the providers of mobile apps (such as Tencent for its WeChat app). If China Mobile charges Tencent for the WeChat app, and Tencent refuses to pay the fee to China Mobile, WeChat users will not be able to use the WeChat services, which will trigger a lot of complaints to Tencent. If Tencent is to pay a fee to China Mobile, it will result in an increase in the operational cost and potential price fluctuations in the stock market.

### **3.3 Users**

Users of WeChat have expressed their rage over any plans by China Mobile or Tencent to charge for their use of the WeChat app. They threatened to switch to other mobile carriers if China Mobile puts the charge into effect. Many users of WeChat have asked Tencent to promise to commit to 'no charge' for the WeChat app permanently.

### **3.4 Government**

China Mobile and other mobile carriers have been in communication with the Ministry of Industry and Information Technology of China (MIIT) to look into ways to charge for applications. If the MIIT complies with the telecommunications companies and implements new fees, it is likely that another free service will take over WeChat's place in no time. In the meantime, the dispute raises many questions for businesses in China. Will the government hamper new business at the expense of innovation to comply with requests from established corporations? How much control can the government wield over new services, and is it feasible and appropriate for the government to regulate new threats?

## **4 QUESTIONS FOR DISCUSSION:**

Q1: What is the best strategy for China Mobile, Tencent and MIIT to resolve the dispute?

Q2: What is your opinion on the principle of Network Neutrality<sup>1</sup> with regard to the conflicting perspectives of the Telecom operator and mobile application providers? Are you supportive or unsupportive of the principle?

## **ACKNOWLEDGMENT**

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<sup>1</sup> Network neutrality is defined by Wikipedia as "the principle that Internet service providers and governments should treat all data on the Internet equally, not discriminating or charging differentially by user, content, site, platform, application, type of attached equipment, and modes of communication."

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