January 13, 2015 6:05 am

China’s tech winners set to consolidate

Henny Sender Author alerts

Dominance of a few players means playing field is not level

Just before the end of last year, Beijing-based Xiaomi raised more than $1bn in its latest round of financing, bringing its valuation to $45bn.

Xiaomi is usually described as a smartphone maker, which indeed it is, as well as being the largest player in China’s huge domestic market. But it is much more than just another hardware company that may soon marginalise Samsung (for example), just as Samsung and others sidelined Sony. Xiaomi has global ambitions and will increasingly pose a challenge.

“Lei Jun [Xiaomi’s founder] has no intention of making money on hardware,” says Richard Ji, founder of hedge fund All Stars Investment in Hong Kong. Mr Ji led Xiaomi’s latest financing and has known Mr Lei for many years. “It is just a customer acquisition channel. It is all about software and internet services. There is a full ecosystem in which hundreds of companies will use the Xiaomi platform.”

Just after the new year, no less a figure than Li Keqiang, China’s premier, presided over the opening in Shenzhen of WeBank, the first online bank in China, partly owned by Tencent Holdings, another of China’s leading internet companies. It was a powerful reminder that Beijing blesses the efforts of these technology companies to take on the most entrenched and powerful state-owned companies.

Tencent has already destroyed the texting business of China Mobile; now it is challenging the banks, whose “serve the people” slogan does not necessarily extend to their customers or the small- and medium-sized enterprises of China.

Chinese tech and internet companies have come a long way. They now have a combined market value of more than $500bn. A full 80 per cent of that market cap comes from China’s three internet behemoths — Baidu, Alibaba and Tencent.

The Credit Suisse China Internet index was up 20 per cent in 2014 (after rising 100 per cent the year before), while the big three players together rose 31 per cent. Without them, the index would have been down 5 per cent. Moreover, the big three accounted for 90 per cent of the value of all mergers and acquisitions in the space, making such deals “the game of cash-rich giants”, according to a Credit Suisse report.

It has not taken long for the incumbents to solidify their position. The pace of change from challenger to incumbent is lightning fast. “The bar to entry is becoming higher and higher,” adds Mr Ji. “Once you get to 100m users, there is a powerful network effect.”

Indeed, when one investment firm looked at Alibaba, it had 70 per cent of the ecommerce market. Part of the question mark over Alibaba’s future previously was how dramatically that market share would shrink over time. Instead, though, it rose.

“We did not appreciate how important size and scale are,” this investor concludes.

That dominance of a few players means the playing field is not level and will help those with the right connections while making success more difficult for start-ups without such connections. Stock selection — and connections — will become more critical as the giants solidify their hold on the market.

China may not have a Silicon Valley, but it now has an impressive infrastructure for start-ups, enabling them to attract both capital and advice at every stage of their development, whether from investors or the founders of China’s tech giants. In addition, the entrepreneurs who build these companies are now seasoned and strategic.

In coming months investors can expect to see a host of other Chinese tech companies following Alibaba to the public markets. For example, one that will probably list this year is Meituan, which has backing from deep pocketed investors including Alibaba, General Atlantic and Sequoia and offers deals on entertainment, hotels and restaurants for its 100m users.

Today, there are many signs of froth in the market. Price levels for the latest financing rounds are dauntingly aggressive and there is little time for due diligence before signing up to invest. It may be too soon to suggest that the biggest money in Chinese internet companies has been made but not too soon to note that when insiders — like elephants — joust, it is the outsiders (or the mice) that get trampled.

henny.sender@ft.com

RELATED TOPICS China, Mergers & Acquisitions