

## INDUSTRY OVERVIEW

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### ECONOMIC GROWTH IN CHINA

Over the past several decades, globalization of trade, economic growth among developing nations and improvements in technology, infrastructure and communications have significantly expanded the global economy. In particular, China's economy has demonstrated strong growth and has become one of the largest economies in the world. Based on information published by the National Bureau of Statistics of China, or the PRC Statistics Bureau, the PRC's gross domestic product, or GDP, grew at a compound annual growth rate of 14.9% between 2002 and 2006, reaching RMB20,941 billion in 2006, making China the fourth largest economy in the world. The table below sets forth GDP and GDP per capita in China for the years indicated:

	Year					Compound annual growth rate (2002-2006)
	2002	2003	2004	2005	2006	
GDP (in billions of RMB) . . . . .	12,033	13,582	15,988	18,308	20,941	14.9%
GDP per capita (in RMB) . . . . .	9,398	10,542	12,336	14,040	15,973	14.2%

Source: PRC Statistics Bureau

According to the Economist Intelligence Unit, or EIU, China had a population of 1.3 billion and an available workforce of 798 million as of December 31, 2006. The large population of available workers together with the relatively low cost of living makes China a cost-effective manufacturing base. This has been one of the major driving forces for the rapid growth of China's manufacturing sector, which in turn has fueled China's rapid export growth. China's export growth has significantly outpaced its GDP growth. According to the PRC Statistics Bureau, the PRC export volume increased at a compound annual growth rate of 30.3% between 2002 and 2006, reaching RMB7,759 billion in 2006. The EIU further projects that China's export volume will increase to RMB17,447 billion by 2011.

Economic growth in China has increased the disposable income of Chinese citizens, and has generated increased consumer demand for goods and services. Growth in demand among Chinese consumers has also resulted in increasing imports into China. As a result, the domestic market in China presents significant opportunities for both Chinese and foreign companies.

The following tables set forth certain data relating to China's actual and projected export volume and domestic consumption for the years indicated:

	Year					Compound annual growth rate (2002-2006)
	2002	2003	2004	2005	2006	
	(in billions of RMB)					
Export volume . . . . .	2,695	3,629	4,910	6,265	7,759	30.3%
Domestic consumption . . . . .	7,169	7,745	8,703	9,692	11,032	11.4%

Source: PRC Statistics Bureau

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	Year					Compound annual growth rate (2007P-2011P)
	2007P	2008P	2009P	2010P	2011P	
	(in billions of RMB)					
Export volume .....	9,864	11,483	13,313	15,291	17,447	15.3%
Domestic consumption .....	12,052	13,488	15,123	16,925	18,914	11.9%

Source: EIU

### SMEs IN CHINA

Small and medium enterprises, or SMEs, have been one of the key driving forces for China's economic growth. According to the PRC Statistics Bureau, in 2004, SMEs and other private sector companies in China contributed approximately 58% of China's GDP and 48% of China's tax revenue and employed over 75% of the available workforce in urban areas. According to the PRC National Development and Reform Commission, there were over 42 million SMEs and other private sector companies in China as of October 31, 2006.

In 2002, the PRC government promulgated the Small and Medium Enterprises Promotion Law to encourage and promote the development of SMEs. Under this law and the regulations promulgated thereunder, SME status is determined according to certain criteria, such as the number of employees, annual revenue and total assets, with industry-specific thresholds for each criterion. With the increasing economic liberalization in China, SMEs have generally gained greater access to capital in recent years, including loans from commercial banks in China. In addition, the PRC Enterprise Income Tax Law that will take effect on January 1, 2008 establishes a unified Enterprise Income Tax rate of 25% on all enterprises incorporated in China, including domestic and foreign-invested enterprises. This will reduce the tax burden for many domestic SMEs subject to a 33% income tax rate under the existing PRC tax law.

### Import and Export Trade

SMEs are a significant driver of China's export economy. According to the PRC Statistics Bureau, SMEs and other private sector companies in China contributed approximately 68% of China's total import and export volume in 2004. Following China's accession to the WTO in December 2001, the PRC government has relaxed the approval requirements for export licenses, thereby enabling many SMEs to export directly to international markets. iResearch, a China-based market research company, has estimated that over 2.6 million SMEs in China directly, or indirectly through third-party agencies, were engaged in import and export trade in 2006 and that the number of such SMEs would increase to 5.8 million by 2012. iResearch has further projected that the total import and export trade volume of SMEs in China will increase from approximately RMB8,018 billion in 2006 to approximately RMB24,455 billion by 2012. The following tables set forth certain estimated historical and projected data relating to SME's import and export trade volume for the years indicated:

	Year					Compound annual growth rate (2002E-2006E)
	2002E	2003E	2004E	2005E	2006E	
SMEs engaging in import and export trade (in millions) <sup>(1)</sup> .....	1.3	1.6	1.9	2.2	2.6	18.8%
Import and export trade volume (in billions of RMB) <sup>(2)</sup> .....	2,388	3,417	4,982	6,327	8,018	35.4%

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	Year						Compound annual growth rate (2007P-2012P)
	2007P	2008P	2009P	2010P	2011P	2012P	
SMEs engaging in import and export trade (in millions) <sup>(1)</sup> . . . . .	3.0	3.5	4.0	4.5	5.2	5.8	14.0%
Import and export trade volume (in billions of RMB) <sup>(2)</sup> . . . . .	10,021	12,218	14,645	17,597	20,828	24,455	19.5%

**Notes:**

(1) Includes SMEs in China that directly, or indirectly through third-party agencies, engage in import and export trade.

(2) Includes import and export trade volumes of SMEs in China.

Source: iResearch China SME B2B EC Research Report (2007)

## Domestic Trade

SMEs also play a significant role in China's domestic economy. According to the PRC Statistics Bureau, products manufactured by SMEs accounted for 58.9% of domestic sales in 2004. iResearch projects that the domestic trade volume generated by SMEs in China will increase from approximately RMB3,569 billion in 2006 to approximately RMB8,152 billion by 2012. The following tables set forth the estimated historical and projected data relating to SME domestic trade volume for the years indicated:

	Year					Compound annual growth rate (2002E-2006E)
	2002E	2003E	2004E	2005E	2006E	
	(in billions of RMB)					
Domestic trade volume <sup>(1)</sup> . . . . .	1,729	2,231	2,683	3,116	3,569	19.9%

	Year						Compound annual growth rate (2007P-2012P)
	2007P	2008P	2009P	2010P	2011P	2012P	
	(in billions of RMB)						
Domestic trade volume <sup>(1)</sup> . . . . .	4,093	4,751	5,555	6,345	7,129	8,152	14.8%

**Note:**

(1) Consists of the domestic B2B trade volume among SMEs in China.

Source: iResearch China SME B2B EC Research Report (2007)

## THE RISE OF THE INTERNET IN CHINA

The Internet has become a powerful medium for content, communication and commerce in China and globally, and the number of Internet users in China has grown rapidly in recent years. According to China Internet Network Information Center, or CNNIC, the number of Internet users in China grew from 59.1 million in 2002 to 137.0 million in 2006, representing a compound annual growth rate of 23.4%. During the same period, the Internet penetration rate in China increased from 4.6% to 10.5%. With the second largest Internet market in the world in terms of number of users, Internet penetration in China is still low compared to developed countries such as the United States and Japan. According to Pyramid Research, a U.S.-based research and consulting company, Internet penetration rates in the United States and Japan were 69.4% and 44.9% in 2006, respectively.

The continuing development of Internet services, reduction in Internet access costs and lower computer prices are expected to further drive the increase in the number of Internet users in China. In particular, the growth in China's Internet market is expected to be further fueled by the growth in broadband access. According to CNNIC, the number of broadband users in China grew at a

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compound annual growth rate of 92.5% between 2002 and 2006, reaching approximately 66% of the Internet users in 2006. Broadband access offers Internet users significantly faster access speed and the convenience of having an “always-on” network connection, which together facilitate greater usage of the Internet for e-commerce activities.

The following table sets forth certain data relating to Internet and broadband users and penetration rates in China for the years indicated.

	Year					Compound annual growth rate (2002-2006)
	2002	2003	2004	2005	2006	
Internet users (in millions) . . . . .	59.1	79.5	94.0	111.0	137.0	23.4%
Internet penetration . . . . .	4.6%	6.2%	7.2%	8.5%	10.5%	—
Broadband users (in millions) . . . . .	6.6	17.4	42.8	64.3	90.7	92.5%
Broadband penetration of Internet users . . . . .	11.2%	21.9%	45.5%	57.9%	66.2%	—

Source: CNNIC

### GROWTH IN B2B E-COMMERCE FOR SMEs IN CHINA

SMEs in China generally face a number of key challenges in the traditional trade environment, including:

- limited geographic presence which restricts their ability to develop customer and supplier relationships beyond their local markets;
- fragmentation of suppliers and buyers which makes it difficult to find and communicate with suitable trading partners;
- limited communication channels and information sources to market and promote their products and services or to find new markets or suppliers;
- relatively small scale of operations which limits their resources for sales and marketing; and
- absence of efficient mechanisms for evaluating the trustworthiness of trading partners.

These challenges present significant opportunities for online B2B marketplaces that offer a cost-effective medium to bring suppliers and buyers together. In particular, online B2B marketplaces offer the following advantages compared to traditional marketing and trading channels such as classified advertisements, outdoor advertising, trade catalogs, trade magazines, trade shows and physical wholesale markets:

- global reach through the Internet which removes geographical barriers for suppliers and buyers around the world;
- ability to connect suppliers and buyers and enable them to find and communicate with suitable trading partners online;
- easy and interactive access to organized information about suppliers and their products and services, which enables buyers to conduct their sourcing more efficiently;
- year-round availability which allows suppliers to display and update their information on the Internet 24 hours a day, seven days a week;

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- low-cost medium for displaying and disseminating information and connecting suppliers and buyers directly; and
- authentication mechanisms and user-generated trust rating systems which assist suppliers and buyers in checking the trustworthiness of their potential partners.

### Increasing Usage of Online B2B Marketplaces

As the Internet continues to gain acceptance in China, the number of SMEs using the Internet to conduct B2B e-commerce has also continued to increase significantly. As SMEs in China generally have limited information technology resources and experience in establishing and maintaining an online presence, they often rely on e-commerce services provided by third-party service providers. The PRC government has also recognized the importance of e-commerce to Chinese enterprises. Under the “11th Five-Year Planning for the Development of E-Commerce” released by the National Development and Reform Commission and the Informatization Office under the State Council in June 2007, one of the primary initiatives for the development of e-commerce in China is to encourage SMEs to use third-party e-commerce platforms.

An increasing number of SMEs subscribe to B2B online marketplaces or other e-commerce platforms operated by third parties. According to iResearch, the number of SMEs that pay for the usage of third-party B2B platforms has increased from approximately 20,000 in 2002 to 350,000 in 2006 and is projected to reach 1.6 million by 2012. The following tables set forth estimated historical and projected data relating to SMEs using and paying for the usage of third-party B2B e-commerce platforms for the years indicated.

	Year					Compound annual growth rate (2002E-2006E)
	2002E	2003E	2004E	2005E	2006E	
SMEs using third-party B2B platform (in millions) . . . . .	1.0	1.6	3.1	5.4	8.8	72.7%
SMEs using third-party B2B platform as percentage of total SMEs in China . . . . .	4.5%	7.0%	12.0%	19.0%	28.0%	—
SMEs paying for usage of third-party B2B platforms (in millions) . . . . .	0.02	0.04	0.09	0.18	0.35	120.3%

	Year						Compound annual growth rate (2007P-2012P)
	2007P	2008P	2009P	2010P	2011P	2012P	
SMEs using third-party B2B platform (in millions) . . . . .	11.7	16.0	22.0	30.6	36.3	41.0	28.5%
SMEs using third-party B2B platform as percentage of total SMEs in China . . . . .	34.0%	42.9%	54.6%	70.5%	78.0%	82.0%	—
SMEs paying for usage of third-party B2B platforms (in millions) . . . . .	0.52	0.70	0.89	1.09	1.30	1.55	24.3%

Source: iResearch China SME B2B EC Research Report (2007)

### Increasing Online Marketing Budgets

The growing usage of the Internet for e-commerce activities among SMEs in China has led to, and is expected to further drive, significant increases in their online marketing budgets. Forms of online marketing activities include Internet banner and other online graphic advertisements, product and storefront listings on online marketplaces and paid search. According to a recent survey conducted by iResearch, online marketing budgets as a percentage of the total marketing budgets of SMEs in China have increased from 2.1% in 2002 to 10.8% in 2006, and are projected to further

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increase to 20.4% by 2012. The table below sets forth estimated historical and projected data relating to the online and offline marketing budgets of SMEs in China for the years indicated.

	Year		
	2002E	2006E	2012P
Marketing budget as percentage of total marketing budget:			
Online marketing budget as percentage of total marketing budget . . . . .	2.1%	10.8%	20.4%
Offline marketing budget as percentage of total marketing budget . . . . .	97.9%	89.2%	79.6%

Source: iResearch China SME B2B EC Research Report (2007)

In addition, iResearch's survey indicates that the majority of these online marketing budgets is expected to be spent on online B2B platforms, such as online B2B marketplaces, operated by third-party service providers. The following table sets forth estimated historical and projected breakdowns of the online marketing budgets of SMEs in China for the years indicated.

	Year		
	2002E	2006E	2012P
Third-party B2B platforms . . . . .	26.0%	55.5%	57.2%
Self-maintained websites and other online marketing services . . . . .	62.0	20.7	12.5
Search engines . . . . .	12.0	23.8	30.3
Total online marketing budget . . . . .	100.0%	100.0%	100.0%

Source: iResearch China SME B2B EC Research Report (2007)