CHINA: From Emulation to Innovation

"In the next five years, there will be more innovation, more invention, more entrepreneurship happening in China, happening in Beijing, than in Silicon Valley. We gotta play our A-game in order to compete with the best."[1]

Travis Kalanick, former CEO, Uber (in 2015)

(4671 words)

Everyone talks about Uber, but few talk about Didi Chuxing, China's transportation-logistics superstar. That's an understandable mistake, because until recently Didi only operated in China. But it's worth expanding our collective radar screen to take in Didi along with Uber. In terms of valuation, both companies are in the top one-tenth of one percent of 100,000 startup companies on startup planet.

Although Didi operates only in China, it is investing and partnering to move outside of China. It has built an alliance with Uber rival, Lyft (and invested $100 million), Ola (India), Taxify (Europe), and Grab (formerly GrabTaxi) in Malaysia, Singapore and The Philippines. An Indian Ola user can use the same app in Singapore to hail a Grab taxi – or vice versa—and a Chinese Didi user can use the same app to grab a Lyft in the U.S. This emerging global alliance helps Didi cover a market area of 3 billion people, stretching from Northwest India to Southeast Asia, home to 20 of the world's 40 megacities. When megacities start looking for partners to help

[1] http://www.bloomberg.com/news/articles/2016-01-18/china-hits-record-37-billion-in-vc-deals-in-challenge-to-u-s--ijkim2fs

solve three of their top hassles—smog, traffic, and transportation supply gaps—Didi is better positioned to solve those problems than any other transportation network manager in the world.

Didi is one of the Chinese blockbusters, now valued north of $60B, along with Baidu ($75B), Alibaba ($421B), and Tencent ($400B), JD.com ($56B), Xiaomi ($50B), Lufax, and Meituan-Dianping. In 2014 China only had eight unicorns, now it has 56 (Europe has 23, the U.S. has 107). And the pipeline is full of up-and-comers like Toutiao (an AI-powered news-and-information, mobile-app company that recently raised $2 billion at a valuation of $20B), and Mobike (China's leading bike-sharing platform), which raised a $215 million Series D in 2017).

Last November, Alibaba's Single's Day Shopping Festival recorded $14 billion worth of sales in the first 24 hours. The closest thing in the U.S. is Black Friday, which has never generated even $5 billion in sales. Alibaba moves more merchandise than Amazon and Walmart combined. In 2013, China accounted for 35% of the world's total online shopping. By 2018, China's spending is expected to exceed that of the rest of the world combined.[2]

China has always had huge state-owned companies, but the emergence of massive revenue-generating private businesses is a relatively recent phenomenon. Only in the last 15 years or so has China developed a powerful startup culture of private enterprises. Just as the U.S. has the PayPal Mafia that emerged from the ashes of the dot-com crash in 2001 (see Chapter 2), China has Baidu, Alibaba and Tencent (BAT), all of which started operations in the late 1990s roughly at the same time as PayPal. They have bought and spun off businesses, and invested in multiple others. BAT has now morphed into the "Alibaba Cabal," which includes Didi Chuxing, and Xiaomi (as Baidu slips a bit). Collectively, these highly valued, cash-rich powerhouses are pouring hundreds of millions of dollars into startups in China and around the world (see

[2] https://earlyinvesting.com/china-booming-startup-culture/

"Recent BAT Investments" at end of article). After decades of Communist rule and large state-owned albatrosses, this is a magical world of Quantum particles replacing Newtonian mass.

Silicon Valley, whose roots stretch back to the semiconductor industry in the 1950s, is still the #1 startup ecosystem in the world, a magnet for VCs and entrepreneurs from around the world. But its antipodes—the Chinese axis of tier 1 cities Beijing, Shanghai, Shenzen, Guangzhou, and Hangzhou—is fast becoming a serious competitor. The Chinese startup phenomenon that began slowly in the early 1990s is now a highly active market with 3,683 early-stage investments totaling $20.2 billion in 2016. It's hard to believe that roughly 20 years after China first allowed domestic venture-capital firms, it has become the world's second-largest breeding ground of unicorns and blockbusters.

The main difference between the two powerhouse ecosystems is that Silicon Valley creates companies with global reach, while the Chinese ecosystem to date has created Chinese-centric companies. Geographically, the Chinese ecosystem is also much larger, covering cities in both the north and south of China, compared to Silicon Valley's San Jose-San Francisco region. But, with government protection and the general difficulties Western firms encounter doing business in China, Chinese companies have grown to such scale they are now expanding globally and spawning multiple spinoffs.

The Chinese startup system is the economic Sputnik of today. Just as Russia's satellite launch in 1957 sparked an all-out U.S. focus on space, China's emergence as a potentially bigger and more far-reaching startup ecosystem, with a ferocious investment agenda, should force U.S. and other policy makers in Europe and India to double down on efforts to kindle and re-kindle entrepreneurship, as Mayor Bloomberg successfully did in New York. On the one hand, there is room in the world and a need for multiple, powerful ecosystems, and investment shouldn't be a zero-sum game. On the other hand, money tends to follow money, and if the Chinese overtake Silicon Valley, the money would likely flow to the victors.

ROOTS OF THE CHINESE MIRACLE

What system (Chinese) led to the emergence of this global economic force? It wasn't Adam Smith's "invisible hand," although that is becoming more of a factor today, but a multi-decade series of reforms started by Premier Deng that turned a Communist economy into a quasi-protected capitalist economy with an emphasis on creating companies large enough to compete with the West (and Korea and Japan).

Economic reforms introducing market principles began in 1978 and were carried out in two stages. During the first stage, the so-called Open Door Policy opened up China to the outside world—foreign investment, foreign travel, and integration with the World Bank and other multilateral organizations. Between 1978 and 1984, 40,000 Chinese scholars travelled to Japan or the West to study. At the same time, the government "decollectivized" agriculture, allowing farmers to plant what they wanted and where, sell excess crops for profit, and even give up farming to migrate to cities. Private and corporate capital accumulation was allowed.

During the second stage of reform, in the late 1980s and 1990s, China privatized or liquidated numerous state-owned companies, and lifted price controls and protectionist policies. In 1992, the Shanghai Stock Exchange, closed 40 years earlier by Chairman Mao, reopened. Between 2001 and 2004, the number of state-owned enterprises decreased by 48 percent. By 2005, 70 percent of China's GDP came from private companies.

In addition to the general liberalization and focus on private-capital accumulation, the Chinese government instituted two programs that together jumpstarted economic development, particularly new private companies in the areas of science and technology: Special Economic Zones (SEZs) and the Ministry of Science and Technology's TORCH program.

SEZs

In the early 1980s, four Special Economic Zones (SEZs) offered tax inducements to attract foreign investment, primarily from overseas Chinese. The zones were near the coast with

access to container ports, designed to develop export trading (following the Japanese post-war model). Shenzen, the first SEZ, was a town of 30,000 in 1979; today, it is a city of 18 million, home to the Shenzen Stock Exchange, one of the largest container ports in the worlds, and now a global leader in hardware innovation.

In 1984, another 14 coastal cities were selected as SEZs. By 1985, their value had become so clear that the initial SEZs were expanded to the Yangtze River Delta, the Pearl River Delta, and the Min River Delta. In time, the Pearl River Delta would become the world's most important manufacturing cluster. By the late 1980s, to counteract a substantial migration of labor from interior to coastal provinces, six Yangtze River ports and 11 border cities were granted SEZ status, although development was limited in interior provinces until the 2000s.[3]

As the concept took hold, provincial governments, municipalities and counties started to develop and promote their own development zones. By 2005, there were 210 national development zones and 1,346 provincial development zones! All were within reach of global ports and airports.

TORCH

In 1988, the Ministry of Science and Technology created the TORCH Program to "develop high technology and realize its industrialization" and promote the "globalization of high-tech industries." TORCH has since created over 150 high-tech zones across China and become the engine of innovation, urbanization, and economic growth.

The statistics are staggering. TORCH is responsible for over 11% of China's entire GDP, more than 10% of the country's total industrial value and close to 16% of China's total foreign exports. Torch Parks have become engines of economic growth in their local communities, typically accounting for a third of the total industrial value of their host cities and often more

[3] https://people.hofstra.edu/geotrans/eng/ch5en/conc5en/China_SEZ.html

than 20% of the local GDP. The Torch Program has seeded many of the names that people associate with Chinese innovation, entrepreneurship, and quality—such as Alibaba, Baidu, Lenovo, Huawei, and SunTech Power.

Steve Blank, author of *The Startup Owner's Manual*: "In size, scale and commercial results, the TORCH program is the most successful entrepreneurial program in the world. Of all the Chinese government programs, the TORCH Program is the one program that kick-started Chinese high-tech innovation and startups. Of all the Chinese innovation programs, TORCH is the one that was run like a startup—iterating and pivoting as it learned and discovered. This enabled TORCH to evolve with China's growing global economy."[4]

TORCH has four major parts: (1) Innovation Clusters, (2) Technology Business Incubators (TBIs), which are supported by (3) Seed Funding (Innofund) and (4) Venture Guiding Fund. In 2007, the Ministries of Science and Finance raised the stakes to get VC's focused on funneling more money into startups. The Government Guiding Fund invests government money directly into VC funds, co-invests with VC's, and covers some VC bets.

4 WAVES OF STARTUPS

The liberalization reforms, along with the SEZs and the TORCH Program, sparked a startup culture. The first wave of startups in the early and mid 1990s were generally created by Chinese studying overseas who had been exposed to the internet. Sohu.com, for example, was started by an MIT grad who got angel funding from MIT's Nicholas Negroponte. Sohu, along with Sina and Netease, all had NASDAQ IPOs before the dot-com crash. Funding for most startups came from Chinese angel investors, along with seed capital from R&D centers and universities for spin-outs or spin-offs.

Science and Technology Industrial Parks were the third source of support for new ventures. Inside the zones were Torch Technology Business Incubators with startups licensed by the local

[4] https://steveblank.com/2013/04/12/the-rise-of-chinese-venture-capital/

governments. These local governments financially supported the startups because the new ventures were seen as contributing to local economic development. This helped the startups qualify for funding from banks and, later, venture-capital firms.

The second round of startups in the late 1990s was led by Chinese nationals, such as Jack Ma (Alibaba) and Pony Ma (Tencent), now affectionately known in China as the "two horses." Other firms from that era include Baidu, SunTech, and renren.com. Again, they were initially supported by angel investments, often from family and friends. These firms tended to emulate Western firms such as Google, Amazon, and Facebook, but focused on mobile users rather than internet, and on local customization.

The third round of startups from the early 2000's on were companies looking to connect to the networks established by Alibaba, Tencent, JD. Com and others, or to emulate larger Western or Korean firms. Didi Chuxing, a merger of two firms that bought out Uber China in 2016, started in 2011 as a clone of Uber. Smartphone maker Xiaomi, now valued at $50B, started in 2011, as a clone of Apple and Samsung. Alibaba's finance arm, Ant Financial, although founded in 2004 as Alipay, was renamed in 2014 as a spinoff firm, and is now one of the most influential players in China's fintech scene, recording 1 billion transactions in one day in 2016. Now valued at $60B, it is looking at an IPO. Toutiao (Headlines Today) is a news reading app that analyzes data from users' social networking accounts and individual reading habits to provide customized information. Founded in 2012, it is now valued at $20B.

The fourth, and current round, of startups is moving beyond emulation and chasing innovation—in AI, virtual reality, facial recognition, biotech, electric engines, and drones. Shenzen's DJI (Dajiang) Innovations, for example, controls 70% of the global drone market; Biotech firm Zai Lab went public on NASDAQ in 2017, raising $150mm; NIO, formerly known as NextEV, manufacturers smart, electronic, and autonomous vehicles (valued at $2.9B). Top AI companies include Face++ (facial-recognition technology used by Alibaba), Toutiao.com (AI-

powered news app with over 700 million users), and iCarbonX (big-data platform that's creating a "Digital You" to predict illness).

Just as the previous wave of startups depended on capital and networks from BAT, today's startups have an even richer capital base. Call it BAT-plus, or the Alibaba Cabal. Mobike counts Tencent among its investors, for example, whereas Ofo is backed by Chinese unicorn Xiaomi and ride-hailing startup Didi Chuxing. As has always been the case, most successful software startups (like Didi and Toutiao) are from Beijing or otherwise in the north, while hardware startups (like DJI) and JMGO (micro projectors) are from Shenzhen in the south. Northern firms are flashier and faster and go for high-profile, big-story concepts, while southern firms move more slowly with lower-margin businesses to build operational excellence before breaking out.

Recent Major Investments

US		ASIA	
TENCENT			
4 clean-tech firms	$1.9B	Didi Chuxing	$6B round
Tesla	$1.7B	China Internet Plus	$3.3B round
NIO	$600M	Flipkart	$1.4B round
Epic Games	$400M	Liangia	$926M round
Riot Games	$400M	Mobike	$600M lead
Essential	$300M	WePiao	$464M
iCarbonX	$155M lead	VIPKID	$200M lead
Fab	$150M lead	Hao Daifu	$200M
Snapchat	$60M round	Hike	$175M lead
WhisperText	$36M	Huochebang	$156M
ALIBABA			
Lyft	$1B round	One97 Communication	$2.75B lead
Magic Leap	$793M lead	Go-Jek	$2B round
Oto	$700M lead	Ele.me	$1.25B round
Tango	$214M	Kakao Pay	$1.2B round
Shoprunner	$206M	Tokopedia	$1.1B lead
Shapchat	$200M	Lazadu	$1B lead
Snap	$200M	Didi Chuxing	$945M
Jet.com	$140M round	Snapdeal	$500M lead
Kabam	$120M	Yiguo.com	$300M lead
Peel	$50M	Weibo	$135M
BAIDU			
Uber China	$2B lead	China Unicom	$1.5B
Velodyne LIDAR	$150M lead	NIO	$600M
Cloudfare	$110M	Yixin	$550M
Circle	$60M	Yinta Capital	$550M
Dynamic Yield	$31M	Womai	$220M lead
Trust Go	$30M	Uxin	$170M lead
Indoor Atlas	$10M	Mia.com	$150M lead
xPerception	undisclosed	Edaixi	$100M lead

MATURING CAPITAL MARKETS

Venture capital in China has come a long way in the last 20 years, again with a push from the government. The first VC firm was U.S.-based IDG Capital Partners, formerly IDG Technology Ventures, founded in 1993 as a China-focused firm (and early investors in Baidu and Tencent).

IDG[5] is still one of the biggest VC firms in China, with $2.5B under management, and offices in Hong Kong, Beijing, Shanghai, Guangzhou, Shenzhen, Silicon Valley, and Boston; in 2016, it launched a new $1B fund in China with Silicon Valley VC firm, Breyer Capital.

At the time, there were some government-financed venture funds, but they were not particularly robust. It wasn't until 1998 that corporate-backed, domestic VC firms were even allowed, and that started a wave of VC funds backed by government, corporate, and foreign capital.

Recently, venture investments have been on a sharp upward trajectory in China. In 2015, venture capital investors put $26 billion into Chinese startups; in 2016, $50 billion, according to *Forbes*. In 2015, the Chinese government launched its own $6.5B venture capital fund for startups. In comparison, investments in the Americas and Europe were $72 billion and $16 billion, respectively. Even more impressive, China *raised* $230 billion in venture capital in 2015.

Along with the capital infusions, the structure of the funds is changing. Local VC funds, a.k.a RMB funds, are becoming the major force with over 90% of the new funds raised in 2016 as RMB funds, compared to a mere 10% in 2005. This is an indication of the evolving attitude and understanding of venture capital, away from foreign investment toward domestic. Up to 20% of China's trillion RMB National Social Security Fund is allocated to VC/PE investment, and billions of RMB have been set aside in a Government Guiding Fund (GGF) to invest in strategic areas like Industry 4.0. [6] GGFs have primarily adopted the format of fund-of-funds, letting those

[5] Since 1992, as one of the earliest foreign investment funds to enter the Chinese market, IDG asinvested in over 200 Chinese companies, such as Ctrip, Home Inns, Baidu, Soufun, Tencent, Kingdee, China Finance Online, Sohu, Wu-Mart, EVE NY, Andon, VANCL and Hanting. IDG has successfully exited from 50 investments through M&A or IPO in the U.S., Hong Kong and China.

[6] https://aws.amazon.com/blogs/startups/demystifying-the-ecosystem-in-china/

professional investors make decisions. Top VCs like IDG, Sequoia, and Shenzhen Capital have all raised new funds with capital from the GGF.

RMB funds typically close a deal in 3-5 weeks, compared to 6-10 weeks for USD funds, because local LPs demand faster return. Lots of RMB funds are set in a 5+2 model (5-year investment period and 2-year exit period). This used to be the U.S. model, but recently exits have been delayed for years, as gushers of investment capital spike valuations. As local funds have focused on early-stage investments, it has pushed USD funds to focus more on later-stage deals. In addition, RMB funds tend to offer higher valuation, normally +10-20%, when competing with USD funds on hot deals. The fund managers prefer to build a track record with high-profile deals.

In the early days of Chinese entrepreneurship, firms looked to NASDAQ for IPOs. That is still true, but the Shanghai and Shenzen stock markets have recently been processing hundreds of IPOs per quarter.

SO BIG, SO FAST?

Tencent and Alibaba, with valuations ~$400B, are in league with Amazon and Facebook and Microsoft, although significantly less valuable than Google ($665B) and Apple ($798B). That puts Tencent and Alibaba in or near the top 10 of the most valuable companies in the world, depending on market fluctuations.

Tencent (from Shenzhen) started as an instant-messaging and gaming company, but is now a broad social-media platform. At the end of 2016, the active QQ instant-messaging accounts numbered 899 million, and its multi-modal WeChat service had 846 million users. On top of those platforms sit a range of products and services, some broad horizontals, some verticals in markets such as finance, education, and travel. In 2016, Tencent's revenue was $22B (up 48% over 2015), and profit was $6.0B (up 42% over 2015).

Alibaba ("open sesame" for small merchants and retailers) is the world's biggest e-commerce

company, as well as the world's biggest overall retailer (it surpassed Walmart in gross merchandise volume in early 2016). Its three main web portals—Taobao (C2C), Tmall (B2C) and Alibaba.com (B2B)—attract 407 million active users, and host millions of merchants and businesses. Alibaba, which handles 80% of China's e-commerce, charges merchants for advertising and transaction fees; it earns much less revenue than some of its global e-commerce peers (like JD.com), but its net income is growing rapidly, and it profit margins are in the 25% range. In fiscal 2015, it posted profits of $5.5 billion. In fiscal 2017, its net profit was $6B. In fiscal 2017, Alibaba's Gross Merchandise Volume was $547B. Its target for 2020 is $1T.

But how did so many companies get so big so fast? Baidu is valued at $80B, Xiaomi at $50B, Didi Chuxing at $60B, JD.com at $56B. One key reason, of course, is the size of the market—1.4 billion people, even though the emergence of a strong consumption-oriented middle class is fairly recent. In the U.S., 190 million people carry a smartphone; in China, it is more than 530 million today, and it will be 700 million or more in three years. At 668 million, the number of Internet users in China outnumbers the U.S. population by 2-to-1—with still plenty more room to grow.

A more important factor was government protection, which did allow some foreign investment but did not allow companies like Amazon, Facebook, Twitter, or Google to compete with Baidu, Alibaba, or Tencent. Lax intellectual property laws didn't help. Groupon, for example, launched in China in 2011 only to discover it was up against 200 clones of its service. Within months, Groupon shuttered offices in China. For Uber, the challenge was spending a $1B a year to try and keep pace with a bigger and scrappier competitor in Didi that took the Uber model and expanded it to multiple transportation modes.

But the home field advantage was also cultural. EBay was undone by Alibaba's Taobao, which offered free listings and appealed to Chinese users with little details like naming moderators after characters from famous kung fu novels. Google said it left China because of censorship cyberattacks, but it also struggled to acclimatize. It took years for Google to realize that many

Chinese couldn't pronounce its name. The company ultimately had to rebrand itself GuGe in China. Even then, many people still chose to call it GoGo.[7]

To build scale fast to compete with larger, Western firms, China also borrowed elements of Japan's keiretsu system, in which firms hold cross-ownership in other firms (as Tencent does in JD.com and Alibaba does in Didi). An even better model for Chinese firms was South Korea's mighty chaebol, far-reaching conglomerates with stronger ties to the state than Japanese firms. Firms like Hyundai, Samsung, and Daewoo transformed a poor nation into a rich nation within a generation, as they quickly built multinational clout. Unlike Japanese multinationals, such as Toyota and Sony, which were more focused, the Korean firms attacked consumer products across the board.

The peculiarities of the Chinese culture (to foreign firms), and government protections certainly abetted the rapid rise of China's massive new private companies. But they also lifted themselves with a strategic plan to build platforms, a superfast, agile approach to business, and a penchant for monetizing small transactions or small-margin transactions. While Western firms focused on the internet and global expansion, Chinese firms focused on mobile users and domestic saturation. And they didn't over-expand or over-invest in competitive markets until they were assured of strength and stability.

FROM PREMIER DENG TO ADAM SMITH?

The intense guiding hand of government that sparked a nascent startup ecosystem over several decades of reform and restructuring has created what is now a rich and self-sustaining startup ecosystem. Premier Li Keqiang frequently calls for "mass entrepreneurship." At the National People's Congress, he bragged that 12,000 new companies were founded each day in 2015.[8]

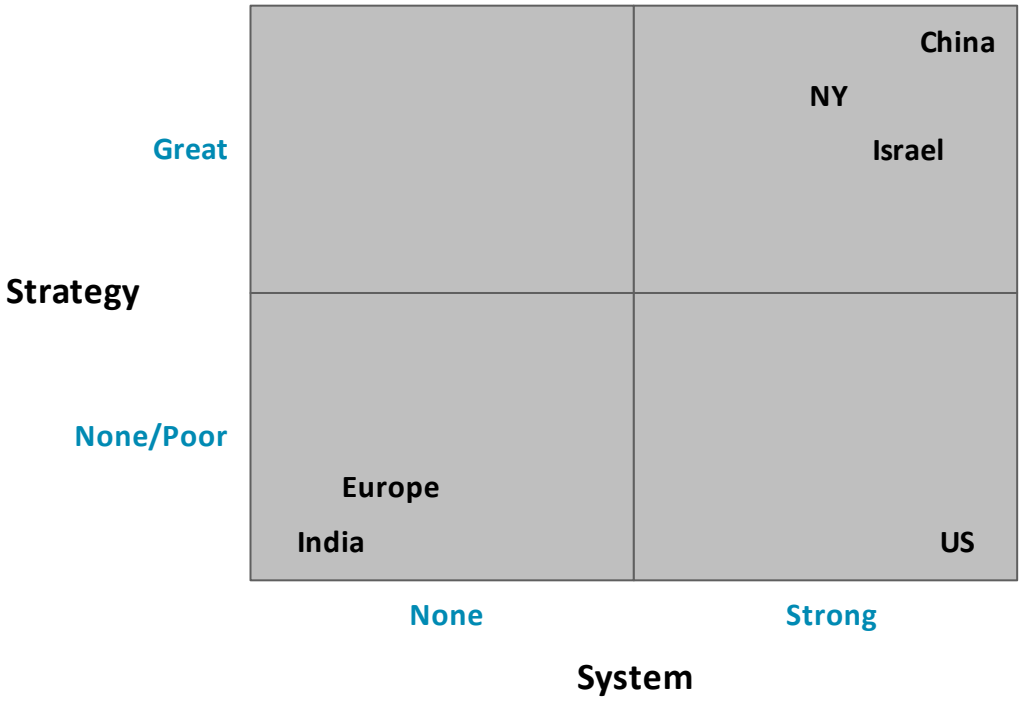
[7] LA TIMES

[8] https://www.nytimes.com/2016/09/04/business/international/venture-communism-how-china-is-building-a-start-up-boom.html?mcubz=0

The Chinese modeled their ecosystem on Silicon Valley and have made it their own. Super successes, spinoffs, proteges, mentors, networks, capital at all stages, culture, and exits—it's a classic startup ecosystem. But unlike Silicon Valley and most of the U.S., China has applied a strategy to leverage returns from the ecosystem. The U.S. has a great system that has been honed over 70 years, but is an Adam Smith, invisible=hand, free-market system. Only Israel comes close to China in terms of strategy and system (see "System and Strategy" chart).

China's combination of government strategy and market system is powerful and unique. Comparing China to India brings its strategy into sharp relief. While India has focused on low-value outsourcing, China has focused on channeling its talent into high-value startups. India IT outsourcing employment is around 3 million, with just 100,000 working in startups. The Chinese IT outsourcing industry is half the size of India's, but its startup workforce just for major companies far exceeds 500,000.

SYSTEM AND STRATEGY



In retrospect, one advantage China had as it was first developing its ecosystem in the 1990s is that it was not part of the dot-com boom or bust. A few firms did list IPOs on NASDAQ (like Alibaba), but with no venture-capital industry to speak of, China didn't see the massive over valuations that led to the crash and the decade-long investment recovery. Rather, China was building from scratch, block by block, and was essentially able to gain five years on the U.S. in the early 2000s.

China has also learned to play the Quantum game. In the 1980s, China was a Newtonian economy, with bloated state-owned and subsidized companies, thousands of factories, and millions of low-cost laborers. Thirty years later, it is a leader in the Quantum startup world—with asset-light companies, outsized CEO personalities and great company narratives, products and services that go viral over social media without heavy advertising, intense focus on customer experience, rapid product iteration and improvement, and broad platforms that

attract satellite players. And, in true Quantum fashion, the valuations are huge, and the cash flows strong—enough to create a self-sustaining Quantum economy that will continue to produce new unicorns and blockbusters.

China may have started by emulating American titans—Alibaba and Amazon, Didi and Uber, Ant Financial and Paypal—but they have improved on the original model. Alibaba moves $550B in goods, but carries no inventory. Didi started with the Uber model and has become a full-fledged transportation logistics company. Ant Financial goes beyond payments to run the world's largest money market fund and uses facial recognition for mobile payments. "When you see a good chess move," said chess champion, Emanuel Lasker, "look for a better one." In some categories, like mobile payments, transportation logistics, and bike-sharing, Chinese tech firms aren't just innovators, but innovation leaders. *Emulate. Emulate and exceed. Innovate and lead.*

What happens next? It's clear that the leaders, Tencent and Alibaba, are leading a massive surge of investment in foreign markets—in internet, mobile, healthcare, clean energy, electric cars, AI. Whether that means they establish new companies overseas, or develop technology that is re-patriated to China, remains to be seen. But they gain access to and control of new technologies. Meanwhile, the government has exported the Newtonian model to Africa and Latin America, investing heavily to build infrastructure. In exchange, China gains access to and control of commodities. And it establishes a foothold for international expansion of its Quantum businesses like Didi, which is now spreading through Southeast Asia and entering Europe via partnerships.

We may be seeing a carbon copy of the U.S. in 1880's and 1890's, the age of robber barons and monopolies. And monopolies, like old AT+T and Xerox, create tangible, Newtonian ("you can take it to the bank") cash flows that let you do big other things. In the U.S., cash flows led to Bell Labs, PARC and other basic-research stalwarts. In China, it could lead to global expansion.

The Chinese system has not been shy about mergers and consolidations, taking strong players and aggregating them into stronger ones (see "Decoding the Chinese System). Didi Chuxing was

the result of several such fusions, most recently Didi Dache and Didi Kuaidi. Meituan-Dianping results from the fusion of Meituan and Dianping. Meituan-Dianping now services 10M orders and deliveries daily.

To appreciate the economic force of these "integrations of leaders," imagine if the following fusions happened in the west:

- Uber & Lyft
- Airbnb & Booking.com
- SpaceX & Blue Origins

Several consequences would result. Profitability would rise (greater scale, competitive strength). Reinvestment power would increase. Ability to fund innovation would expand.

These are precisely the economic benefits that the leading Chinese startup combinations are achieving. And they *are* funneling these economic advantages into funding innovation. The heavy hand of government, not Adam Smith's invisible hand, created this blockbuster ecosystem. But now, the babies are massive and ready to compete internationally. Now, the capital markets are stocked and have a pipeline of candidates to fund. Now, emulation has turned into value-add and true innovation.

Sidebar

DECODING THE CHINESE SYSTEM

"In the next five years, there will be more innovation, more invention, more entrepreneurship happening in China, happening in Beijing, than in Silicon Valley. We gotta play our A-game in order to compete with the best."[9]

What did Travis Kalanick mean with this quote that opened the chapter? What was he talking about? Maybe he looked closely and saw the rules, the programming that drove the Chinese system. It can be captured in just a few lines.

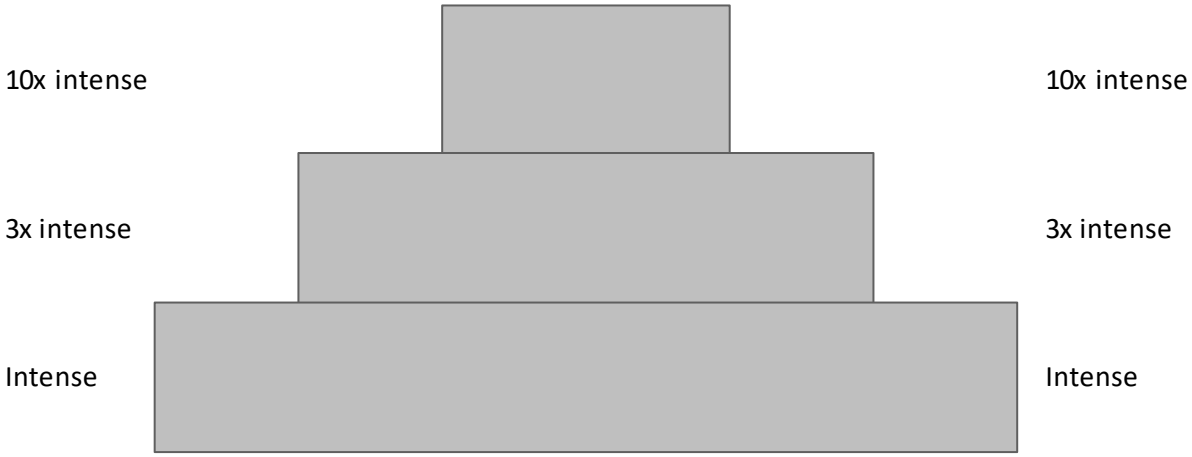
1. Copy	Never waste treasure, time, attention, or emotional energy to reinvent.
2. Swarm	If one can copy, so can 200. Let the race begin.
3. Speed	Customers won't wait, nor will investors. Move at the maximum rate possible, increasingly referenced to as "China speed."
4. Combine	Take the 2-4 strongest players from the race and unite them.
5. Leap	You've gone for the increments, now go for the leap. Not 10% better, but 100% better. Alibaba far leaner than Amazon, Didi far more complete than Uber, Ant Financial goes far beyond PayPal, Toutiao far beyond the Facebook newsfeed.

[9] http://www.bloomberg.com/news/articles/2016-01-18/china-hits-record-37-billion-in-vc-deals-in-challenge-to-u-s--ijkim2fs

Like Navy Seal training for companies, the system produces great, subtle fighters. It then combined 2-4 of the best into a team that is even more competitive. A team that knows how to fight, and how to invent. A team that redefines “competition.”

Others may have to learn that new definition.

LEVELS OF COMPETITIVE INTENSITY



The top of the pyramid will set the standard for competition and value creation in the next decade.