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Google Stays in China. And Baidu Keeps on Winning

The Chinese Internet giant has increased its share of the search business to 64 percent

By Bruce Einhorn

In early July, as Google (GOOG) executives waited for the Chinese government to renew its license to operate in the country, Baidu (BIDU) was dispatching a recruiting team to Silicon Valley. On July 10, Baidu's vice-president of engineering, Wang Jing, met dozens of applicants interested in moving to China to work for the No. 1 search engine in the world's largest Internet market. "People recognize Baidu is not just a local company," says Wang, 46. He joined Baidu in April after nearly four years with Google. "They understand our ambitions."

Baidu, which next month celebrates the fifth anniversary of its Nasdaq initial public offering, has enjoyed an 82 percent rise in its stock price this year. That compares with a 21 percent drop for Google and a 19 percent fall for Chinese portal Sina.com (SINA). Investors are rewarding Baidu for its dominance in the Chinese search market, where the company has a 64 percent share, according to Analysys International, a research firm in Beijing. That's more than double the share of second-place Google. "Baidu is willing to do whatever the government wants, to play by the rules. That's to Baidu's benefit," says Jason Helfstein, an analyst at Oppenheimer in New York. "Google is trying to do things that they think are the right thing to do, even if it has negative business implications."

Baidu's lead may grow, thanks in part to the technological convolutions Google has gone through to stay in business in China. In order to comply with Chinese law without violating its own commitment not to censor search results, Google created a landing page that appears after users in China enter a search term. When users click on a link on the new page, they get redirected to a search engine located in Hong Kong. (Chinese censorship rules don't apply in the former British colony because of Beijing's "one country, two systems" policy.) The extra steps are an inconvenience to users that will drive more people to Baidu, analysts predict. And where users go, advertisers will follow.

Google's China search engine "doesn't operate like a normal website," says Wendy Huang, an analyst in Hong Kong with RBS. "As long as Baidu keeps its core search business, companies will go to Baidu naturally." Baidu, she says, doesn't "even need to try too hard."

Baidu Chief Executive Robin Li, a State University of New York at Buffalo graduate who worked for Infoseek in the late 1990s before starting Baidu in 2000, is focusing on building the company's lead with new technology and old-fashioned marketing. Earlier this year he sent sales executives to 100 Chinese cities to meet with potential advertisers among small and midsize businesses and answer their questions about keyword advertising. The marketing push "has been quite effective in improving the brand," says Wallace Cheung, an analyst in Hong Kong with Credit Suisse (CS). He expects Baidu to earn $493 million this year, more than double its 2009 profit, on sales of $1.2 billion, 84 percent higher than last year. Li's salespeople are also busy promoting Baidu's new online sales system, called Phoenix Nest, which makes it easier for companies to buy keywords as well as related words that don't necessarily use the same Chinese characters.

Next, Li may push Baidu into new businesses. He has tried to make the company a force in social networking, with a service allowing users to get in touch with people who make similar online queries. Teaming up with U.S. private equity firm Providence Equity Partners, the company has started a venture called Qiyi, an online video site similar to Hulu. Another joint venture, an e-commerce partnership with Japanese retailer Rakuten, launched a test site in June. Baidu owns 49 percent of RakuBai, with the Japanese partner owning the rest.

Not all of Baidu's ventures have panned out. The company's first attempt to expand beyond China, a search site in Japan, has not made a significant contribution to sales. Although Baidu in January fended off a lawsuit brought by Western record companies alleging it facilitated searches for pirated MP3 downloads, legal fights haven't ended. In an Apr. 30 statement, Neil Turkewitz, executive vice-president of the Recording Industry Association of America, decried what he called "brazen and notorious theft" by Baidu, which denies any wrongdoing. The company has had embarrassing problems at home, too. In July a Chinese court ordered Baidu to apologize and pay $3,200 to a woman whose ex-boyfriend posted nude photos of her online.

Rivals aren't surrendering the market to Baidu. Hong Kong-listed Tencent operates popular online games and runs China's dominant instant-messaging service. Google, for all its woes, isn't out of the action, either: The Web giant is still the strongest site for conducting searches in English, which happens a lot in China, says Morgan Stanley (MS) analyst Richard Ji. Still, Baidu is well positioned to grow stronger. It has 220,000 advertisers, a fraction of the potential market of 40 million small and midsize businesses, according to spokesman Kaiser Kuo. "We have a lot of space ahead of us."

The bottom line: *With Google struggling in China, Baidu is thriving thanks to new products and old-fashioned marketing.*

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