Attractions of a "Walled Garden"

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The Internet sectors of China and India, the world's two most populous nations, offer a study in contrasts. Chinese Internet companies dominate in such areas as online search, games, news, e-commerce, social media, social networking and video, while domestic Indian firms are confined to market-leading positions in travel, jobs portals and e-commerce. China's Internet sector has a market capitalization of over US$250 billion, while India's is just under US$4 billion. Finally, China's Internet firms enjoy the benefits of the country's "walled garden," basically a controlled environment in which market access is tightly regulated (despite the part-ownership of large foreign companies), while India offers almost unfettered access to foreign companies.

There are several good reasons that explain why China's online sector is much larger than that of India. China's economy is more than four times bigger than India's and its populace is three times as prosperous on a per capita basis. It also has a much higher Internet penetration rate of 46%, compared to India's 19%. Different evolutionary roots for the entertainment and media sectors might have helped China's Internet segments grow. Chinese firms also have something of a linguistic buffer. Since English is widely spoken in India, and English-language content is well-accepted there, foreign content is readily portable to Indian audiences, unlike the populace in China. Still, none of these factors perhaps fully explain the sector size differential. To understand the disparity, one should really consider the varying market access frameworks.

The idea of borderless trade in goods and services is an attractive one. And very often it has proven to be the right model in Asia. Free trade has been the bedrock of Asia's prosperity for several decades now. Evidence also suggests that walled garden policies haven't always been effective. For example, India has protected its industrial sector for decades with import substitution policies that included the licensing of industrial activity and controls over foreign investment—only to abandon them as this strategy turned out to be ineffective, bureaucratic and conducive to rent-seeking behavior.* So, in theory, an open garden policy for the Internet sector should be more desirable compared to a walled garden approach.

But in purely economic terms, the Internet sector might be an exception to the rule. One reason could be the importance of the network effect—meaning the value of a product for one user depends on how many other users there are—and the scale effect. With the Internet sector's low barriers to entry, network and scale externalities that provide a competitive edge matter much more for online businesses as winner (usually) "takes all." Therefore, if domestic players are provided the necessary leeway to build scale, the competitive advantage might be more enduring.

Reduced competitive intensity tends to be a negative side effect in a protectionist environment. In China's case, a walled garden approach does not seem to have dimmed the competitive embers as the strong appetite for acquisitions among Chinese Internet companies suggests a fierce jockeying for position in an increasingly competitive market. Also, after having established a dominant position in the vast domestic market, Chinese Internet players are now focusing on expanding overseas. Will India's homegrown Internet sector ever be as dominant? Time will tell, but it might prove to be a hard task.

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*When corporations or countries use resources to obtain an economic gain elsewhere without reciprocating benefits back through wealth creation.