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Market Update

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Google toughens stance on free expression and privacy in China

Alexis Krajewski, Associate Director in the Governance & Sustainable Investment at major asset manager F&C Investments, comments on Google's announcement on that it is considering withdrawing business operations in China:

Last night, Google announced that it is considering withdrawing its business operations in China. This follows a serious security attack on the Google technology architecture from inside China including the theft of intellectual property, direct attacks on customer G-mail accounts, the targeting the email accounts of human rights activists in China, and attacks on other companies.

The announcement has had an immediate financial impact, with Google's shares falling by 1.7% during after-hours trading. Yesterday, shares of leading Chinese competitor Baidu fell 3.5% after being attacked by hackers, whilst Alibaba.com, Yahoo and Microsoft were down 2.5%, 0.36% and 0.66% respectively. However, Baidu showed signs of recovery today, partly driven by expectations that Google's retreat will open up market share in this burgeoning Internet market.

Google will no longer offer a censored version of its search engine in China, but will attempt to offer an uncensored version to its customers in China. It has already beefed up security for all G-mail account holders, reverting to an https based system which encrypts all emails.

F&C's Governance & Sustainable Investment has been engaging Google, along with other leading tech companies including Yahoo!, Microsoft, and Nokia on issues of censorship and privacy over the last three

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years. The team anticipates that Google will be unable to offer an uncensored version of Google.cn and may have limited its potential to offer other products in the market.

Should Google decide to leave China, it would be a bold principled move but one with potentially long-term ramifications: this could cut off access a very profitable growth market, particularly for its newly launched Nexus One 3G mobile phone. Furthermore, this decision raises the question of whether Google will also review operations in other markets with Internet censorship regimes and poor security.

Google has clearly raised the bar on how far US companies are prepared to tolerate censorship and security breaches in China. The question now is, will Yahoo!, Microsoft and Cisco follow step? The impact for these businesses is likely to be much greater as their exposure to China is bigger. On the flipside, IT security providers like McAfee and Nortel stand to benefit as G-mail users and others buy additional security software. Despite negative impact to business, we believe that the US Congress may push for more IT companies to follow Google's lead and consider withdrawing.

In terms of Asian competitors, the decision could bode well for domestic peers such as Baidu, Alibaba and private companies like Sina and Sohu who will also need to operate under the Chinese censorship rules. However, overall security weaknesses are also harming domestic companies and will require additional capex to bolster IT security protection."

-ENDS-

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Notes to Editors

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- F&C is an active fund manager with a multi-specialist investment model where individual teams have strong accountability for their products and processes. The group is also an active shareholder with a leading franchise in governance and sustainable investment.
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- In March 2009 F&C signed a Memorandum of Agreement with Hua Xia Bank, one of China's twelve nationwide joint stock commercial banks, to establish a joint venture fund management company in China in which F&C will have a 19.5% interest.

* As at 30 September 2009.