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GRADUATE SCHOOL
OF BUSINESS

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Twin Trajectories

Exports or domestic consumption: which will rule?

- Private Chinese firms overcome hurdles to investment in the US
 - Li-Ning pilots a turnaround—will it be enough?
 - Private airlines struggle for a place in the sun
 - James McGregor discusses China's identity

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In "The Ascent" (p. 40 Vol. 10, June 2013) Huawei was referred to as a state-owned company, though Huawei is in fact a privately owned company. The error is regretted.



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What China will Become Next

In the past 30 years, China has achieved the kind of economic development that would have taken many other countries centuries to attain. It has done so by riding on factors like cheap labor, massive demand in export markets financed by cheap credit in the US, and generous welfare programs in Europe. But it came at a cost: of damaging its own environment. Everyone knows that China's development model will, and has to, change to meet the new realities of the world, such as the decline in purchasing power in the advanced economies and slow growth in the once unstoppable emerging economies.

With a Gini Coefficient of about 0.5, will China be the next Brazil, a country that fell into the middle-income trap?

With government policies that have failed to ease the overheated housing market in the big cities and many "ghost towns" in tier-2 and tier-3 cities, will China be the next Japan that slid into a situation of the "lost 20 years" after its real estate bubble burst?

With a huge amount of local government debt accumulated in provinces and municipalities, will China be the next US that is still trying to recover from the subprime crisis and a long slow-growth era?

With the government's stranglehold over economic issues and giant state-owned enterprises, will China be the next Soviet Union which enjoyed a high economic growth rate initially because of central allocation of resources and eventually collapsed?

With rising labor costs and demands to raise the quality of Made in China products, will China become the next Germany, the only advanced economy that has enjoyed high returns from export of high-quality products?

My answer to those questions is that China will be none of the above. China has been seeking its own unique path of development. Just as China has achieved unprecedented growth in human history in the past 30 years by learning from the experiences of all the major economies and adapting them to its own domestic context, it has to find its own model of development for the next 30 years.

The Chinese economy, as you'll read in our cover story, is undergoing a readjustment of sorts. In my view, growth will be slower, but healthier. The new model of development, which will rely on more domestic consumption than exports and investment, will not only benefit China, but also the rest of the world. China will be a huge market, and no longer just a source of cheap labor for exports. China will be a new source of innovation as its investment in R&D is going to continue to grow at a pace that is higher than any other



major economy in the world. More importantly, the highest number of entrepreneurs created in the world will work with the highest number of university-educated engineers in the world to commercialize those new technologies. They will employ new business models to sell them to the largest markets in the world. Some Western experts are predicting that the ongoing and upcoming technological advances such as 3D printing will wipe out all the competitive advantages that China has. They may have neglected two important factors: one, China has invested heavily in research in those technologies and is even leading in some of them; and two, those new technologies will also be available to Chinese companies who have the resources to buy and commercialize them at

what is known as the "China speed". Please turn to page 22 for our analysis on the future of China, which will not be red like the former Soviet Union, nor will it be grey as the skies in Beijing. The future for China will be bright—and green.

Meanwhile, elsewhere in this issue, we take a look at the critical issue of labor in China, and how companies are responding to changes in labor laws as well as rising wages (page 10).

We also look at sportswear brand Li-Ning's turnaround strategy on page 44 and Alibaba's evolution and future prospects on page 48. Do not miss our stories on China's digital advertising market (page 38) and the future of private airlines in China's aviation market (page 18). In our interviews section, we bring you an exclusive interview with Philip Kotler, who literally wrote *the* book on marketing on page 57. We also bring you an interview with China expert James McGregor on the evolution of China's identity and where it's headed (page 60).

We look forward to hearing from you. Please email us on ckgsb-magazine@ckgsb.edu.cn

Yours Sincerely,

Zhou Li
Assistant Dean, CKGSB

For more insights on the Chinese economy and business, please log on to <http://knowledge.ckgsb.edu.cn/>

Package delivery drones will soon enter China's skies, Beijing's mega financial district belies slowdown fears, Chinese companies are finding friends in Frankfurt, and Xiaomi gets a big bump from Google's talent pool



Xiaomi Not so 'Xiao'

Xiaomi got a big nudge from a big player as one of Google's top Android executives, Hugo Barra, left Google for the Chinese phone maker to help it develop its international game plan. Xiaomi has been the dark horse of the China smartphone race, but its patented MIUI Android-based interface is making a splash with Chinese smartphone users, as is its pitch-perfect price point, unhorsing Apple and taking fourth place in China's smartphone market.



Packing up China Brands

Iconic US luggage maker Samsonite International is gearing up to acquire numerous Chinese and other Asian brands in an effort to diversify its product mix to the tune of \$1 billion, *The Wall Street Journal* reported. The luggage maker expects China to overtake the US as its single-biggest market in as soon as three years thanks to growth in tourism and local-brand purchases, said company CEO and chairman Tim Parker.



Yahoo! Says "Zaijian"

Yahoo! has finally shut down its China web portal, leaving behind only a goodbye message on its web page directing viewers to now.taobao.com. This marks the last of Yahoo!'s slow China exit as part of Alibaba Group's decision to gradually take down the Yahoo!-branded services it operates. But globally Yahoo!, like many after a breakup, has undergone a makeover with the launch of a revamped logo favoring a sans-serif font and a deeper hue of purple.



Gift From the Heavens

Shenzhen-headquartered delivery company SF Express has begun testing delivery drones, self-powered flying machines that can deliver packages to remote areas. *South China Morning Post* reports that the drones are "outfitted with eight propellers, comes complete with a space where packages can be inserted and can reach a flight altitude of about 100 meters". The eventual use of drones could save SF Express money in fuel costs and hourly wages.

htc Ups its China Game

Taiwan-based HTC is vying for Chinese consumers with the development of a China-specific mobile-software system in a bold move to help revive sliding sales, *The Wall Street Journal* reported. The new operating system—set to debut by end of the year—involves close integration with Chinese apps like microblog Weibo, according to HTC Chairperson Cher Wang.

Slowdown Schmowdown!

A Chinese government-owned investment company is backing a 20-year long project, giving economic naysayers the bird. If completed as planned, the Lize Financial District on the southern outskirts of Beijing would provide between 8 million and 9.5 million square meters of new floor space, almost doubling the Chinese capital's current stock of high-grade offices. The zone would be larger than London's Square Mile and Manhattan's financial district combined, *The Wall Street Journal* reported.

Ali-Insurance?

It seems like Chinese e-commerce giant Alibaba is trying its hand at everything lately, and now it wants in on life insurance action as well, *Caixin* reported. China Life Insurance signed an agreement with Alibaba to sell insurance policies through Alibaba's platform. The insurance company also considered setting up a wholly-owned subsidiary by the end of the year to explore online marketing channels.

Moutai in Trouble?

It may be time to sober up for China's most renowned liquor maker as shares of Kweichow Moutai suffered their steepest drop in seven years in August on lackluster profits and government crackdown on lavish spending and official banquets. The company's first-half net income rose 3.6% to RMB 7.25 billion (\$1.2 billion), according to a company statement, well wide of the expected 10% growth mark. Gulp.

Frankfurt Says Willkommen

Chinese companies are trading hot dogs for bratwurst with a total of 22 China-based issuers having listed on the Deutsche Börse in Frankfurt last year. In the past two years, Chinese issuers have outnumbered all other foreign nationalities' listings in Frankfurt, according to Dealogic. Deutsche Börse has welcomed Chinese companies, offering lower listing fees, easier qualification requirements and a quick IPO process.



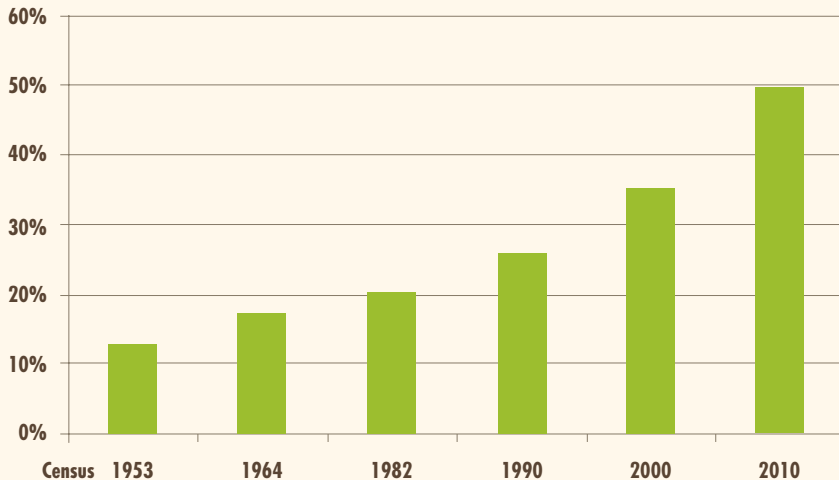
China's Urban Layers

China has hit a major milestone this year in its quest to become an urbanized nation. For the first time in China's history, more than half of its population are now considered "urban residents". Urbanization in the Chinese context has been most widely equated with the phenomenon of rural China dwellers migrating to China's first-tier coastal cities. But urbanization has come to mean much more than that as policy makers are determined to convert large swaths of China's rural landscape into urban communities. Here is a picture of the different stages of China's urbanization saga, broadening the classic definition of the word.

Rise of the City Slickers

China's urban population as a % of total population according to the census

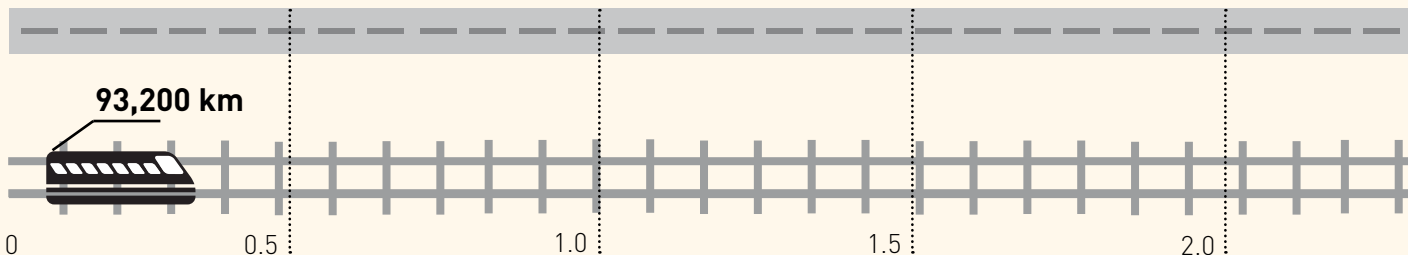
The sixth and most recent census took place in 2010, but NBS released urbanization figures this year showing more than 50% of the population as urban.



Source: National Bureau of Statistics

The Road to Urbanization

The total kilometers of completed highway and railway in 2012



2012

Urban population (% of total)	52.57
Four-star hotel (units)	2,214
Hospitals (thousands)	21,979

2008

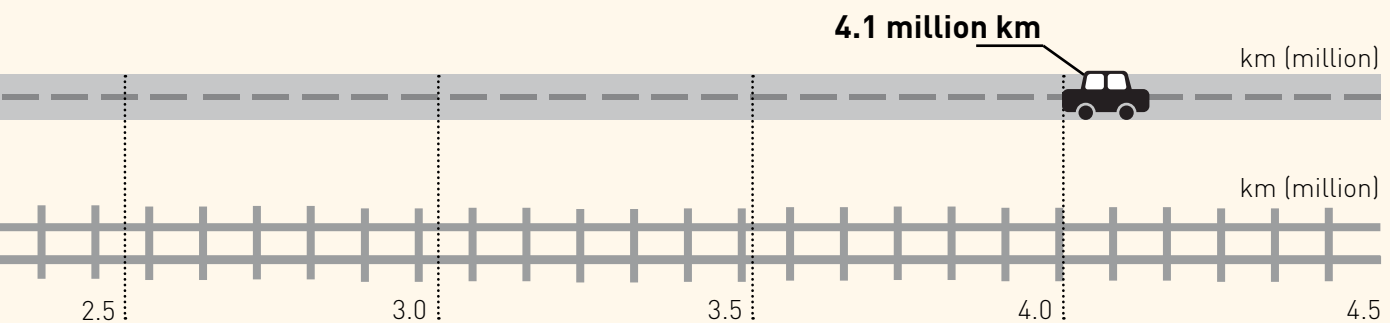
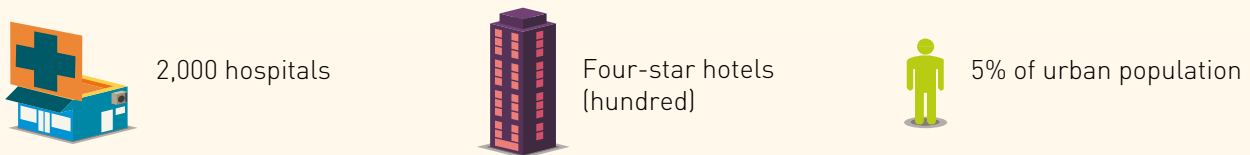
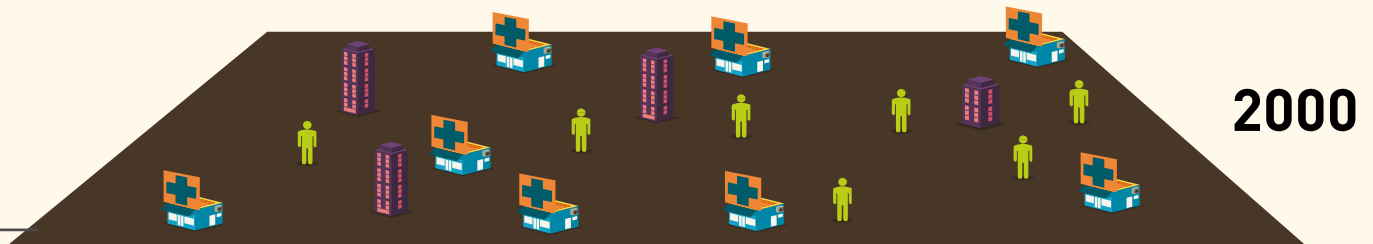
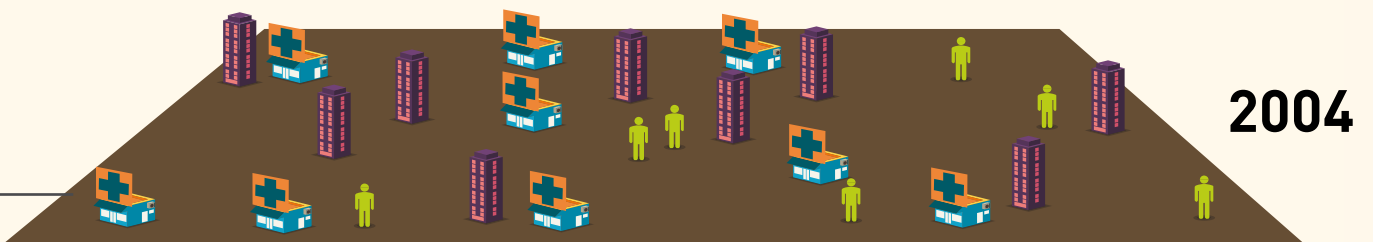
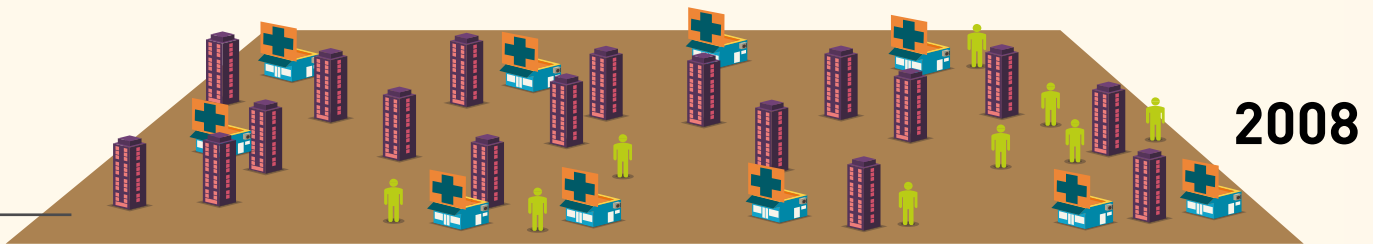
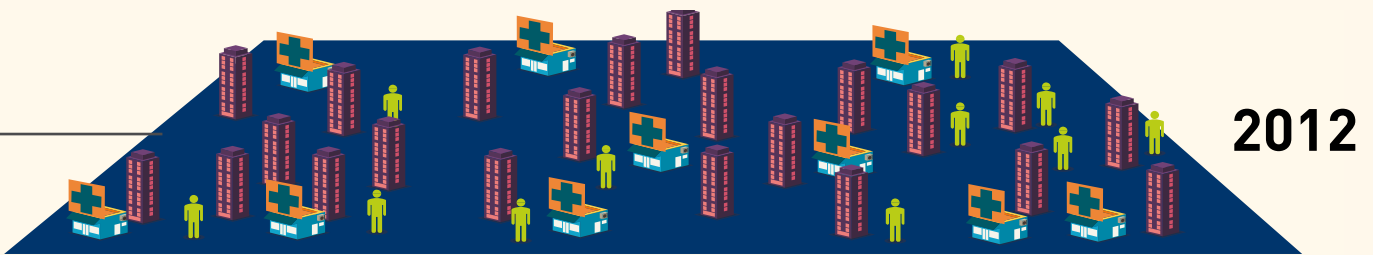
Urban population (% of total)	47
Four-star hotel (units)	1,821
Hospitals (thousands)	19,712

2004

Urban population (% of total)	41
Four-star hotel (units)	917
Hospitals (thousands)	18,393

2000

Urban population (% of total)	36
Four-star hotel (units)	352
Hospitals (thousands)	16,318





Bolshie in Beijing

China's labor costs are soaring even as the economy slows. How are companies responding?

By Christopher Beddor

It was a tactic designed to grab headlines, and it succeeded. In late June, workers at a medical parts factory in Beijing held hostage Chip Starnes, a visiting American executive, demanding that he provide better compensation. The company's employees guarded exits, rattled windows and shined lights into the building at night. Six days later, the beleaguered executive was released after he agreed to pay \$300,000 in benefits to almost 100 employees.

Since early 2013, several "bossnappings" have occurred at large international and domestic firms in Shanghai and Guangzhou, on top of scores of more traditional strikes and labor protests. Official statistics on labor unrest are not publicly available, but over the past three years "we've seen consistently high numbers of strikes and worker protests", says Geoffrey Crothall, communications director at China Labour Bulletin, an organization that monitors Chinese labor laws and unrest.

Analysts say such incidents are the re-

sult of a combination of forces, including China's tightening labor market, tougher regulations and a slowing economy.

"We're absolutely seeing a squeeze," says Andrew Polk, Resident Economist at the Conference Board, a research group that works closely with large companies in China. "[When we are] talking to executives, rising labor costs are definitely top of mind for them. It's not the ultimate determinant of whether you do business or not, but it has become an increasingly serious concern."

Toil and Trouble

Wages for private-sector employees rose by 14% in real (inflation-adjusted) terms in 2012, higher than the 12.3% increase recorded in 2011, according to China's National Bureau of Statistics. By contrast, growth in labor productivity—the amount of goods and services generated by each worker—is moving in the opposite direction. As China closes the technology gap

with developed countries, productivity gains will hit a natural plateau, whereas before productivity was reflecting China's 'catch-up' to more developed countries. The Conference Board estimates productivity increased by 7.4% last year, down from 8.8% in 2011 and the slowest pace since 1999.

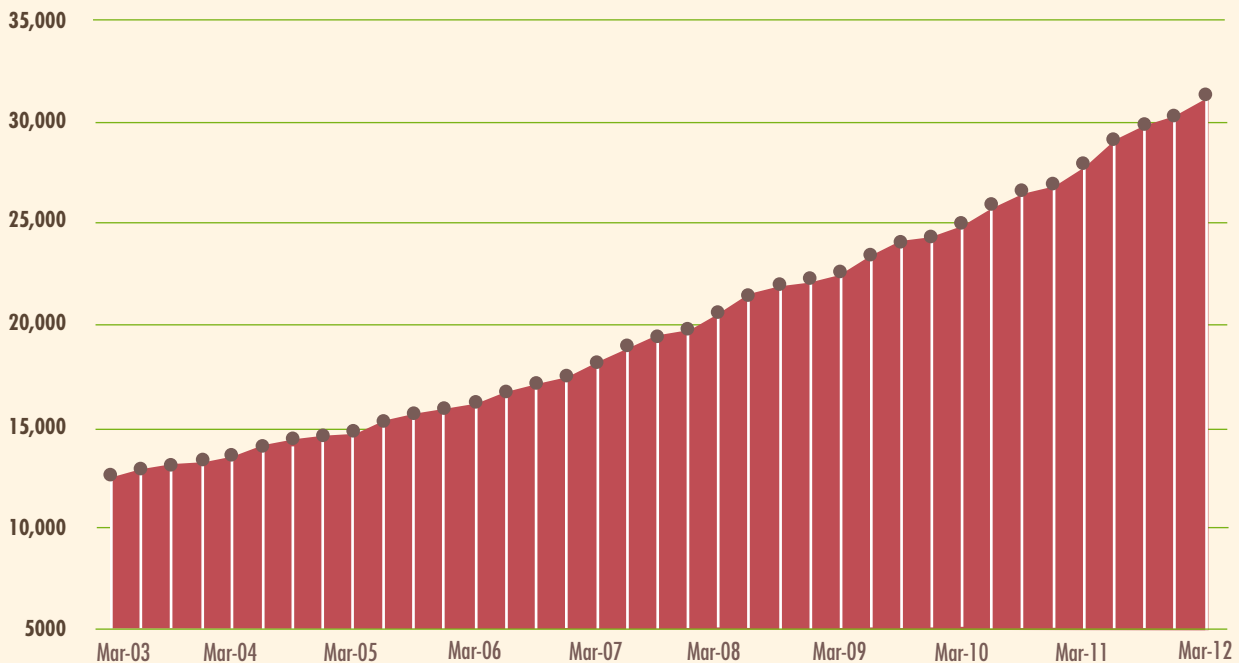
This "wage inflation" is likely to continue for years to come. To explain why, economists often refer to the "Lewis Turning Point", a theory of development created by the economist Arthur Lewis. As poor countries industrialize, Lewis argued, wage growth is initially subdued because factories can draw on a large pool of surplus labor in the countryside. But as that pool dries up—the turning point—wages suddenly spiral upwards.

Li Xiaoyang, Assistant Professor of Economics and Finance at Cheung Kong Graduate School of Business, says the turning point is "one of the reasons why labor costs are going to continue to rise".

Wages on the Rise

China's average annual wages from 2003-2012

Average Annual Wages (RMB)



Source: China's Ministry of Labor and Social Security

China's labor laws have also contributed to the squeeze. The country's labor laws were once widely viewed as weak and enforcement of even basic labor rights was dismal. In 2008, however, the central government passed a landmark new "Labor Contract Law", significantly tightening the rules. Among the law's provisions are that all employees must have written contracts, are entitled to one month of severance pay for each year of service and caps the amount of overtime employees can work.

The ramifications of the new law were immediate. Labor cases accepted into arbitration surged from around 350,000 in 2007 to nearly 700,000 in 2008, according to official statistics. While that figure later fell slightly—to around 600,000 in 2010, the latest year for which figures are available—it remains roughly double the average before 2008.

Even in the US employees don't always need a formal contract (though in practice most do), and managers can fire at will (so long as it is not discriminatory), notes Ronald Brown, a Professor of Law at the University of Hawaii and author of several books on Chinese labor law. "China has some terrific labor laws—they're very comprehensive and very detailed," he says. "The real question is always the level of enforcement, and the consistency of enforcement."

Local Flavor

Implementation of the law falls to the local Labor Bureau. Each bureau has a dedicated arbitration commission with the power to hear cases and render judgments, separate from the court system. While these decisions are often binding, in some cases employers and employees can appeal to the courts. On the whole, legal experts say the system itself is speedy and reasonably predictable, with the number of cases settled each year roughly matching the number accepted.

More controversially, some local governments refuse to enforce certain new labor laws at all. Sometimes this is the result of officials looking to boost local businesses in order to gain personal promotion



The real question is always the level of enforcement

Ronald Brown
Law Professor
University of Hawaii

within the Communist Party hierarchy, but at other times it is merely a bow to reality. Kevin Jones, a Shanghai-based Partner at Faegre Baker Daniels points to the recent example of "labor dispatch" regulations, one of the most important new additions to the law since 2008. The rules, which came into effect on July 1 this year, are designed to end the practice of factories using labor dispatch agencies—similar to temporary work agencies—to hire new workers without paying them the benefits of direct employment. In regions of China with lots of manufacturers, however, officials have not yet begun enforcing the rules.

"Authorities are having a difficult time because there are so many people working on dispatch," says Jones. "If you suddenly cut it off, employers aren't going to take them all on as direct hires—you could have mass lay-offs." Most companies are therefore taking a "wait-and-see" approach to the new rules, he says.

The exception is often foreign companies. Multinationals, whether by dint of their generally larger size or foreign status, tend to attract greater regulatory scrutiny. Recent cases such as the government investigation into British pharmaceutical

company GlaxoSmithKline offer incentive to foreign companies to be immediately compliant with the letter of the law while their smaller Chinese competitors can wait until it is actually enforced

"In general, the implementation of these rules for domestic companies is so lax that there's a discrepancy between how much foreign firms must pay for labor and how much domestic firms must pay for labor," says Polk of The Conference Board. "It's a hidden tax on foreign companies, and one of the key mechanisms for keeping the playing field level."

Stuck in the Middle

Yet for both domestic and foreign firms alike, the combination of tougher regulations, rising wages and a slowing economy is taking a toll on company bottom lines; economists at Deutsche Bank estimate a 1% drop in China's GDP growth translates into a 10% fall in net corporate profits.

On a legal level, many firms are coping by putting in place detailed employee handbooks, says Jones of Faegre Baker Daniels. It may seem trivial, but by clearly articulating worker responsibilities in a handbook, managers who fire bad employees stand a much better chance in arbitration or the courts.

Furthermore, executives are becoming more careful about how they lay off staff. In the past many opted for involuntary termination, in which employees must be offered statutory severance pay plus 30 days' notice. That leaves workers with plenty of time to file disputes, says Jones.

Instead, managers forced to lay off large numbers of workers—such as during a factory closing—now aim for "termination by mutual agreement". If employees agree to accept the statutory minimum severance plus two to three months' salary, they forfeit their right to go to arbitration, which could save the employer money in the long run, says Jones. He also advises companies to offer another month of pay if workers sign off on the same day that they've been notified, mitigating the risk that sticklers will hold out for more.

At the business strategy level, higher labor costs are leading some firms to re-

think their business models. “Companies are starting to face the reality of doing business in a more slowly growing world,” says Polk of the Conference Board. “What we’ve seen from our research is that CEOs are starting to look inward. They’re less concerned with the external environment—which they can do little about—and are instead focusing on innovation and human capital.”

He notes that Chinese firms have traditionally been adept at “process innovation”, designing more efficient ways to manufacture products. Now they are looking to climb higher up the value chain into fields such as design and marketing, which require highly skilled workers and bring fatter margins. Multinationals, on the other hand, already dominate those areas and are quite innovative. They are generally responding to the squeeze by looking to get more out of their existing Chinese workforce, by investing in better equipment, providing more training and the like.

“A Major Problem”

For some industries, especially low-margin manufacturing, the squeeze is enough to make executives look abroad, or to less developed regions in central and western China. Foxconn, the world’s largest elec-

tronics contract manufacturer, has built new factories at cheaper locations in Sichuan and Henan. Countless textile firms have shifted operations to Southeast Asia and South Asia. Zhang Ruimin, CEO of the appliance giant Haier, said in a recent interview that of the 24 countries in which his company has manufacturing facilities, only Japan, the US and Italy have higher production costs than China, and added that these costs “will become a major problem” unless the firm relocates some of its factories.

Rising costs and regulation may even be affecting the decisions of manufacturing companies not already in China. In an annual survey of executives from more than 300 companies by A.T. Kearney, a consulting firm, the US edged out China this year to become the preferred destination for new business investment, due in part to China’s rising costs and slowing growth. A similar survey by AlixPartners found that 58% of manufacturing executives are either seriously considering or already engaged in “nearshoring”—building new production facilities closer to home rather than in China (usually in the US or Mexico). The number one driver, according to executives, is rising costs.

Overall, multinational firms are clearly

slowing new investments into China—though not stopping them altogether, says Polk of the Conference Board. Many are waiting to see the economic agenda of the new Chinese administration before making further investment decisions, he added.

Even so, the mere talk of relocation can be worrying for employees. Anecdotal reports abound of factories suddenly closing and bosses disappearing rather than paying employees their severance packages. Statistics are hard to come by, but during the 2008 downturn state media reported that in Zhejiang province alone about 400 such incidents of “fleeing bosses” occurred. The pattern has directly fed into recent labor unrest by encouraging workers to take action at the first whiff of a closure to secure severance pay, such as at the Beijing medical parts factory.

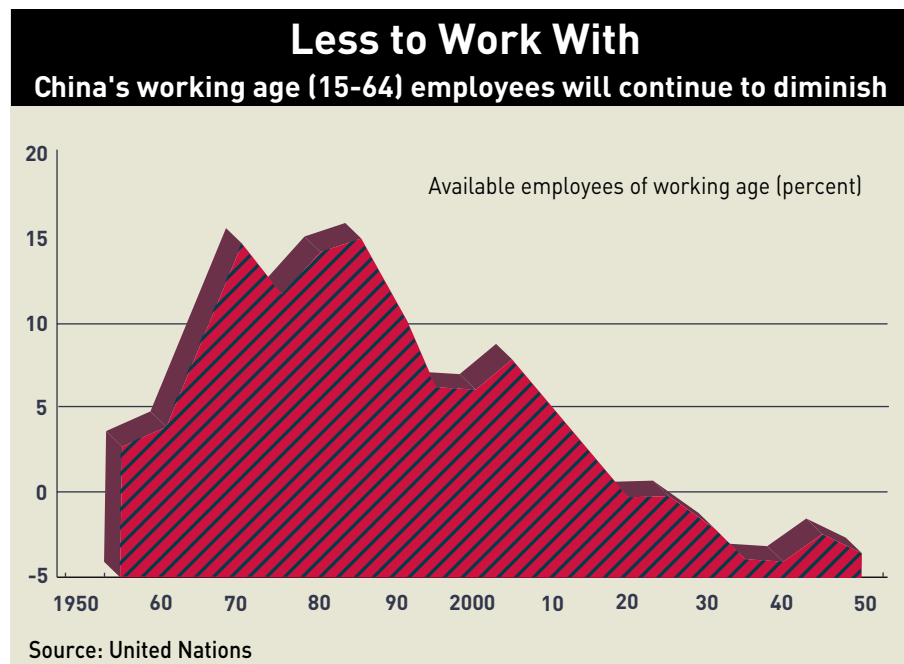
“Workers are increasingly taking what you might call pre-emptive action,” says Crothall of China Labour Bulletin. “When they see the signs that a factory is slowing production and might be closing down, they will take action to make sure they get paid before the factory does close or the boss simply disappears.”

World’s Supermarket

For all its complications, China retains a strong pull for firms. Analysts say advanced infrastructure, an ecosystem of suppliers for raw and semi-finished goods, a deep pool of corporate services such as law and accounting, a skilled workforce and a fast-growing consumer market of its own all make doing business in China attractive, despite the headaches.

“The analogy here is a supermarket and a farmer’s market,” says Li of Cheung Kong Graduate School of Business. China is a bit like a supermarket, which has just about everything at a decent price, though perhaps not the cheapest. By contrast, Vietnam, Cambodia or Bangladesh provide something akin to a rural farmer’s market: some of the best selection and lowest prices in town, but only for produce.

“If you just want cheaper labor, go to Vietnam,” says Li. “But if you want the complete package, China is still the best place to do business.”



Making it in America

How private Chinese companies are navigating mergers and acquisitions in the US

By Ana Swanson



At times, the obstacles seemed insurmountable. The acquisition of A123 Systems, an American manufacturer of lithium ion batteries, by a Chinese auto parts maker named Wanxiang triggered vehement opposition in the US.

Lawmakers protested that the technology being sold to the Chinese had been developed with \$132 million of taxpayer money. Retired military officials warned that the transfer abroad of the company's advanced products, used in energy grids, unmanned aerial vehicles and pulsed power weapons, could put American national security at risk. Local competitors interested in acquiring A123's assets for themselves added their voices to the chorus. To reassure the American public, Wanxiang excluded A123's defense contracts from its bid; these were sold separately to an Illinois-based company. But the criticism kept coming.

Yet American regulators approved the acquisition in January 2013, and the deal ultimately went through. A123 became part of Wanxiang's 6,000-person workforce, more than half of which is located in the US.

The deal was just one data point in a recent upswing in private Chinese investment in the US. According to private research company Rhodium Group, Chinese companies completed a record \$4.7 billion in transactions in the US in the first six months of 2013, the strongest first half ever recorded. Furthermore, recent data show a dramatic increase in investments by private enterprises. From the beginning of 2012 through the second quarter of 2013, private firms conducted 84 investments totaling \$5.39 trillion in the US, compared to 24 deals for a total of \$6 trillion by state-owned firms, according to Rhodium Group data.

The floodgates appear to be opening to meet the growing demand from private Chinese firms for assets, and the US demand for capital. Obstacles remain, but formerly unsophisticated Chinese firms are increasingly following the lead of companies like Wanxiang in figuring out how to allay security concerns, dodge public relations crises and successfully make

deals in America.

Go Forth and Multiply

Private entrepreneurs are increasingly taking the lead over China's state-owned enterprises when it comes to US investment. From the beginning of 2012 through the first quarter of 2013, private Chinese com-



In principle, most sectors in the US economy are attractive to one or another kind of Chinese firm

Derek Scissors
Senior Research Fellow
The Heritage Foundation

panies spent more on US investments than in the 11 previous years combined, according to Rhodium Group, with 16 of the 17 acquisitions in the first quarter of 2013 done by privately-owned firms.

The Chinese share of investment remains small compared with overall stock of US investment—only about half a percent of inward FDI—but that's set to change. More than \$10 billion worth of Chinese deals in the US were pending as of July, according to the Rhodium Group.

"The US has everything you want," says Derek Scissors, a Senior Research Fellow at The Heritage Foundation, a con-

servative think tank that tracks Chinese outbound investment. "In principle, most sectors in the US economy are attractive to one or another kind of Chinese firm."

Scissors separates private Chinese companies into two main groups: smaller private Chinese companies who are seeking to "get out of China entirely" and gain access to US customers, and larger private companies seeking technology, brands, resources and expertise to take back to China—such as Shuanghui International's bid for Smithfield Foods in May, or Dalian Wanda, which struck a deal to acquire US cinema chain AMC Entertainment Holdings last year.

Growing political support at home has also been working to clear the way for private companies, including the government's effort to provide some of its ample foreign currency reserves to companies making overseas acquisitions, says Teng Binsheng, Associate Professor of Strategic Management at Cheung Kong Graduate School of Business. Once a deal has approval from the Ministry of Commerce, the company can apply to China's state-owned banks for a dollar-denominated loan, he says.

Certain Chinese industries also get better treatment in the Chinese stock markets, Teng adds, giving them more cash to play with in cross-border investing. Teng cites the Shuanghui-Smithfield deal as an example: Agricultural companies receive higher valuations in China than in the US, giving them bigger cash reserves to field US acquisitions.

Suspicious Minds

Yet most Chinese companies and M&A advisors readily admit deals still face many potential pitfalls. More than \$34 billion of potential Chinese acquisitions in the US have fallen through due to "a nasty surprise of some sort", Scissors of the Heritage Foundation wrote in a note entitled "China's Global Investment Rises: US Should Focus on Competition."

To buy a US entity, potential Chinese acquirers must clear two official approvals: an examination of any potential national security risks by the Committee on

Foreign Investment in the US (CFIUS), and an investigation into anti-competitive impacts by the Department of Justice and the Federal Trade Commission

Chinese companies can receive more scrutiny in these approval processes than acquirers from other countries because of fears that China’s loose rule of law and independent courts leaves companies more susceptible to government manipulation, says Thilo Haneman, Research Director at Rhodium Group. “Without rule of law, the government ultimately can manipulate private and state-owned enterprise alike.”

Even so, these approvals are not a significant obstacle for most Chinese acquirers. Only a handful of acquisitions are rejected due to national security concerns, most often in the sectors of advanced technology and telecommunications.

Chinese companies have also seen deals rejected because of their location, as in the case of the failed purchase by Ralls Corp of four wind farms in Oregon near restricted US naval airspace. Ralls, which belongs to two executives of privately-owned Chinese construction company Sany Group, purchased the wind farms without reporting the transaction to CFI-

US. Based on CFIUS recommendations, US President Barack Obama then issued an executive order requiring Ralls to divest its purchases, the first such order in 22 years. Ralls sued the president in September, claiming that the order violated its constitutional rights, but its case was overturned.

“That was an obvious red flag for an experienced CFIUS lawyer, but the company never consulted a lawyer about CFIUS in the first place,” says Haneman. “If you handle it well, [if] you have the right lawyers, private firms usually do not have problems with identifying those risks and mitigating them.” Ironically, the erroneous perception that these security reviews pose a significant obstacle is a greater barrier to would-be acquirers than the approvals themselves, says Haneman.

Part of the reason for this perception is undoubtedly the nature of the American public environment, in which politicians and journalists actively question potential risks to national security for Chinese companies of all stripes. To Chinese companies, this loud and usually critical conversation may make it seem like deals are doomed to fail.

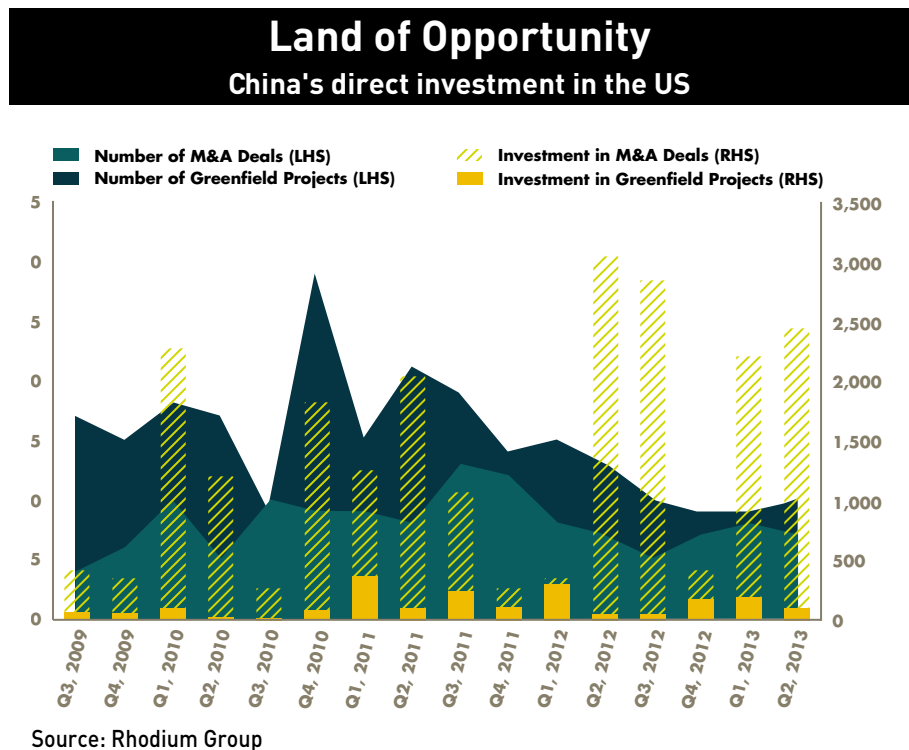
But the CFIUS review itself is a straightforward procedure, says Pin Ni, the President of Wanxiang America. “We just need to respect the system. We’re in a democracy, and in a democracy everyone can have an opinion,” he says. “The press will talk about it, Congress people will step in. In a democracy, that’s their job. What you really need to deal with is CFIUS.”

Some Chinese companies more experienced with operating in the US are beginning to take initiative to assuage popular suspicions. Wendy Pan, a partner in O’Melveny & Myers LLP’s Shanghai office, who advised Chinese genomics sequencing institute BGI-Shenzhen during its acquisition of Complete Genomics, says her firm counseled the Chinese company to take a proactive strategy to minimize regulatory and PR risks. One such risk came from US-based competitor Illumina, which claimed publicly that the acquisition was doomed to be rejected by CFIUS, which is the opposite of what ultimately happened.

“Since gene sequencing is such a cutting edge technology, it can be easily misunderstood by or misrepresented to the public,” says Pan. She and her colleagues advised BGI-Shenzhen to file voluntarily for CFIUS clearance, as well as publicize BGI’s previous charitable work with American non-profit organizations such as the Gates Foundation and Autism Speaks.

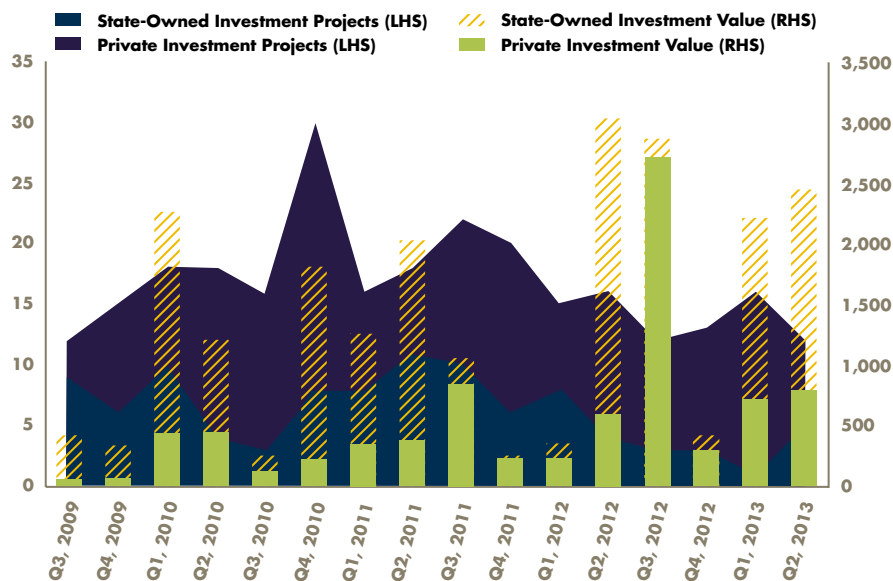
For less experienced Chinese companies, navigating America’s independent and dynamic media environment can still be a challenge. Many Chinese companies prefer to keep a low profile at home to avoid unwanted attention from the media or government regulators, and when they go abroad, they tend to continue those practices, said Pan.

“There’s a Chinese saying, ‘*Ren pa chuming, zhu pa zhuang*,’—people are afraid of getting famous, just like pigs are afraid of getting fat ... Chinese companies do not like to talk openly about strategies, business visions, business plans. In Western business culture, this is unusual. So some misunderstandings are caused by the [different] business style,” Pan says.



Catching Up

China's private-led vs. state-led direct investment in the US



Source: Rhodium Group

Not all PR campaigns launched by Chinese companies have proved helpful to their fortunes in the US. CKGSB's Teng cites the example of Huawei: the Chinese telecom company became the target of an aggressive campaign by US IT infrastructure company Cisco after Huawei ran ads in the US featuring the Golden Gate Bridge, suggesting there was no difference between its products and those made by California-based Cisco, whose logo is based on the Golden Gate Bridge.

In general, however, Chinese companies are getting savvier in their ability to launch PR campaigns. This may help to allay popular fears about Chinese companies and reduce political opposition at the Congressional level.

Caveat Emptor

The major barrier for private Chinese companies looking to invest in the US is not the national security approval, but institutional or experiential barriers. As relatively new entrants to the US market, Chinese companies are still learning how to properly navigate America's dramatically different institutional and media environ-

ment, which is based on rule of law rather than personal relationships.

"Do you have a lawyer, how are you going to get your land zoned, how are you going to pay your taxes? I don't think [Chinese companies] know how to do most of these things," says Scissors of the Heritage Foundation. "They overestimate the gate-keeping problems in the US and they underestimate the operating problems in the US."

In addition to cultural and managerial differences, companies without US experience may face operational challenges stemming from a gap in knowledge and experience between them and the target company. "When [Chinese companies] go out to acquire an American company, they face a difficult challenge, which is that the target tends to have a better system than the buyer. So what do you do with that?" Says Teng of CKGSB.

For many Chinese companies, the initial strategy has been to leave the target company and its management system intact. But in the case of targets that are already struggling, this is often an imperfect solution.

Chinese consumer electronics maker TCL learned a hard lesson in this regard when it acquired Thomson's TV business in 2005, says Teng. "They left it alone for one or two years, and [by the time] they realized the French management had run out of options it was too late for the Chinese management to do anything. It cost billions, and the acquisition was a total failure," he says.

But Chinese companies are showing growing confidence in guiding their acquired companies. Wanxiang America President Pin Ni echoes this idea when talking about the lessons his company had learned from its more than 20 acquisitions in the US.

Compared with when it began making acquisitions, Wanxiang's greater experience and confidence now gives it the flexibility to do deals where they bring in a new management team to support the company. "We can do deals that have a little more risk involved," Ni says.

Teng sees Chinese companies gaining the experience to work with a broader range of targets in the future. "Some very interesting companies may welcome strategic investors, but not sell right away. That means you have to get in through some kind of alliance first, and then if the two parties work well together, that may lead to an eventual acquisition down the road," he says.

Private Chinese firms are proving quicker to adapt than their state-owned counterparts, says Haneman of the Rhodium Group. "We have seen a lot more sophistication over the past two or three years, especially on the Chinese side, in finding the right partners and the right strategies for navigating overseas regulatory environments," he says.

By and large, struggling American companies still look to Chinese investors for liquidity, and not much else. But that is slowly changing. As Chinese companies learn to flex their own managerial muscles and capitalize on domestic markets and resources, acquiring Chinese firms can offer their targets more than much-needed cash. They can represent new life in every link on the value chain. ■

TAKE OFF

Can private airlines get off the
ground in China?

By Engen Tham



Jill Mao, a 22-year-old student, was due to fly at 4pm from Shanghai Pudong airport to Hong Kong in June. But when she got to the airport, she found out that the flight would be two hours late due to bad weather, even while skies looked clear. Mao was irritated. At 6pm, the service staff told her that it would be another half-an-hour, saying that the flight was in fact delayed because of a backlog of planes from yesterday's delays. Then at 6:30pm she was told she would have to wait another half-an-hour.

Tired and hungry, with no compensation, Mao finally arrived in Hong Kong at 11pm, four hours later than scheduled. "This happens all the time," says Mao.

China's aviation network is notorious for flight delays. A flight leaving from Beijing's airport is the least likely in the world to take off on time, according to industry statistic collator FlightStats, as 82% of flights are delayed, with Shanghai as the second global worst with 71%.

In acknowledgment of the shortcomings, the government lifted its six-year moratorium on approving exclusively private airlines in May to rubber stamp newly established Qingdao Airlines and Ruili Airlines. Although this move has the scent of deregulation, it is likely to have little impact on carrier efficiency in the medium-term. A market dominated

by government-run giants with deeply embedded inefficiencies will be a tough place for private airlines to land. But entrepreneurial will survives, despite the realities of a sector choked by a lack of infrastructure and monopolistic practices.

Come Fly with Me

For six-years, the Civil Aviation Administration of China (CAAC), the government ministry supervising aviation affairs, halted approval of purely private carriers to consolidate the industry, which had become unwieldy as liberalization in following 1980 yielded numerous airlines that had little management experience. "Things got out of control, there were massive [financial] losses and they wanted to stop it," says Will Horton, a senior analyst at the Center for Aviation, a global aviation market intelligence provider.

Now with the industry well 'consolidated', Beijing is once again opening the gate for private airlines as it recognizes there is a burgeoning demand for lower-cost flights, says Jiaoe Wang, Associate Professor at the Department of Economic Geography and Regional Development at the Chinese Academy of Science.

The concession also comes at a time when the nation's economic growth is slowing, and a healthy airline industry could help resuscitate growth. "Each ad-

ditional passenger that flies has a huge effect on the economy and it's a trickle down effect: an additional passenger spends money getting to the airport and spends money at the destination. So it's in any government's interest to have as many people flying as possible, because of all the money they generate," says Horton.

"Private airlines have a huge market within which to expand," says Fengjun Jin, a professor and a transportation geographer from the Chinese Academy of Science. Routes in or connected to China will account for 193 million of the 831 million new passengers by 2016, according to a forecast released by International Air Transport Association last December.

But privately-owned airlines have met significant challenges in a market dominated by four state-owned players. China Southern Group, Air China Group, China Eastern Group and HNA Group all together occupy 90% of the market, while private carriers only hold a paltry 4.5% according to a May Credit Suisse report.

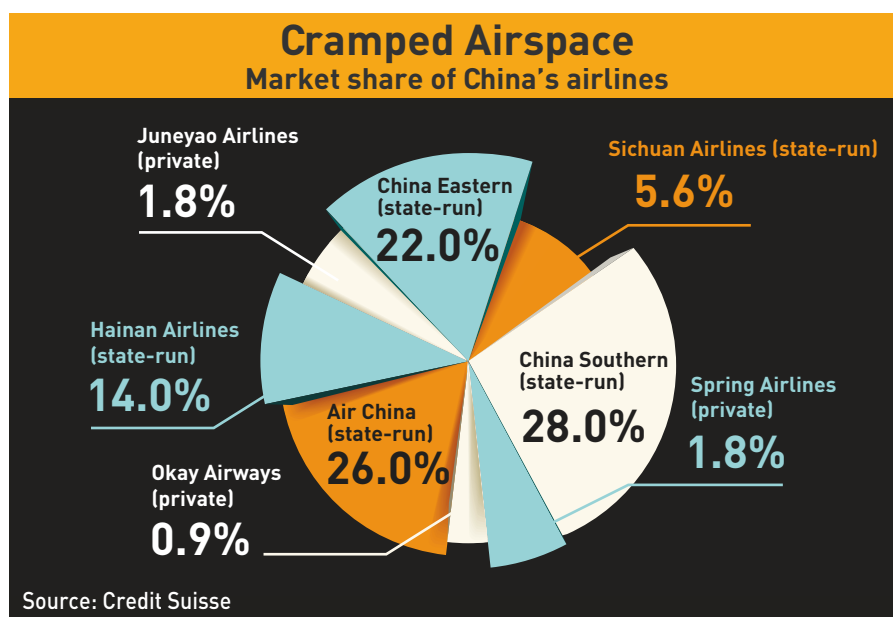
And that doesn't account for the private airlines that didn't make it out of the 2008 financial crash. Okay Airlines, East Star and United Eagle all either folded or were bought out after the crash. East Star became the first bankrupt airline in China in 2009. In the same year, Sichuan Airlines bought the struggling United Eagle and the Tianjin Da Tian W. Group acquired Okay Airlines. These casualties have tarnished the reputation of private airlines and made it more difficult for independent carriers to raise money.

Closed Skies

An overextended and unsophisticated aviation system still makes it difficult for small carriers lacking economies of scale and state-backing to survive downswings.

A crucial issue is lack of airspace. In China, civil aviation can only use 32% of mainland skies, according to figures from the China National Airspace Technology Laboratory, causing diversions and delays.

Each diversion and delay erodes a nascent airline's vulnerable margins,



making it difficult for private carriers to weather the storm. “The infrastructure is so messed up. When you’re faced with delays, it’s hard to predict your costs. Flying to China we have to carry a lot of fuel, which is not cost efficient at all and sometimes we face huge delays, which eats into your fuel. This affects more the smaller domestic carriers,” says a senior first officer from a world-class international airline who declined to be named due to the sensitive nature of the topic.

Often, Chinese air-traffic control will cite the weather for flight diversions, those in the industry claim this is deceptive. “When I flew to Beijing recently, traffic control suggested we divert for weather purposes, but the weather looked fine to me. For the last two months, we’ve had several weather diversions every month which is not normal for any airport,” said the senior first officer. “Most airports let the pilot decide if they can make the landing. But in China they seem to decide for you before you even attempt the approach, so it’s really strange,” he adds.

Airlines are also subject to impromptu cancellations. “Sometimes air traffic control will tell you, due to flow control or airspace restrictions, Beijing airspace is closed, an hour before you get there, which is ridiculous. It’s not easy for pilots,” the senior first officer says.

One result of overly congested airspace is mis-managed air traffic control.

“China’s air traffic controllers have not had experience to deal with this kind of volume. The way they give air traffic controls is inefficient. They will make us descend very early and they will force you to descend quickly which is inefficient. As pilots we don’t want to descend and then hold straight and level at a lower altitude for a long time, we just want a smooth gliding descent which wastes the least fuel,” explains the senior first officer.

Flying too Close to the Sun

Another obstacle private carriers have faced is government favoritism of its state-owned brethren. “The control that state-owned operators have over the market is still very, very strong. It is more diversi-



Spring is a low-cost carrier, so it’s more efficient

Will Horton
Senior Analyst
Center for Aviation

fied, but not massively,” says Wang.

Some of the state-owned airlines cooperate with provincial governments to form fixed-based operators. The airline will invest in a provincial airport in return for rights over routes, which leaves little room for private airlines to maneuver, according to Wang.

State airlines also cooperate with provincial governments to create subsidiary carriers, like Air China’s subsidiary Dalian Airlines. A provincial carrier may not have direct ties to Beijing, but it will still have rights over routes, Wang explains.

Beijing also tightly grips international routes, over which Air China has first right of refusal, showing a very strict hierarchy of favoritism among even the state-owned carriers. For example, Air China can fly international flights from Beijing, its home base, but also Shanghai, which is China Eastern’s turf. However, China Eastern cannot fly long-haul from Beijing if Air China is on those routes.

Further down the food chain, the big four muscle out principal players and have also openly admitted to colluding on prices, in order to stifle competition according to a 2010 report titled “Price wars and price collusion in China’s airline markets” written by Yahua Zhang and David K. Round, published in the International Journal of Industrial Organization.

Even lower down the value chain, all state-connected carriers collude to block private airlines from the market, says Horton, and foreign carriers are kept most at length. Scoot, the low-cost carrier owned by Singapore Airlines, was forced to fly out of Tianjin when it was refused Beijing slots by the CAAC, says an analyst, who wishes to remain anonymous as he is not authorized to talk to the media on this topic.

The carriers influence Beijing by asking that foreign airlines only get handed badly timed slots that are likely to be less profitable. “There is all sorts of influence you can have on the government and this is not unusual to the airline industry in any part of the world, but in China it’s just to a higher level,” says Horton.

The Little Airlines that Could

China officially opened its aviation market to private investors and operators in 2005 to much excitement, but the excitement drowned in a succession of private airline bankruptcies prompted by the chokehold of the big state carriers. Eight years later, it’s still a tough space for the operation of private airlines, but Spring, China’s only low-cost carrier and Juneyao, a boutique outfit, have achieved some success.

“Spring is a low-cost carrier, so it’s more efficient in terms of its productivity because of its low-cost base strategy,” says Horton. Spring received approval in 2004, and since then has been doggedly pursuing cost efficiency. The airline only sells tickets through its own-name website, cutting out middleman costs. Spring operates with the motto “Two Highs, Two Lows and Two Singles”. ‘Two highs’ refers to high load factor of 95% and an aircraft utilization rate, the number of hours that planes are put to use on routes, that is two hours longer than industry average. The ‘two lows’ are low marketing costs and low management costs. Lastly, the ‘two singles’ refers to the carrier only operating one class across its aircraft, which are all of one make.

As a result, the muscular Spring Airlines reported profits last year that surpassed its state-owned competitors. Over-

all passenger numbers increased 9% in 2012, while Spring's surged by 27.4%, according to CAPA data. The airline plans to riff off its domestic success by expanding its international presence, including a Japanese subsidiary in the works for this year that will aid in the development of its services between Japan and the mainland.

Such efficiency still eludes the big four whose longer history means higher staff salaries and higher costs. Many of the state airlines have also undergone mergers within the last decade that have made them even less nimble, such as the merger between China Eastern and Shanghai Airlines. "With these mergers, the airlines haven't become more efficient—they've actually become more inefficient—they're dragged down by suddenly amassing all these people and these planes and these networks and flights and they don't know what to do with it [all]," says Horton.

Juneyao, on the other hand, has risen by partnering with stronger airlines. Incorporated in 2005 in Shanghai, the airline works with a marketing model that contrasts with Spring, operating as a luxury or boutique airline. Juneyao has interlined with Singapore Airlines and now code-shares with Air China and China Eastern, which means Juneyao can sell seats on flights operated by these two airlines and vice versa. "You can put passengers on your airline and reduce your risk, because someone is giving you passengers and you just have to carry them," explains Horton.

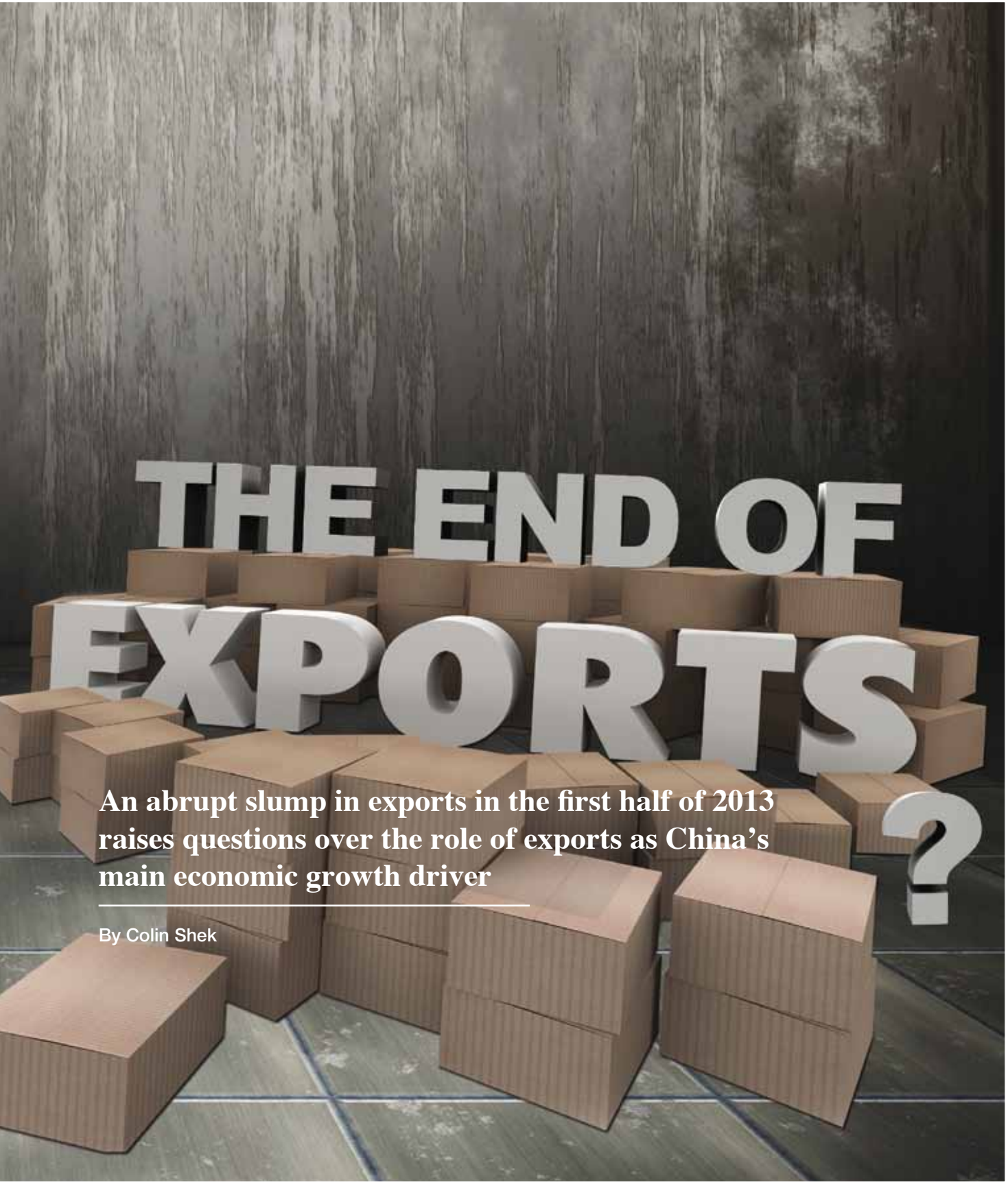
For two years, Juneyao's monthly traffic has been growing at a rate of 10-20%, according to CAPA data and has been profitable every year since incorporation.

But the new independent airlines may opt for a new strategy. The Credit Suisse report said "We expect the new entrants to become niche players expanding into new routes connecting to tier 2 cities underserved by bigger players."

Although Beijing's deregulations moves in the aviation industry may encourage private carriers, structural inefficiencies and the dominance of state-owned airlines mean that it will be a while yet before passengers like Jill Mao can hope for a flight that leaves on time. ■







An abrupt slump in exports in the first half of 2013 raises questions over the role of exports as China's main economic growth driver

By Colin Shek

Business last year was the worst that Yang can remember since she began working for Yongli Suitcase in Wenzhou, a coastal city renowned for its freewheeling entrepreneurialism, eight years ago.

The RMB 40 million of goods the luggage maker exported in 2012 was a far cry from the heady days four years earlier. “The best year for our company was 2009, when we exported RMB 100 million,” says Yang, a salesperson who only gave her family name.

Yongli’s struggles typify the reversal in fortunes that many small and medium-sized enterprises (SMEs) have suffered in recent years. In the boom times, few Chinese cities soared faster or higher than export-rich Wenzhou, which came to be regarded as a bellwether for the economy.

Wenzhou was one among many hotbeds of private enterprise in China, where success grew from the bottom-up development of family-owned SMEs that per-

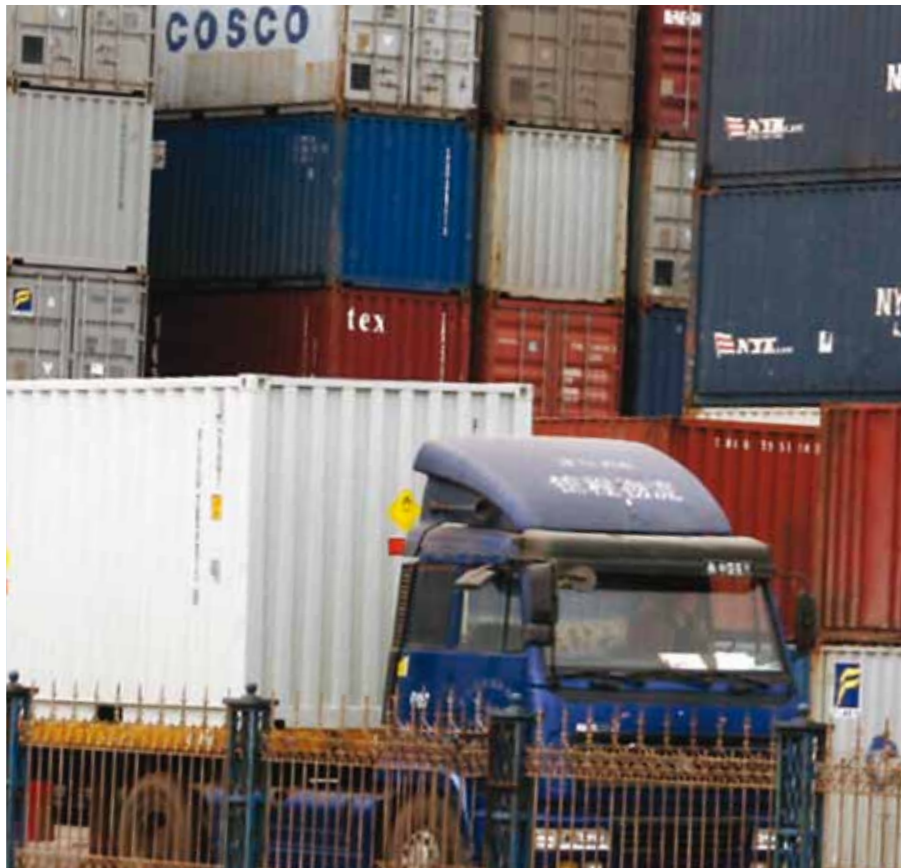
fectured the art of low-cost manufacturing for overseas customers. But just as beleaguered exporters in Wenzhou are now staring down the barrel of an uncertain future, questions are now mounting over the role of exports as a driver of Chinese economic growth on a national level, now and in the future.

Trade figures for June added to the anxiety after they came in well below expectations. Exports fell on an annual basis for the first time in 17 months, declining by 3.1% according to customs data from that month. Imports were down 0.6% versus an anticipated 6% rise. In July exports rebounded with a 5.1% rise and again in August with a 7.2% rise, but the sudden fall in June has still left China watchers and China businesses unsteady and considering the best long-term game plan.

The June collapse in trade fanned fears China was headed for a severe slowdown. “If the softness in the trade sector persists, China is unlikely to achieve its

“
Improvement
in productivity
has been able to
spread to other
sectors

Qinwei Wang
Economist
Capital Economies



A container truck drives past containers at a terminal in the Port of Tianjin

trade growth target of 8% for this year,” ANZ bank’s China economists Liu Li-gang and Hao Zhou said in a research note in July.

If exports have been China’s bread and butter for decades, what happens to exporters when an economic slowdown coincides with a government-backed campaign to re-balance the economy away from exports and toward domestic consumption?

Factory to the World

In China, missing trade targets would have seemed inconceivable several years ago. Exports have boomed over the past two decades and played an oversized role in Chinese economic stability. The value of exports stood at \$91.7 billion in 1993, before more than quadrupling to \$440 billion in 2003, according to customs statistics. In the month of December last year alone, export value reached a historic high of \$199.2 billion.

World Bank data shows exports of goods and services represented 11% of China’s GDP in 1980, two years after the country adopted its reform and opening-

up policy. That share swelled to 16% a decade later and reached 39% by 2005.

That ratio is very high when judged against developed economies and China's emerging peers. Exports accounted for just 14% of GDP in the US in 2011, the highest for more than three decades, according to the World Bank. Exports as a share of India's GDP measured 24% last year, the nation's highest percentage in more than 30 years. Numerous other countries have higher shares than China—Malaysia's was 87% last year, for instance—but the GDP for those nations are only a fraction of China's GDP, and none have had the same impact on global trade in terms of scale.

Beyond the simple fuel that exports have provided to China's GDP growth are the productivity gains and technological advances made by export-oriented SMEs as they churned out goods to sate foreign demand. Those benefits rippled out to the wider economy as China emerged as the new global factory.

"Foreign demand boosted the manu-

facturing sector, and that resulted in a very big improvement in productivity," says Qinwei Wang, a China economist with Capital Economics in London. "That improvement in productivity has been able to spread to other sectors, [and] has been able to help China achieve the fast growth over the past few decades."

As for the sectors that comprise the majority of China's exports, manufactured goods were still the leaders at the end of 2011 according to the official statistical yearbook from China's National Bureau of Statistics. Manufactured goods totalled \$17.9 billion in 2011, near all of the total exports of \$18.9 billion.

"Chinese firms are shifting their positions upwards," says Wang. "Before, they used to produce clothing and shoes but now they are starting to produce more electrical equipment—iPads, iPhones. data suggests that the value-added part of the exports is increasing. That's a big trend, [and] it will continue to increase."

Within manufactured goods, growth

in low-end items like textiles, rubbers and metal products still reigned supreme ringing in at \$3.2 billion, an increase of roughly \$500 million from the previous year. But growth in higher end manufacturing goods was catching up. Growth in both chemical products—increasing by nearly \$300 million from 2010 reaching \$1.1 billion in 2011—and in machinery and transport equipment—increasing more than \$100 million from 2010, reaching \$9 billion—signalled a shift in weight from low-end products to more technically demanding heavy machinery, as experts point out is a result of improvements in productivity and technical expertise.

"Because the market is so competitive, it forces the domestic industry—which otherwise tends to be very protected by access to credit and connections with the government—into innovation, into better research," says Michael Pettis, Professor of Finance at Peking University's Guanghua School of Management.

"Without the export sector, I don't

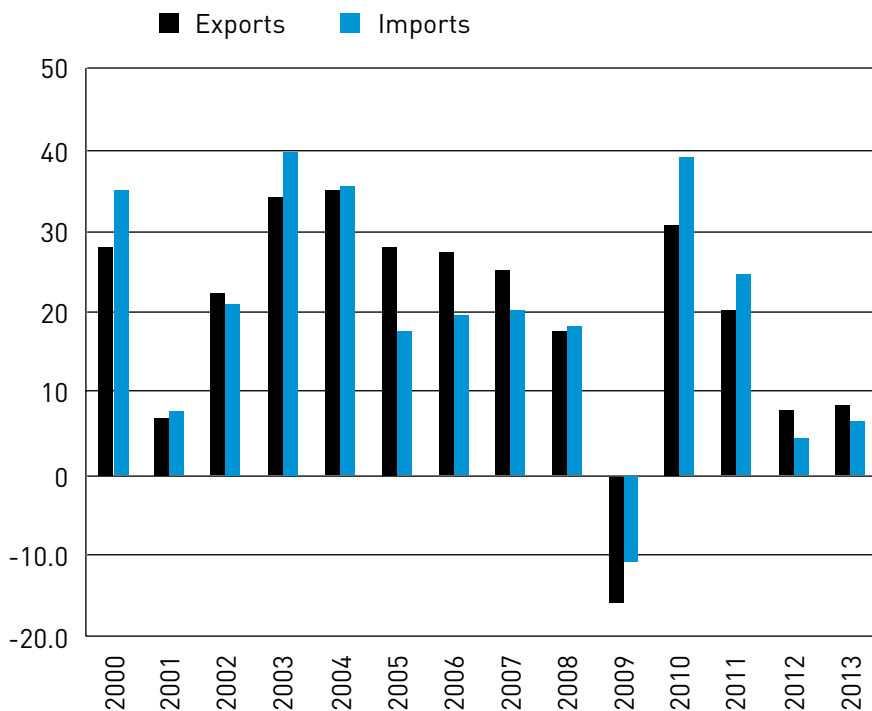
Who Needs Their Exports More? Exports as Percentage of GDP for the US and China



Source: US Bureau of Economic Analysis and Economic Intelligence Unit

China's Trade Flows

The yearly balance of China's exports and imports as % of GDP



Source: Global Trade Atlas using official Chinese statistics

think we could've assumed there'd be a lot of upgrading of Chinese manufacturing abilities," says Pettis.

The surge in exports was felt at China's ports and reflected in the trade balance. In 2006, Shanghai and Shenzhen were the only two mainland ports to make the global top 10 by container traffic, but they have since been joined by Ningbo-Zhoushan, Guangzhou, Qingdao and Tianjin, according to the World Shipping Council.

Exports have also charged China's much discussed trade surplus, which peaked at nearly \$300 billion in 2008, according to postings from the central government.

Withering Demand

Now China's export sector is being buffeted by severe headwinds. "China faces relatively stern challenges in trade currently," said customs spokesman Zheng

Yuesheng after the release of June's dismal trade figures. "Exports in the third quarter look grim."

Export value between January and March rose 18% from the same period in 2012. Year-on-year second quarter figures, however, show just 3.8% growth.

Wenzhou has been ground zero for this slump in exports. The local economy expanded 6.7% in 2012, more than one percentage point below national growth of 7.8%, government data shows. Last year's growth was also down significantly from 11% in 2010 and 9.5% in 2011.

The city's export sector has had little to cheer since Wen Jiabao, then Premier, paid an official visit to local factories in October 2011. Wen pledged financial support to small companies during his visit, which came after a startling number of bankruptcies stemming from a lending crisis. Scores of bosses who were unable to make payments on underground loans fled, with

some even taking their own lives.

The desperation has spread beyond Wenzhou. "Last year was the worst year for us. We only exported \$2 million, half of what we sold in our best year of 2002," says a salesperson with an arts and craft maker in Zhuhai, a manufacturing hub bordering Macao and a ferry ride away from Hong Kong.

"Our products are mainly exported to the US and Europe. The economic recession in these places cut our orders by 20-35%," says the salesperson, who asked not to be named as she was not authorized to speak to media.

Weak demand in developed markets was reflected in June's trade data, which showed that exports to Europe, the US and Japan fell 8.3%, 5.4% and 5.1%, respectively.

"Foreign demand is not strong and there's no convincing sign that it's going to rebound," says Wang.

The plummeting trade has laid bare the vulnerability of China's key export industries. The value of Chinese textile and



Foreign demand is not strong and there's no convincing sign that it's going to rebound

Qinwei Wang
Economist
Capital Economies

clothing exports rose by 20.1% in 2011 from a year earlier, but that growth rate slumped to just 2.8% in 2012 according to official customs data.

Problems Back Home

As foreign demand began ebbing and a prolonged economic slowdown set in, the Chinese government voiced its intention to rebalance the economy by stoking private consumption in the world's most populous country. That will be easier said than done. Chinese households have borne the brunt of China's export and investment-driven growth, according to Pettis. The household sector, he says, has been exploited over the past three decades to support the country's rapid growth through "hidden transfers" of resources.

"You can think of environmental degradation as a transfer. It reduces the cost for companies but it increases the health costs for households," says Pettis. He singles

out the undervalued Chinese currency, low wage growth relative to productivity gains, and low interest rates as the most important of these distortions, as they have effectively underwritten China's trade boom.

The consequences of China's export growth at the expense of households can be seen in Chinese household consumption's share of GDP. Household spending—excluding home purchases—stood at 51% of GDP in 1981, according to the World Bank. It has fallen steadily since then, and averaged 34.5% in the four years from 2008 to 2011.

"The household's share has dropped and the state's share has risen. Consumption is driven by households, so if the household's share dropped, so did the consumption share," says Pettis. Driving up consumption would involve eliminating the hidden transfers—which have subsidized the growth of China's export sector—and growing the household share

of GDP. That would shrink the Chinese state's contribution to GDP—a notion that would be fiercely resisted by powerful vested interests.

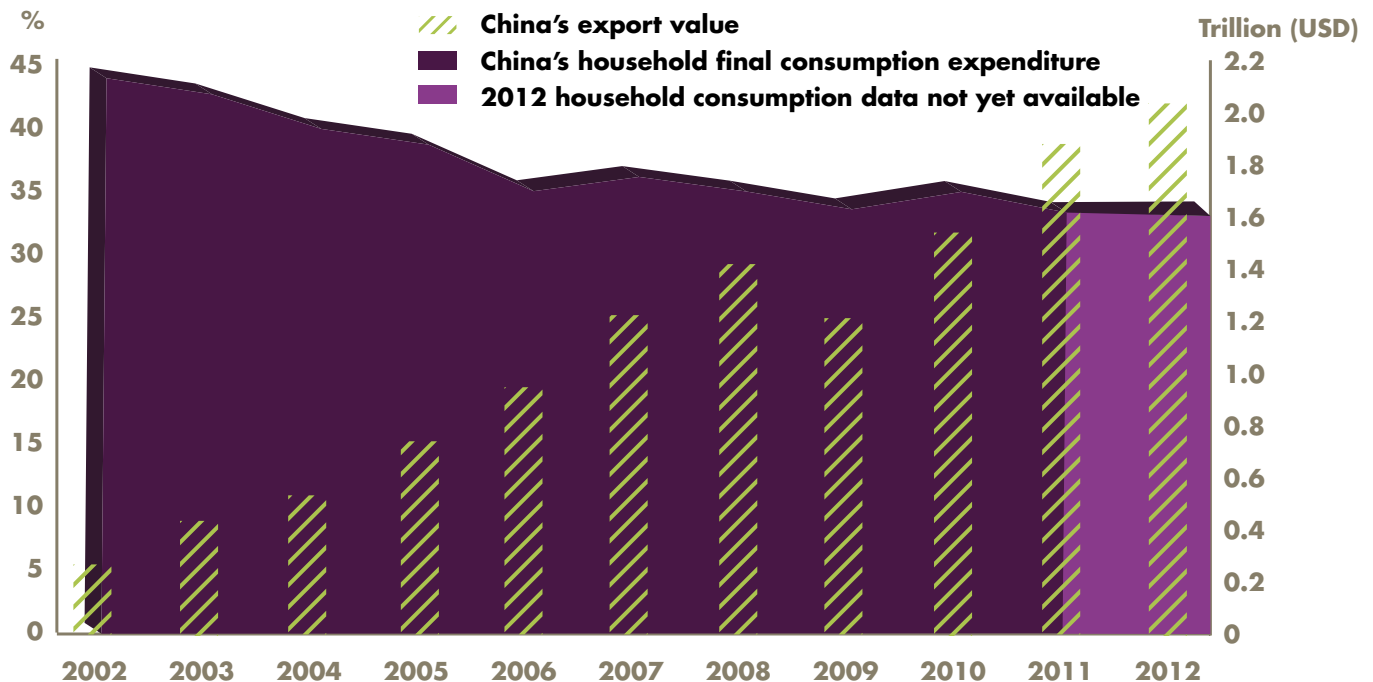
Beijing's attempts to engineer an ambitious shift from investment-led growth to a consumption-driven model have also coincided with weak domestic economic performance, either by default or design.

Tepid demand has also set in as the cost of doing business in China rises. The government has embraced higher wages to spur consumer spending, with minimum wages up by 60% since 2009 in spite of the economic slowdown. Research from brokerage CLSA shows nominal manufacturing wages have soared 165% since 2005, while the touted productivity improvements have offset only around 40% of that salary growth.

Economists say that relative to manufacturing productivity, Chinese wages are quickly catching up with the US. More

The Long Road to Economic Rebalancing

China's export value vs. domestic consumption



Source: General Administration of Customs and World Bank

expensive labor has fed speculation that manufacturers will seek to ‘reshore’ production in the US, as costs saved by making goods in China evaporate.

“Many people are worried about the outlook of China’s exports. One argument is that the fast growth of wages will damage the competitiveness of export firms. [But] Chinese firms can still leverage the improvements in productivity to offset the increase of wages,” says Wang.

Along with rising labor costs, recent appreciation in the renminbi has also taken its toll on exporters. China’s currency has gone from being controversially weak to uncomfortably strong, strengthening against the US dollar by about 5% annually since Beijing reformed exchange rates in 2005. So far this year, the renminbi has gained around 1.5% against the dollar, more than last year in total.

Government to the Rescue?

The alarming slowdown in June’s exports fanned speculation that Chinese policymakers would offer some help to ailing exporters. While China’s leadership has firmly ruled out a large-scale fiscal stimulus, Beijing did announce supportive measures at the end of July for exporters. These included streamlined customs procedures, fee cuts and tax exemptions.

“It’s moving things in the wrong direction because if [the central government] cuts taxes, then it’s going to have to turn somewhere else for those tax revenues. And the typical somewhere else is the household sector. It has the same impact as depreciating the currency—it basically forces up exports at the expense of the household sector,” says Pettis.

As Pettis notes, there is a disconnect between the public campaign for consumption growth and the measures policymakers are actually taking, which means exporters may not have to contend with a full-on economic shift for quite some time. But certain government stances on economic transition are unavoidable, particularly when trading currency valuation, which would be the quickest way to boost exporters.

A spate of large companies failing due

to a stumbling export sector could see Beijing spring into further action, to stave off a potentially destabilizing round of mass layoffs. But devaluing the currency to improve the price of Chinese goods sold abroad is likely not in the cards, according to Pettis and Wang.

“The reason I never believe [currency depreciation] would happen is because that means instead of rebalancing the



The heart of the imbalances are very low interest rates, low wage growth and an undervalued currency

Michael Pettis
Finance Professor
Peking University

economy, China is taking steps to make the imbalances worse. Remember, the heart of the imbalances are very low interest rates, low wage growth and an undervalued currency,” says Pettis.

Stabilising the currency, rather than devaluation, may be fair game according

to economists with foreign banks. “The renminbi has appreciated too quickly... and negatively affected export growth,” said Ma Jun, Deutsche Bank’s Chief Economist for Greater China, in a July research report. “We believe that the People’s Bank of China will be instructed to keep the renminbi more stable in H2 [second half].”

The prospects for China’s export machine will hinge upon the rest of the world, with the US playing the dominant role, says Pettis. “The US is starting to recover. Europe isn’t. I don’t think Japan is going to be a lot of help for the next few years. It really depends on the US recovery, and the US recovery is happening but it’s weak, so I think [exports] could easily be derailed by trade actions of other countries.”

Exporters and manufacturers are also taking action to insulate themselves against further losses. Besides the switch to higher-value exports in the form of machine tools or electrical and electronics systems, Chinese firms are shifting low-end production to either other regions in Southeast Asia, or China’s hinterland, to take advantage of cheaper labor.

“It makes you more competitive and also profit margins are higher,” says Wang. “Also China is moving some production from the coastal area to the hinterland, where they have cheaper labour. And those laborers in the coastal areas are more productive, so they can be used for other high-end production.”

The country is likely to downsize, not abandon, its role as factory to the world. “Chinese firms are still holding up,” says Wang. “The bigger picture is that China’s exports sector is experiencing adjustment, but not in a worrying way. Export growth is going to be in line with economic growth or slightly under.”

But Such optimism is in short supply in the quiet workshops of Wenzhou. “Our rising labor costs and the yuan’s appreciation have squeezed our meagre profits,” says Yang from Yongli Suitcase.

“However, we have to make the products for our customers. We have to pay our debts. We hope things will be better in the future.”



Lean In on the World

Sheryl Sandberg, the Chief Operating Officer of Facebook, wants to see more women in the corner office

By Xin En Lee & Neelima Mahajan

Sheryl Sandberg, the Chief Operating Officer of Facebook, has turned herself into an evangelist for women. Sandberg, who regularly ranks on various lists of the most powerful women in the world, believes that there is no such thing as true equality in the world. “There is not a single country in the world where women have an equal share at the tables where decisions are made,” she says, citing statistics that prove her point. Out of all the countries in the world, many hundreds, 16 heads of state are women. Barely 21 of the Fortune 500 CEOs are women. “I think even more concerning than the absolute numbers is the fact that in many ways, progress for women has stalled,”

says Sandberg.

Sandberg herself and her spectacular rise up the corporate echelons at Google and now Facebook (and, of course, her earlier stints at the US Treasury Department and the World Bank) hardly paint the picture of a woman who has been held back by gender-related stereotypes, institutional barriers, or women’s own mental barriers. There is a lesson for women in Sandberg’s success, one that she writes about in her bestselling book *Lean In: Women, Work and the Will to Lead*.

In Beijing recently, Sandberg spoke to *CKGSB Magazine* at two different events on what needs to be done to change the paradigm of women in leadership—and

the Lean In movement (Leanin.org) that she has launched to encourage women to close the ‘ambition gap’.

Q. What are some of the institutional changes you would like to see happening to encourage women in leadership?

A. I’d like to see better public policy for women around the world. In the US, women are not guaranteed a single day of maternity leave. In China, women get 98 days. So I think that’s certainly a change we should see. But what I’d really like to see is more women in leadership positions so that more of the public policy decisions everywhere in the world are made by women.

Q. To what extent are the tenets of Lean In universal or international?

A. They are very universal. I've had a woman in almost every country in the world right a foreword for the book. Yang Lan (a Chinese media mogul) wrote it for China. And in each of those forewords, women are saying the same things, which are these are the stereotypes that have held us back. Interestingly, no matter how different cultures are, the fundamental stereotypes of what is male and what is female are similar all over the world.

Q. Do you support affirmative action along gender lines? Why or why not?

A. Affirmative action is a complicated phrase. There is actually no one good meaning of affirmative action. There have been times in the history of different countries where having explicit policies that benefit one group are important and there are times when they are not. Each country has to decide what are the right policies for it at the right time. But I do know that we can't legislate ourselves out of this problem and that if you look at the countries that have the very best laws in the world for women, the most affirmative action, the most quotas, countries like Norway, they still have less than 3% of their big companies run by women. So public policy can do some but it can't do everything.

Q. In China Chairman Mao famously said, 'Women hold up half the sky.' Are there any lessons that we can pick up from China's experience with women?

A. I think that [in] Chinese families, there's a lot of power in women. Women are making a lot of decisions in ways that I think are very important and something we can really learn. There's also been a lot of success in getting women into leadership roles. It's still not 50/50 as it should be, but it's been, in some ways, very successful. If you look at the very top companies women have about five-and-a-half percent of the CEO jobs, but if you look at the next tier of companies, the kind of SMBs (small-medium sized business), women have 20% of the CEO jobs and so I think that shows good progress and of



Too many women don't get the support they need

course there is more we can do.

Q. How do you intend to keep sustaining this conversation you've started? What is your vision for leanin.org in a space where there are so many global women's organizations?

A. I really wanted the conversation to be bigger than just me or the book. I wanted it to be a community, which is why I worked with others to form leanin.org. Our goal is to make this conversation for women all over the world, and it's working. We have more than 270,000 people connected to us, and if you go to the website, you can see a lot of these conversations. We're very focused on helping women form circles. In Beijing, we know at least one of these events where about 100 women came together to form circles.

Q. You mentioned that you wanted to help women keep up skill-sets, so can we see more clearly what leanin.org is trying to do in that regard?

A. We're trying to do three things—we're trying to create an ongoing conversation and community around equality. We do that on our website, we do it on every social media platform, we do it on Tumblr and everything we can use. We're trying to have a conversation. You'll see a lot of Lean In stories. We're trying to make this lots of other people's voices.

The second thing we're doing is Lean In education. We have some videos up there, and they're dealing with things

like gender bias and how to negotiate as a woman. We're trying to take materials that only very senior women like me would have access to, and make them freely available to everyone.

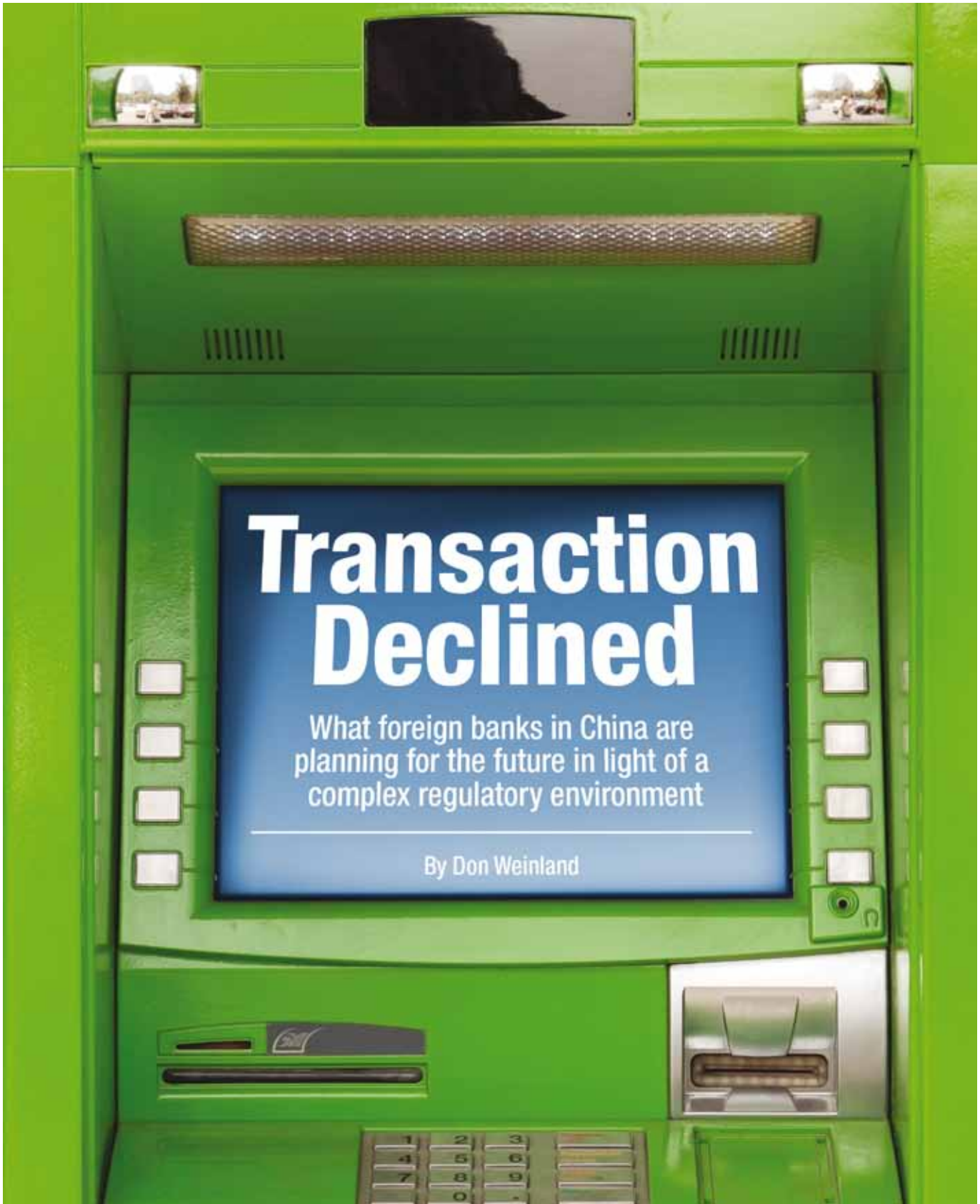
The third thing is circles, which is peer mentoring. Too many women don't get the support they need and we're working with partners to mentor women and we want to help women help themselves. We have more than 7,000 circles, and we have them running in 50 countries. We want to see more circles in more college campuses, in more countries, and more women supporting each other. We're already hearing back from the circles—what's working for us, and what's not working.

Q. How have the men who are in CEO level positions responded to you, and how do you know they've internalized your message?

A. We're also working with companies and it goes to your point about male CEOs. We have over 220 partners, and these include companies, non-profits and they jump in and say we really want to lean in. I've done a number of events with a number of CEOs, and we've seen a really big pick-up. We've seen companies which are starting circles within their companies. [In] Cisco, he [CEO John Chambers] assigned my book to his top 400 managers, and he asked all of them to write a memo on how they were going to be better on women. I've just shared the stage with Bob Moritz, the Chairman of PricewaterhouseCoopers and he has asked all his senior people to mentor women and diverse candidates. He said, 'We're not getting enough mentorship for people who aren't white males... I want my senior staff to mentor'.

I did an event with the CEO of Symantec. They're starting circles within their company, and they are also reading the book and passing it down. They're having every manager read the book with their direct reports, men and women. And the next group is supposed to discuss the book. ■

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(To watch the video log on to CKGSB Knowledge: knowledge.ckgsb.edu.cn)



Many of the world's largest manufacturers have set up storage units and factories in the Waigaiqiao Free Trade Zone about 20 kilometers from the bustling center of Shanghai, mostly to reap tax benefits. The quiet streets and subdued environment are little indication of the more than \$100 billion in trade value that passed through the zone and two nearby free trade areas in 2012, roughly 3% of the country's overall trade volume, according to a note from HSBC.

In early July, China's State Council said it planned to turn the three zones into a single financial space where market forces will reign more freely than anywhere else in the country. In practical terms that would mean allowing free conversion of the renminbi and speedy establishment for wholly-owned foreign banks, among other things.

The Shanghai Free Trade Zone rules will supposedly house the country's most relaxed banking and exchange rules, allowing international banks to capitalize on the offshore services that make them successful on the global stage. Foreign banks have sought such reforms since the 1980s, while slowly being allowed back into the mainland market after decades of exclusion.

Premier Li Keqiang has lauded it as breakthrough reform and even reportedly fought against banking regulators to push the plan through. But even so, it would be little more than an oasis of free market forces in an otherwise harsh regulatory environment that has kept foreign banks from establishing themselves in the sought-after retail and commercial bank industry.

"It will just be a bubble for reform. Outside [of the zone] will stay the same," or remain unreformed, says one Shanghai-based banking insider, who asked to remain anonymous due to the sensitivity of the topic.

Managing Expectations

The records of the biggest foreign banks in China say they have operated on the mainland for well over a century. Standard Chartered says it opened its first office in 1858. HSBC Holdings traces its roots back to 1865 in the two cities of its namesake,

Hong Kong Shanghai Banking Corporation.

Of course, in the 1950s after the Communist Party established New China, only a few foreign banks were allowed to stay in the country under strict confinement. Four decades later in 1995, a handful of foreign banks asserted themselves on the mainland via partnerships with domestic banks, mostly those that had long-standing ties with China. Today, they constitute the country's biggest foreign banks: HSBC, Standard Chartered, Citibank and Hong Kong's Bank of East Asia.

Other banks rushed into China in the late 1990s when the government allowed foreign banks to set up representative offices and subsidiaries. By early 2000, there were 191 representative offices and subsidiaries with \$36 billion in assets, according to documents from the Cato Institute, an economic think tank based in Washington, DC.

"People were excited about the WTO [World Trade Organization accession]. They could see the market was about to change," recalls Noyan Rona, the Chief Representative at Garanti Bank's representative office in Shanghai. Garanti Bank is Turkey's second-largest bank and entered China during the initial rush in 2000.

The WTO Letdown

When China became a member of the WTO in December 2001, regulators promised to let foreign banks expand around the country, deal in the local currency and launch real retailing business within five years. They also said banks could apply for wholly-owned local incorporation.

On the eve of the five-year deadline, China Banking Regulatory Commission (CBRC) even told nine foreign banks to prepare to be incorporated, a 2007 report from consultancy KPMG showed.

Today, much of the hope for a foreign banking boom has all but subsided as promises go unfulfilled under the large shadow of Chinese banks.

In 2012, foreign banks held only 1.82% of the total \$21.46 billion industry assets, according to CBRC's latest industry report. What's worse is that figure

shrank from 1.93% in 2011, down from a peak of 2.38% in 2007. At the end of 2011, China hosted 37 fully incorporated foreign banks, a flat line since 2009, according to the report. According to a 2012 IMF report, the emerging market average for foreign bank assets is 49% of the total bank assets.

In mid-July, Deutsche Bank, with more than \$2 trillion in total assets, shuttered its last retail branch in Beijing, a bad omen for the industry as a whole. Deutsche Bank declined to comment on the closure.

On and Off Paper

The dreary outlook can be attributed to over-regulation on and off paper. During the past five years, regulators have increased the level of regulation for both domestic and foreign institutions while giving less guidance, says Dennis Chan, Deputy General Manager of Nordia Bank in Shanghai. Stockholm-based Nordia has one branch in Shanghai and a representative office in Beijing.

In 2010, the CBRC issued stringent rules on working capital loans so that loans of more than RMB 10 million would reach the real economy and not be immediately appropriated into investments like real estate.

"I have never seen this before in my past banking experience," says Chen, who has worked in the Chinese banking sector since 1994. "That regulation could very well help local banks. But for foreign banks, they normally have better credit control than Chinese banks. This limited the way we operate."

But difficulties extend beyond the regulations on the books. Foreign banks will struggle to get routine paperwork approved by authorities, says one insider who asked to remain anonymous. Approval can take long periods of time, standards change constantly and often arbitrary requirements are included. Most frustrating, this person said, is how procedures differ between cities.

"Every step costs the banks money. And it's no small cost," the insider says. "On paper they have met the [WTO] obligations. But in practice they are still far off."

Furthermore, the past 10 years of economic reform have not included China's judiciary, and the legal framework that binds foreign business in the country remains weak, according to a paper issued last year by the European Chamber of Commerce. This can be a precarious environment for the foreign banks that support these businesses.

Running the Gauntlet

If conditions seem rough for big banks like HSBC, small banks are all but disqualified. The four major foreign banks that operate in China have an 85% hold on China's foreign bank market, leaving the other foreign banks with a tiny percentage of the total market.

One reason is the CBRC requires all entrants to have at least \$20 billion in total assets before they can even consider applying, and then the application is fraught with steep costs and roadblocks.

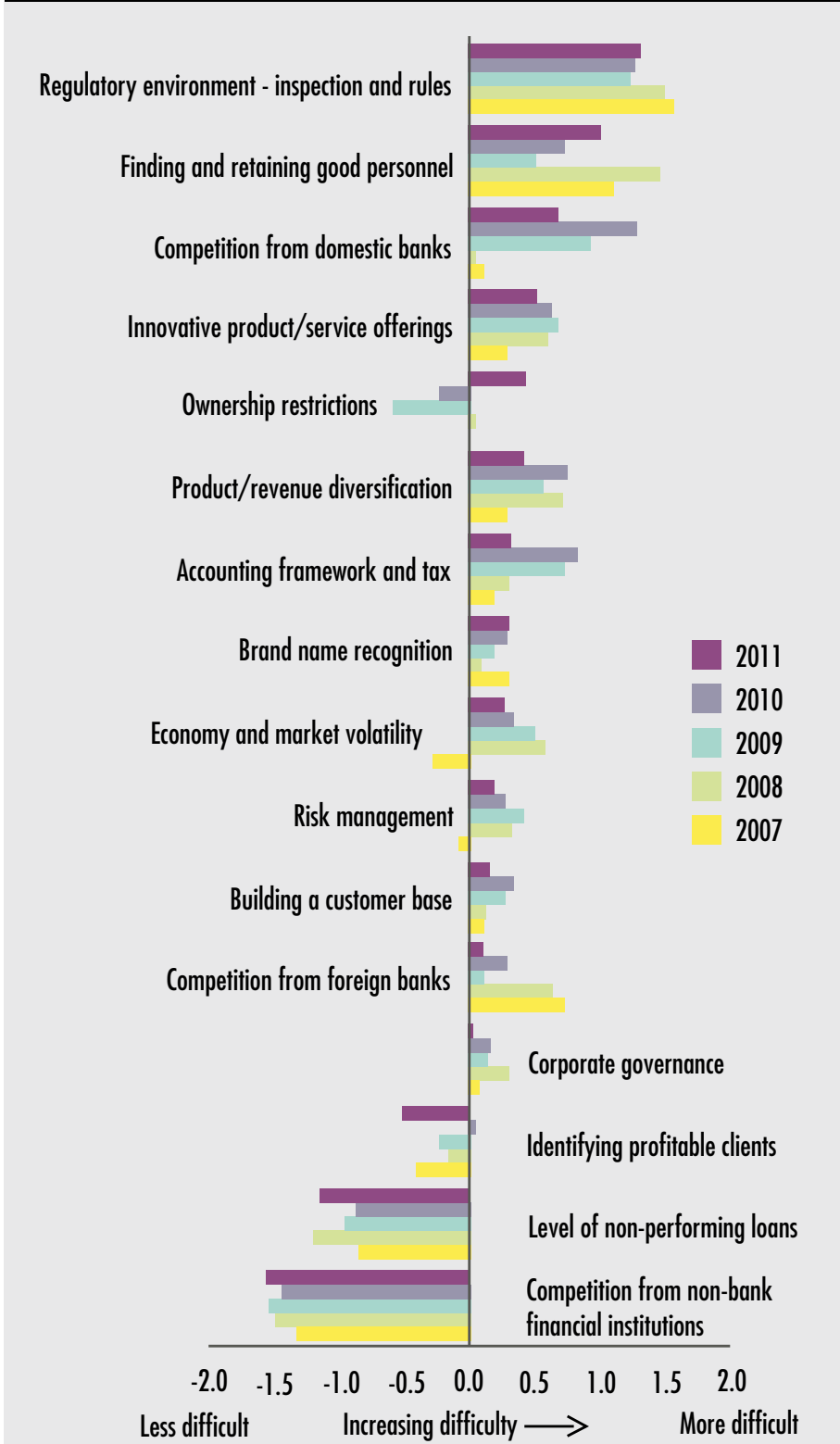
The first step is opening up a representative office. Banks will need to maintain \$30 million in reserves. The CBRC requires the banks to deposit 40% of their capital at the central bank for safe keeping should they default, a unique requirement in the international banking market. In many developed markets, foreign banks are held to the reserve requirement of their home country, though this is changing in the US and UK where foreign bank fallout after the 2008 financial crisis has prompted a reevaluation of the rules.

Only after three years as a representative office can a bank apply to open a branch in the country. This kind of bank is limited to doing trade finance and letters of credit. Also, these branches aren't permitted any transactions in RMB. Whether lending to foreign companies or Chinese firms, loans and deposits must be denominated in their respective foreign currencies.

The most difficult restriction in the ongoing application process is that the banks must turn a profit during this time. After three more years of income-generating operations, a bank can apply to lend in the local currency.

The high reserve ratio and 40% of the banks capital deposited at the PBOC can

Main Foreign Bank Complaints
PwC survey of international bank executives



Source: PricewaterhouseCoopers International

make the first three years of business difficult, and the slow process discourages expansion and keeps smaller players from growing in the market.

“To be honest, it’s very difficult here for many reasons. The bigger [banks] that succeeded, I think it’s because they were able to get more licenses to operate other forms of business [such as credit cards],” says Jean Thio, a partner at law firm Clifford Chance in Shanghai, who specializes in banking and capital markets. “The bread and butter of the business is hard to do without a large distribution network.”

Carving a Niche

Without the option of retail and commercial banking, many banks with small presences in China cater almost exclusively to trade between China and their home country. Garanti does letter of credit verification for Chinese and Turkish businesses trading goods between the two nations. It does not have retail branches, nor does it plan any foray into this market in China.

Bigger banks like Citi have continued to specialize and offer new products, like Citi’s mutual funds and credit card business. But progress in niche banking is hit-and-miss in China. Approvals for new kinds of products come on a case-by-case basis.

Citi’s branded credit card is an exception to the rule. Only Citi and Bank of East Asia have been allowed to issue cards that aren’t part of a joint venture with a Chinese bank. Visa’s and MasterCard’s ventures into branded cards on the mainland have forced them to partner with UnionPay, the payment platform owned by a consortium of Chinese banks that dominates the domestic payment processing market.

In June, industry insiders cried foul when China’s central bank stopped a payment platform other than UnionPay from processing MasterCard transactions. Once again, China was accused of not living up to its WTO obligations.

One clear answer for the big-name foreign banks is private banking. These

financial institutions have done well using their reputation to attract high net-worth individuals who are wary to put all their money into Chinese banks. At HSBC, the minimum amount required to open a private account is \$100,000.

“They normally have a very big brand recognition. As soon as they set up shop, they have credibility,” says Liu Jing, Professor of Accounting and Finance at Cheung Kong Graduate School of Business in Beijing, of foreign banks and their ability to pull in rich Chinese customers. “Their footprint in China might be very small but their brand is very big.”

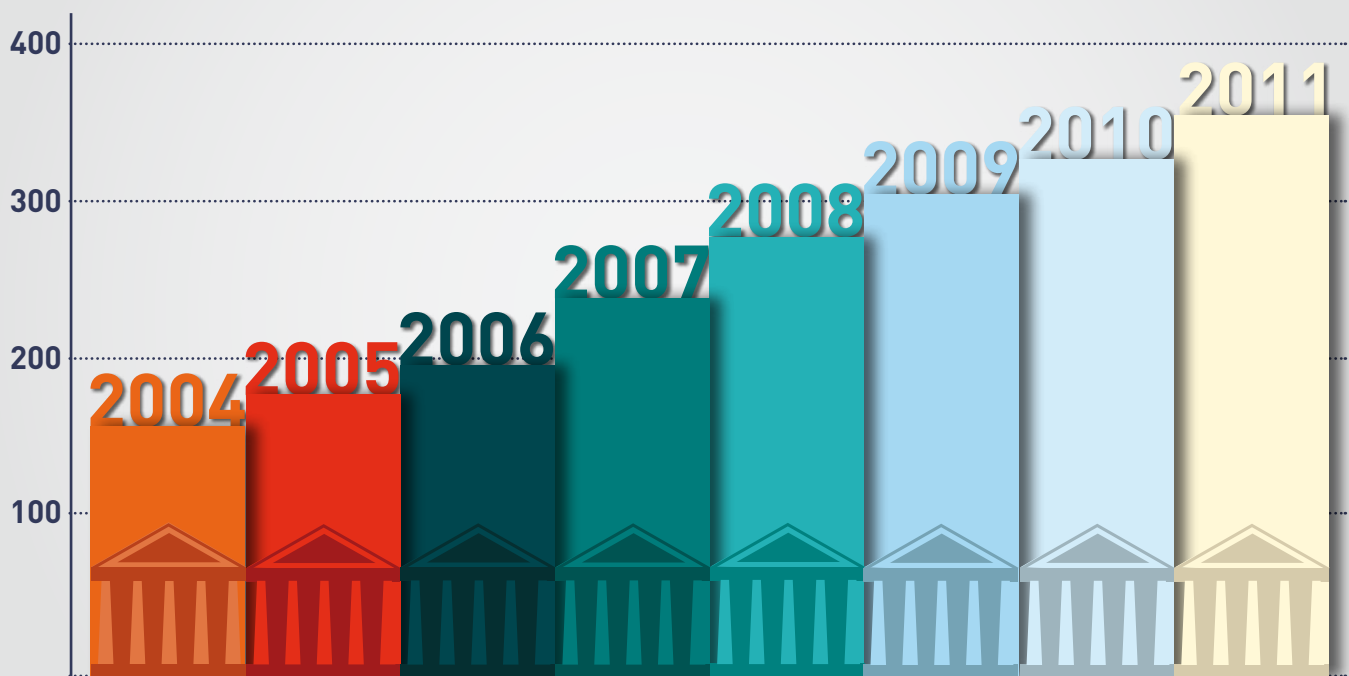
Big Bang Theory

These trends point to the fact that foreign banks are far from reaching their full potential and still waiting on major reform in China.

In early 2012, Chinese state media published a five-point plan for reforming the financial sector. At the end of the list—and lacking a clear date—was the plan to

China Footprint

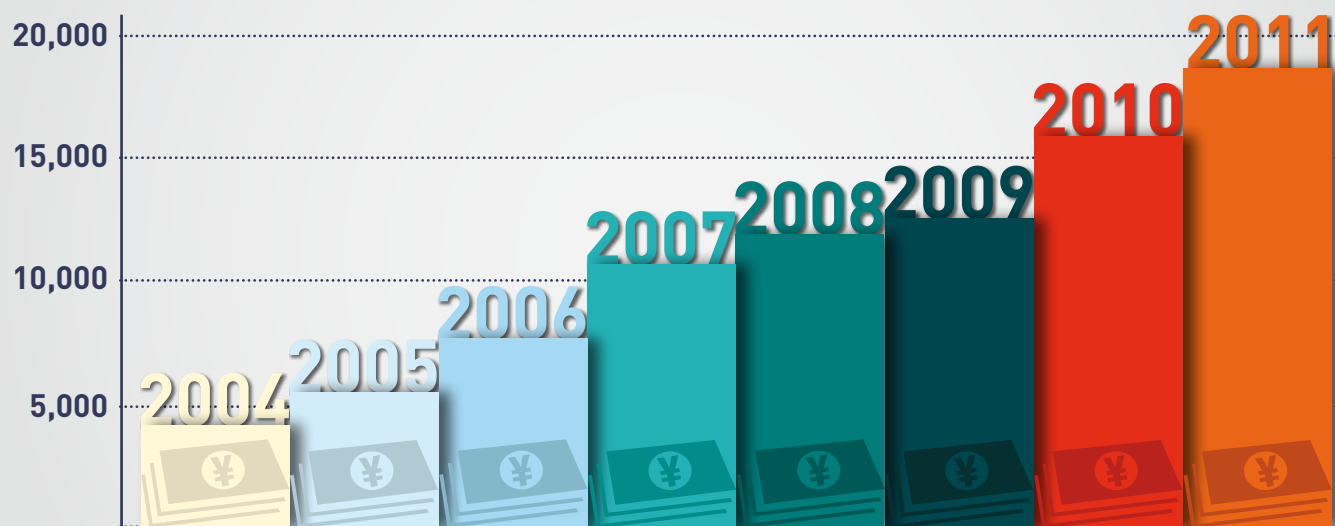
Number of foreign banking institutions in China



Source: China Banking Regulatory Commission 2010 Annual Report and official statistical data

China Loot

Foreign bank assets in China



Source: China Banking Regulatory Commission 2010 Annual Report and official statistical data

liberalize the renminbi. The People's Bank of China and the State Administration of Foreign Exchange has tight control over the currency's use. Since 2008, the regulators have slowly allowed for cross-border trade in RMB, starting in Hong Kong and culminating in RMB 1 trillion circulating outside the mainland this year.

But most of those transactions take place in Hong Kong and hardly allow for foreign banks to conduct the kind of international transfers necessary to support a mainland-based global financial hub, which is what regulators say they want Shanghai to become by 2020.

"With international banks, their advantage is really doing banking on the international stage," Liu says. "But China really restricts how money flows in and out of the country. That tempers their competitive advantages. I think that's the biggest challenge."

To China's regulators, there are several examples nearby of how, and how not to liberalize a currency. When Thailand opened its capital account in the mid-1990s, the country experienced a quick influx of cash from international investors,

only to see that capital flow out just as rapidly a few years later as questions over the country's financial stability mounted. That outflow would lead to the Asian financial crisis of 1997.

South Korea, where foreign bank assets averaged 20.5% of total country assets between 2004 and 2009, took a much more gradual approach to opening its market, according to International Monetary Fund documents, slowly pushing through reforms between 1988 and 1996. Much like China, Korea used ceilings on lending rates to channel cash to specific sectors. The full convertibility of the won has brought in many foreign banks and their expertise, transforming Seoul, South Korea's capital, into a regional financial hub.

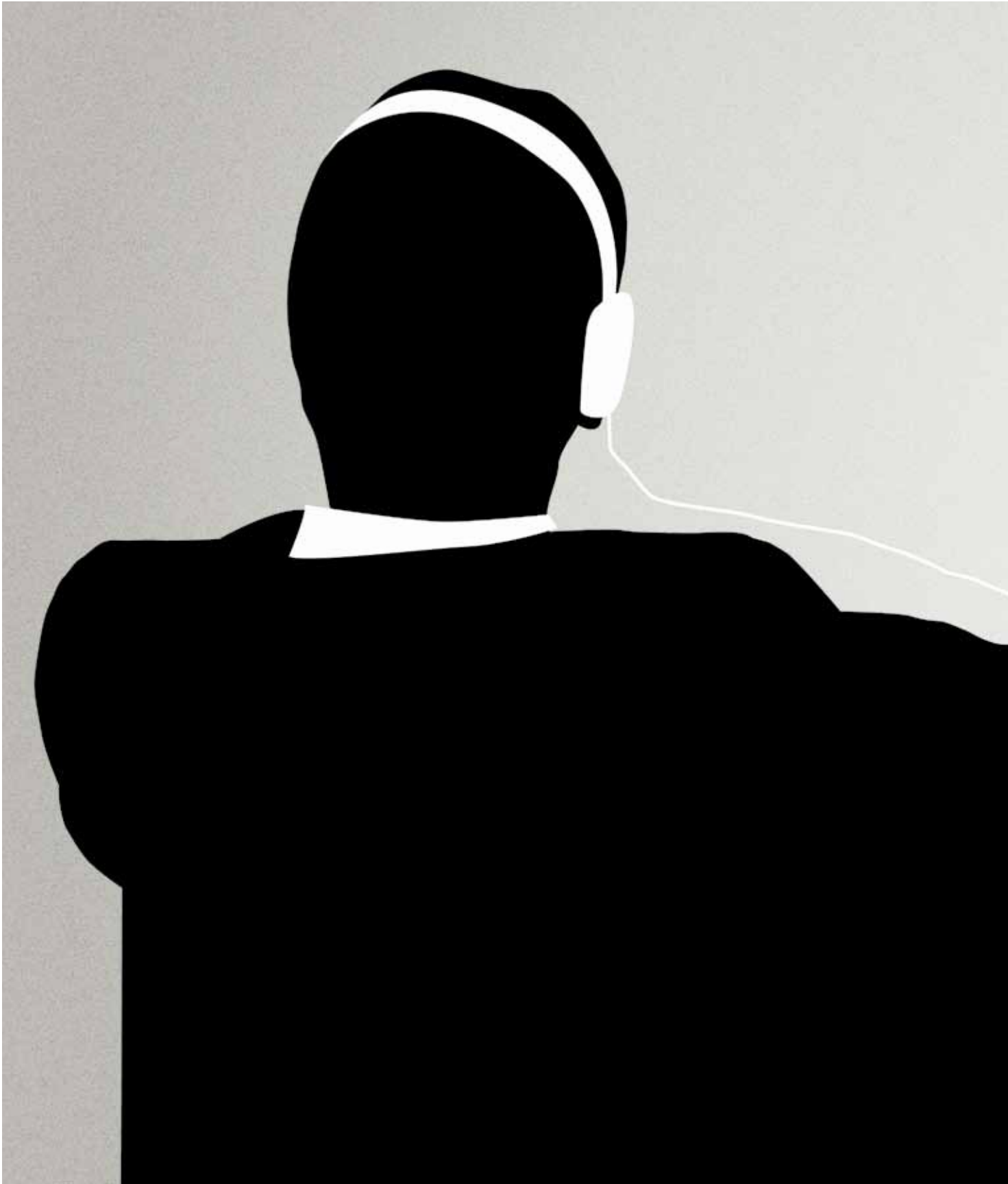
But South Korea's financial market is a good deal smaller than China's, housing only 37 foreign banks, 15 of which came under investigation in late 2011 after the central regulators raised concerns over the volatility that foreign bank-led capital flows bring to the market. China's own banking regulators likely consider such a scenario as they ponder reform.

Real Reform

The Waigaiqiao Free Trade Zone will be a testing ground for reform on a national level, according to a late August report from HSBC. The bank says the time is ripe for such sweeping change. About 16% of China's cross-border trade was settled in RMB in the first half of the year, up from 12% during the same period last year. Alex Fuste Moto, Chief Economist at Andbank in Andorra, said in a recent report that cross-border trade in RMB would hit 40% within five years, a factor that will pressure regulators to act.

In that respect, the country is bursting at the seams with demand to do business in RMB, and foreign banks are ready to facilitate that business. This much is evident to technocrats in Beijing, but willingness to relax control is questionable.

PBOC and CBRC are more than financial supervisors. The overarching regulators are also some of the most powerful political organizations in the country. Freeing up the banking market and liberalizing the renminbi jeopardizes their importance in the economy, something they will certainly resist. ■



MAD MEN 3.0

What will define China's successful advertisers in the digital age?

By Suzanne Edwards

The scene begins with a guttural male yell and the rich thump of a large drum, the camera panning across the Chinese mountainside surrounding the Great Wall at sunrise. All at once a vibrant red flag waves, and little by little the viewer glimpses acrobatic feats performed by athletic male dancers in imperial garb. The music builds and the drum beats faster and the performers turn out en masse in the Temple of Heaven to leap, bound and flip through the air. All the colors and charisma culminate in one final panoramic view of the Great Wall, China's iconic landmark, as the text appears on the screen: "Marlboro, a new year brings a new spirit that spreads across the land."

That was one of the last tobacco advertisements to be seen on TV in China before authorities banned tobacco advertising on television in the late 1990s. With massive marketing dollars and nowhere to land in the world's largest tobacco market, tobacco companies became the pioneers of online advertising in China. Today, those companies are employing all of the vital tricks of effective online marketing, from microblog accounts to online mini-films featuring time traveling cigarettes, and online games where players can win what? Cigarettes.

Tobacco companies are no longer alone in online China, and online marketing is no longer a frontier. As the largest mobile and internet market in the world, China's online marketing arena has great potential of scale, but in a place where media costs are soaring and online user information is not readily available, China's digital Don Drapers have to get thrifty and constantly evolve their techniques.

Pack your Moneybags

A 2013 iResearch report shows China's online advertising revenue reached RMB 75.31 billion in 2012, rising by 46.8% year-

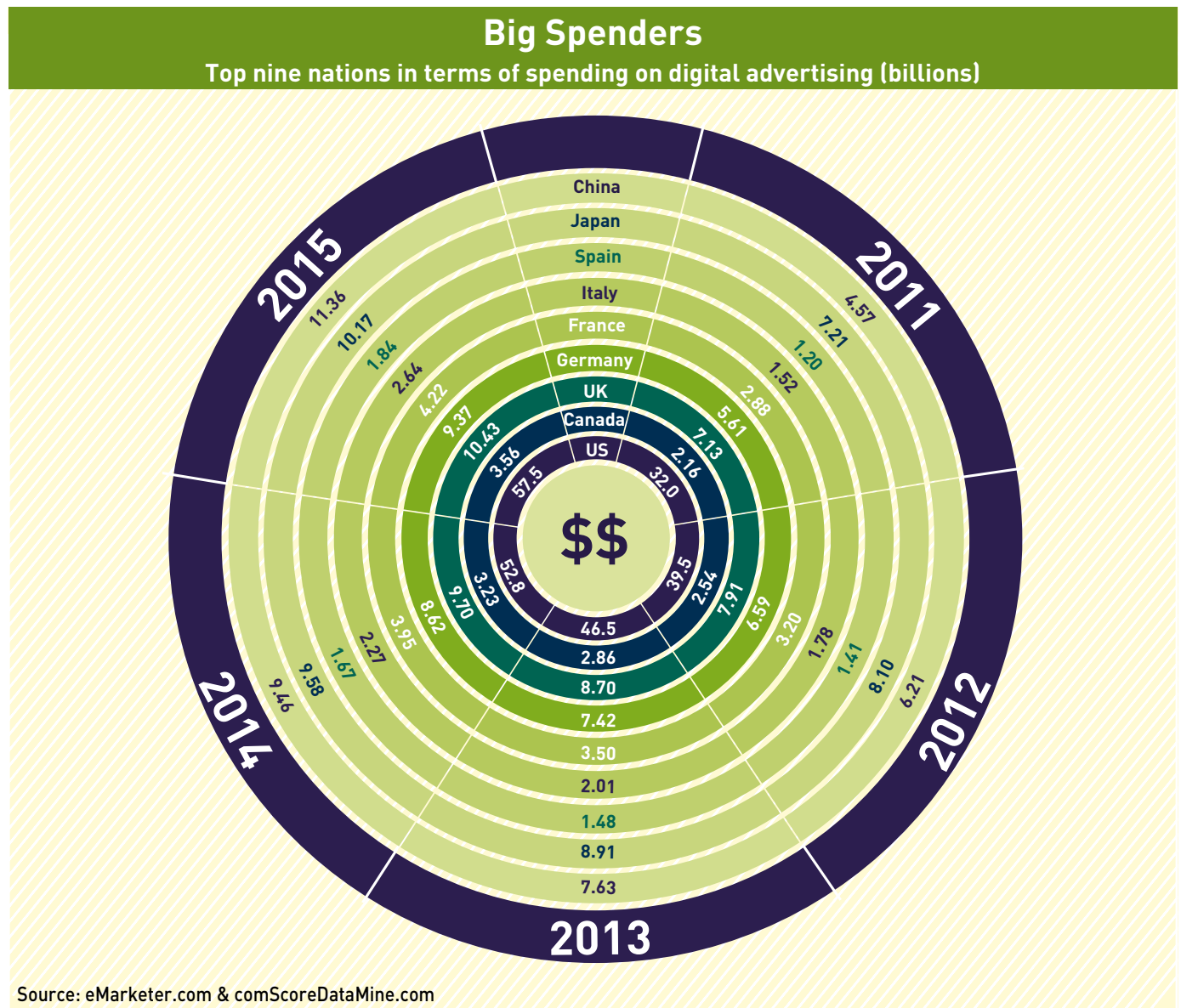
on-year and hitting a record high. Online ad revenue is predicted to exceed RMB 100 billion in 2013, out-sizing TV ad revenue. In addition, the rate of internet usage in China is now 44%, up 10% from last year's rate thanks to the 464 million citizens that accessed the net via smartphones or other wireless devices, according to the China Internet Network Information Centre.

In the past, traditional media kits—TV, radio and print—were used mainly to educate the public about a certain product and build brand awareness. Online advertising, especially in China, has instead been used to impact the actual purchasing

decisions, according to Zhang Kaifu, Associate Professor of Marketing at Cheung Kong Graduate School of Business. But that is now beginning to change.

"It's not just the ads, if you look at TV and radio, the mediums themselves are also moving online. The specialization that has always taken place between different mediums is also happening within online advertising today," says Zhang.

China's online video market grew to reach a total value of RMB 2.42 billion, a 39% increase from the same period a year before according to an April 2013 iResearch report.



The growth of online advertising is taking money away from traditional mass media. Newspaper advertising revenues were around RMB 68.55 billion in 2012, down 12.6% from the same period the year before, the first negative growth in the past decade, and it continued to fall in the first quarter of 2013 by 12% year-on-year, according to a report from market intelligence firm Research and Markets.

“For companies that are newer to China and haven’t reached critical mass yet, their budgets are smaller, they wouldn’t be doing TV at all, because they couldn’t afford it, and they’d be spending their money through a combination of online, mobile and activation [promotions],” says Charles Sampson, CEO of global advertising agency Young & Rubicam China. “If you have younger demographics, this can really work for you.”

It’s likely that these pre-critical-mass firms are most responsible for the shift in marketing dollars from traditional mass media to online media.

The Loyalists

In the near term, the conservative streak among Chinese firms will keep the traditional ad mediums alive, particularly TV and outdoor advertising.

“As a general rule for bigger clients who have bigger budgets, the majority is still spent on TV, outdoor, you know mass media, but online and digital is definitely growing. Typically the percentage for that kind of client may be between 20 and 30% spent online, which is significantly more than, say, three years ago when it was 10%,” says Sampson. And offline advertising revenue in China still benefits from an education lag. Clients, he says, are not yet convinced of online marketing.

“What you’d see in the West for example is some clients would just launch 100% of the campaign online, that is much rarer here,” says Sampson. “But I think that’s a mistake, especially for clients who have a [target] demographic with customers in their 20s and 30s.”

“There was a huge gap maybe three to five years ago, between the amount of time that people were online and the amount of

money that companies were spending on their online advertising. Now that gap is closing, and we’re seeing a similar evolution with mobile advertising,” says Marc Violo, Associate Director of the Digital Lab at Ogilvy & Mather Shanghai.

Another factor keeping firms hooked on TV is the perception that China’s lower tier cities are best reached through offline media. But CKGSB’s Zhang notes, and other studies show, that rural residents who do have internet access are devoting more of their time to online activity, particularly shopping, as traditional retail channels under-serve these markets.

Digital Outback

“People in small towns actually spend more time online shopping and looking at products than people in bigger cities,” Zhang says.

But it’s not only e-commerce that’s taking up internet surfing time in smaller cities. A project by Starcom MediaVest Group in 2011 spanning 13,000 consumers in 500 lower-tier cities, dubbed “The Yangtze Study”, found that digital ads reached roughly 60% of their audience. In addition, people in third-tier cities spent 3.57 hours per day on average online, compared to 3.25 hours by first-tier users.

With entertainment made more accessible through websites like Youku Tudou and Sohu, the computer is becoming the center of household entertainment. For marketers, the emergence of online video as a key platform is part of the increasing segmentation taking place online.

“A lot of traditional ad agencies haven’t set themselves up for digital as well as other companies, so the challenge now for marketers is they have to work with a traditional agency, a media agency and sometimes a social media agency, and getting all these agencies to work together is a challenge” says Greg Paull, Principal at R3 Marketing Consultancy in China. “It’s definitely costly.”

We’re Online, Now What?

Media agencies in developed markets have been dealing in internet data analysis for years. Facebook display ads now

relay content that is specific to age, education, location, relationship status and likely much more. According to CKGSB’s Zhang, internet users are six times more likely to click on an online advertisement when advertisers leverage targeting capabilities. But these tools are still not widely used in China, so online advertising content is not as well tailored to its viewers.

“Advertising is less mature in China than in the West. China has different social networks to play around with, but their social networking sites lack the same flexibility as Western ones,” says O&M’s Violo, saying Facebook is open source while getting Sina-Weibo user information usually depends on a special relationship with Sina. For this reason local agencies can take the upper hand in flexing their relationships with various media agencies, he adds.

After data collection, marketers have several platforms to work with: search engines, gaming, online video, social networking/microblogging sites and instant messaging.

“Search and instant messaging have always been at the top and are still big, but online video and gaming have definitely broken through as crucial,” says Violo.

According to iResearch, in 2012 Baidu’s ad revenues reached RMB 22 billion, making it the single most important online advertising platform in China, accounting for more than 30% of total online ad revenue in 2012. Video sites Sohu and Youku Tudou combined reached ad revenues of nearly RMB 4.7 billion, and online game ad revenue rang up RMB 830 million.

“With most of the marketers we deal with now, online video is a key part of their strategy, so you see a lot of shift in marketing dollars from TV advertising to go into online video,” Paull says.

Video Star

The preference for online video advertising starts with cost efficiency. CCTV’s prime ad slot, before the main evening news program, reaped RMB 5.4 billion at the media auction for 2013 media spots, which overall drew RMB 15.9 billion. It’s little wonder that smaller firms are ditch-

ing TV all together.

TV advertisements are more subject to official oversight which contributes to content homogenization. Control of the Internet is less rigorous and there's greater freedom with the video content. Violo of O&M says another key difference between TV and online video ad spots in China is that online video viewers tune in for longer, allowing for longer advertisements and more complete storylines.

"Effective online videos in China tend to have emotional storylines with a TV format adapted to online video sites. They're also a longer format," Violo says.

But humor is not to be discarded, says Sampson. One online video that went viral this past year was an advertisement for 999 anti-itch cream. The video series features a buxom Chinese lady modeling instructions for scratching one's bodily itches with panache. The translation of the voice over for one of the videos is as follows:

1-2-3-4 Raise leg

2-2-3-4 Make a seductive look

3-2-3-4 Lift up skirt

4-2-3-4 Use the opportunity to scratch the itch"

This ad is more risqué than what would be found on TV and is also part of a series, a hot trend in online video advertising.

"More and more clients are seeing the potential for longer-form content that can be played on the web, obviously the cost is lower, and the viewer numbers can be pretty large," says Sampson, citing examples like Wrigley and Mars Chocolate as firms that have embraced the tack of online-movie-series advertising.

But the most brilliant online content can be wasted if not targeted correctly, and targeting starts with good intel.

Skeptical Advertising

Generally, online advertising allows marketers to track an ad's impact with website views and clicks so they can constantly evolve content. But in China, marketers complain of generally inflated traffic numbers and inaccurate measurements.

"Global measurement platforms, don't always work in China, so there is less ac-

countability and transparency in data collection points," says Violo.

According to a 2013 R3 survey, 40% of digital marketing professionals say traffic accuracy is their biggest concern in digital marketing and 80% believe site traffic data is generally overstated.

Consumers in China also doubt the information they receive, a "trust deficit" that Sampson says is exacerbated by high profile corruption cases and product safety scandals. In response, brands are paying ever-closer attention to social media. "In terms of the media that people really trust, it's weibo [China's main microblogging platform]."

"I think you've got to give microblogging a year or two and that's going to become the dominant media," says Paull.

But even trust in weibo sites is under threat, Sampson says, with some of the most popular key opinion leaders with vast weibo followings increasingly being seen as bought off by vested interests.

Go Mobile or Go Home

The future predominance of mobile advertising is an inevitability that big advertising agencies are diligently trying to convey to their China-based clients.

"Mobile is now the leading digital platform in China, which presents huge opportunities for brands. Agencies are already evangelizing this," says Violo of O&M.

Among the early proponents are Alibaba, which purchased an 18% stake in Sina-Weibo earlier this year, and its mobile rival Tencent. But Violo also adds that mobile is still a "difficult nut to crack" in China because of the limitations of many popular mobile platforms.

"It's limited and not location specific, which makes it less effective, mobile advertising should be about providing locally relevant communication," says Violo.

Once advertisers can crack the nut, there is ample reason to be excited about China's mobile possibilities. A 2011 survey from global tech market intelligence firm ABI Research showed actions taken by mobile users in China in response to ads delivered to their mobile devices. Nearly 46% had investigated a product or service

and 45% had signed up to receive text alerts. Mobile is clearly making strides.

Not to be Forgotten

The e-marketing and mobile craze shouldn't detract from some more basic, and cost-effective, options that can have a potent effect when done well.

Sampson of Y&R recalls a campaign his company implemented for GAP in which they purchased all the outdoor space on Shanghai's retail-saturated, and centrally located, Nanjing Road. Pedestrians were inundated with billboards and banners touting the "let's GAP together" advertising slogan. Sampson refers to this as one of the most effective campaign strategies in his recent memory, and the costs were highly manageable.


"With media fragmentation, outdoor is one of the last mediums through which you can reach a lot of people quickly," says Sampson.

Promotions also go a long way in China because consumers crave product access. Paull of R3 offers the example of Dell Computers, which has stuck to a global business model of selling its products online, making China the only market where it has had to actually set up a retail outlet.

"They [Chinese consumers] like access and to see the products before they buy it, so there's a big role for offline events and that continues to grow," Paull says.

Whether it's TV, outdoor, online video or mobile, Sampson insists that agencies and clients will have to up their creative game from where it stands.

Sampson says he devotes much more time to client education in China compared to places he has worked before. Clients in China need to be more firmly guided toward long-term campaigns with creative sustainability, and away from cheap branding that appeals to an inflated sense of materialism.

"People underestimate the sophistication level of consumers here, and I think it's one of the reasons why creativity, branding and engagement is lagging behind where it should be. There are human truths that work as well here as anywhere else," he says. 

Dangerous Middle Men

The loan guarantee structure is inherently flawed and if left unchecked, has crisis potential

By Song Zhongzhi

In principle, the banks are the best players in China's financing arena for assessing and managing the risk of lending to a certain firm, and are, thus, the best positioned to lend money to small and medium-sized enterprises (SMEs). But the realities of private sector financing in China show that companies cannot always rely on banks to provide the desperately needed capital. This disparity has birthed the overly large shadow banking industry.

But for enterprises and firms that shun the shadowy lending organs that charge interest rates anywhere up to 60%, and can exact a variety of extralegal means of dealing with a defaulted loan, another option has presented itself.

Loan guarantee companies have taken their business to the next level and are underwriting loans at increasing rates to help the firms secure loans from the bank. Just as with any other insurance system, the risk is ostensibly shifted from the bank to the loan guarantee company whereby the underwriter is taking the responsibility should the firm default on their bank loan.

What makes this a viable business in any market are the fees that the loan guarantee companies charge for their services, and as long as there isn't a massive number of loan defaults, it's a profitable operation.

The problem and the danger of an over reliance on these underwriters by the banks, is that these companies are in many cases insuring firms who aren't credit worthy in order to collect as many



fees as possible, and banks are more or less accepting the guarantees with little scrutiny since they're under political pressure to lend to China's cash-strapped SMEs. So in a way, the bank is turning a blind eye to the fact that the risk has not really been mitigated, only underwritten, because as long as they're finding a way to make loans, they're following their political directives.

Aside from the political pressure aspect, this is very similar to what went on at the front end of the recent financial crisis in the US, when banks would grant mortgage loans to households that did not meet the standard credit requirements, then create and sell the mortgage-backed security, thereby passing

the toxic assets onto the next investor. In China, the loan guarantee companies are acting much in the same way as the US banks did, underwriting credit to companies that simply don't qualify for loans.

We know from observing the US that the structure is flawed, and a meltdown is inevitable. It may not be next year, but eventually this system will go bust.

What China has going for it now is that the scale of this business is still relatively small. The significant scenarios of loan default that we read about are fairly isolated, but if all of the policy banks in China start lending with abandon through loan guarantees, then the problem becomes massive. Right now the risk on a national level is low, but it has the potential to become a much more urgent situation.

To solve the problem of credit constraints for SMEs, the credit market, rather than the government, has to be the driving force. If the players in the credit market do not have the incentive to serve SMEs, then they will find ways to get around any top-down policy, just like what banks did by passing the risk of lending to SMEs to loan guarantee companies to fulfill their unwilling 'requirement'. As a result, a policy that aims to help SMEs may actually bring more damage to the credit system. A better policy should encourage competition among all players including banks, where serving SMEs is in their own interest.

Song Zhongzhi is Assistant Professor of Finance, CKGSB

Cautious Optimism

The latest CKGSB Business Conditions Index indicates that Chinese entrepreneurs have a modestly positive outlook

With all the talk of growth slowing down, how are China's entrepreneurs faring? Are they actively making new investment decisions, or are they being cautiously optimistic, or even downright pessimistic? Each month CKGSB's Case Center and Center for Economic Research conduct a survey of leading entrepreneurs in China to gauge and track changes in their business sentiment. The result of this survey, the CKGSB Business Conditions Index (CKGSB BCI), produced under the guidance of Li Wei, Professor of Economics and Emerging Markets Finance, provides a barometer on the state of the economy as viewed from the eyes of China's entrepreneurs.

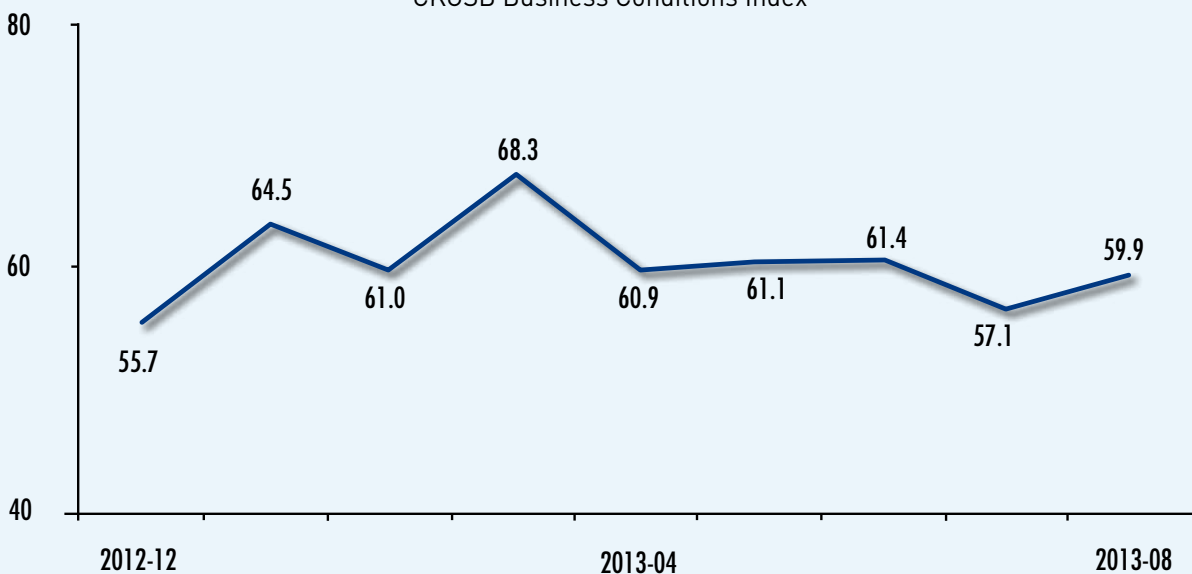
According to the August BCI, released in early September, the overall index has increased to 59.6, up from July's 57.1. This

indicates China's business leaders are optimistic about business conditions over the next six months.

The CKGSB Business Conditions Index is generated wholly on the basis of statistics gathered from leading enterprises whose executives have studied or are studying at CKGSB. We ask respondents to indicate whether their company is more, the same, or less, competitive than their industry average, and from this we derive an industry competitiveness index. Consequently, as most of our sample firms are in a relatively strong competitive position in their respective industries, the CKGSB BCI indices are higher than the government and industry PMI indices. Users of the CKGSB BCI index may therefore focus on changes in the data over time to help them forecast trends in China's economy. ■

China's macroeconomic situation is stabilizing...

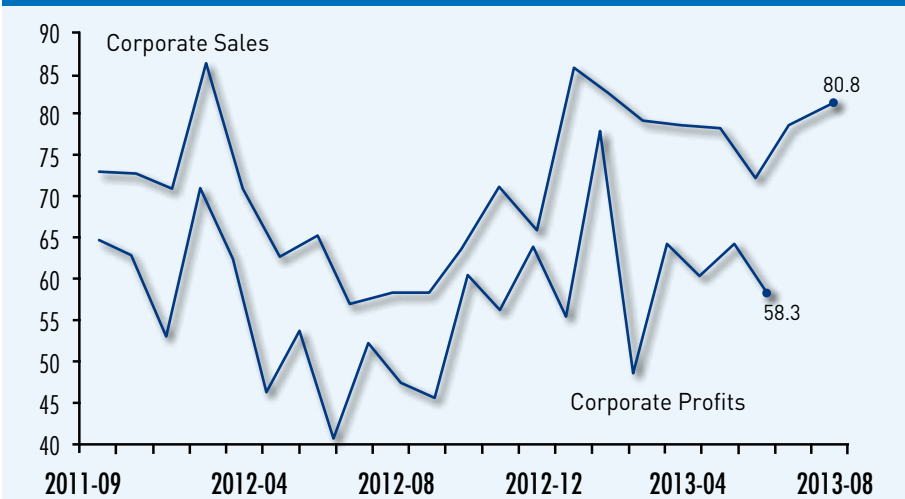
CKGSB Business Conditions Index



...as is industry competitiveness



Sales prospects are upbeat, but companies are cautious about profitability...

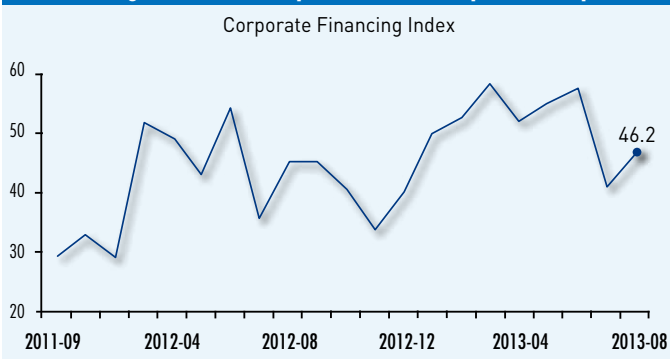


The corporate sales index has risen for two consecutive months, bringing an end to a downward trend that set in earlier in 2013. The corporate profit index is 6.3 points lower than in July, at 58.3. These two indices show that firms are not pessimistic about prospects for the next six months.

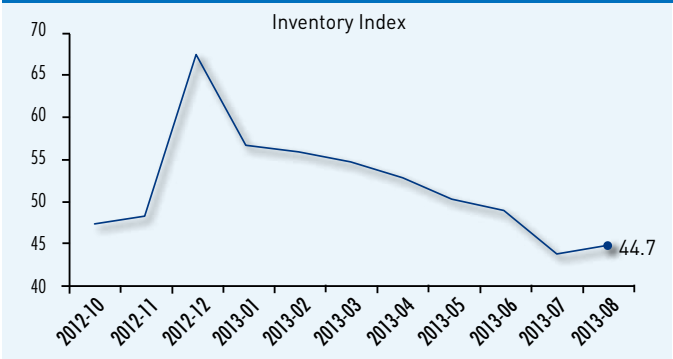
Optimism about financing is seen by most companies as being at a similar level to the same time last year. As the majority of our sample comes from private firms, this mainly reflects the financing situation for the private sector.

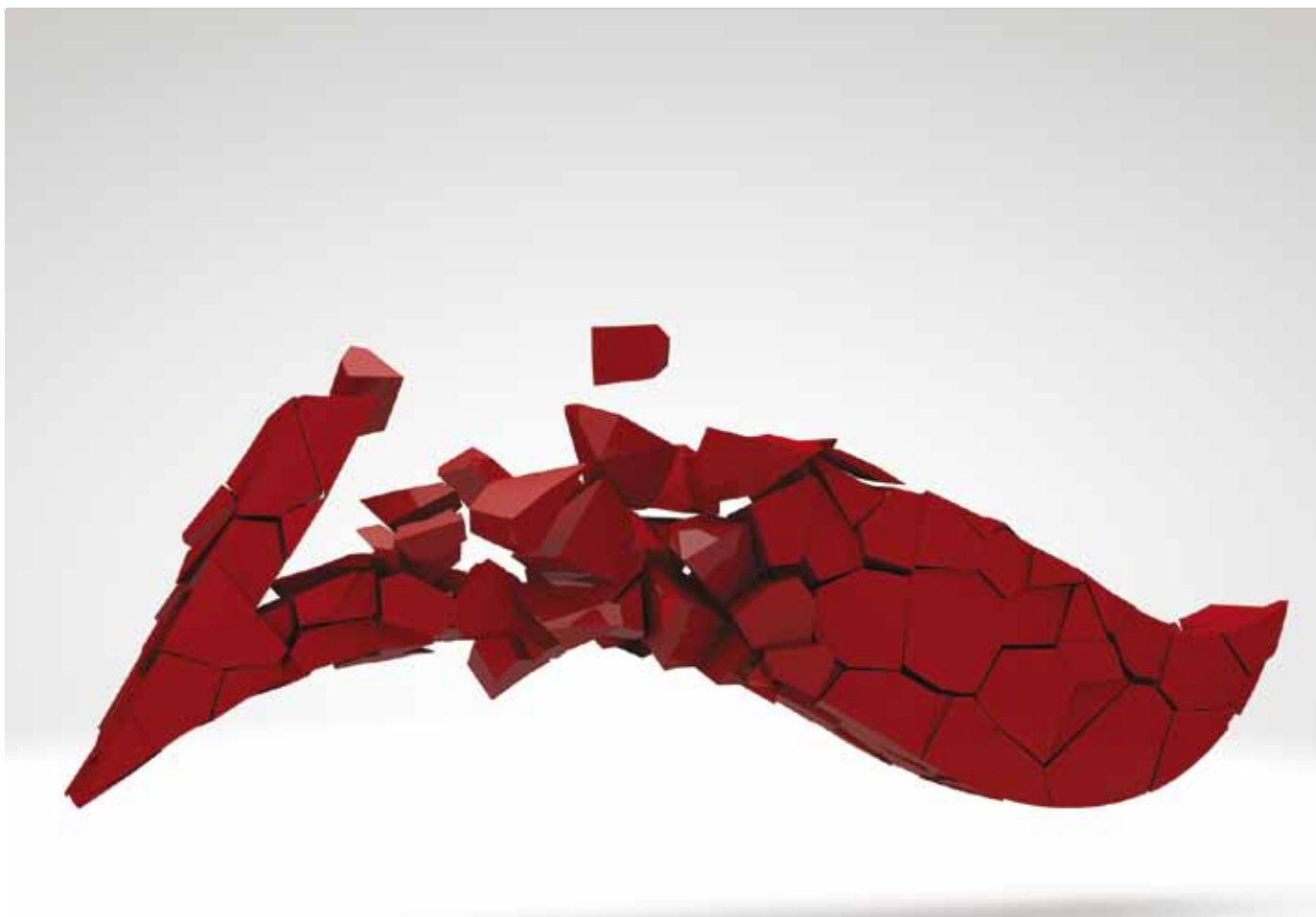
The downward trend in 2013 with four consecutive months reading below 50 bears witness to Chinese firms' inventory reduction efforts that started last year.

The financing situation for the private sector is expected to improve...



...and inventory levels are not expected to rise by much





HOLDING IT TOGETHER

Can Chinese sportswear giant Li-Ning
make the change?

By Xin En Lee

In the 2008 Beijing Olympics, legendary Chinese gymnast Li Ning epitomized the image of a powerful, rising China when he soared across the Bird's Nest in one of the Olympics' arguably most unforgettable moments. The image of a rising China did not just end there, for here was the leader and namesake of the leading Chinese sportswear brand, capturing global imagination in a moment which vastly outweighed the millions that global competitor Adidas had spent on the event. Ultimately a much smaller Chinese company with a fraction of Adidas' resources showed just how powerful a Chinese brand could be, a fact not lost on discerning sportswear observers.

Furthermore, Li-Ning the company had managed to consecutively steal top NBA stars like Shaquille O'Neal and Baron Davis from under Nike's nose, while commandeering a logo that was almost uncomfortably similar to Nike's famous swoosh. On opening a design center in Nike's native Portland, Oregon, Li-Ning's message was heard loud and clear: 'watch out US brands, we're here to stay'. The company seemed unstoppable, registering more than 30% growth every year. But its fortunes were to change dramatically. By March 25th of this year, the Chinese sportswear giant was in hot soup, posting losses of nearly RMB 2 billion, its first annual loss since it listed on the Hong Kong Stock Exchange in 2004.

News from the ground also paints a picture of a company trying to navigate its way through turbulent waters.

State-run *China Daily* reported in July this year that during the off-season sales in April, stores were selling Li-Ning apparel from two to three years ago at 80% off. The analyst quoted in the article noted that the larger-than-usual size of the discount and the production date of the apparel reflected the seriousness of the company's inventory problems.

A sportswear analyst, who asked not to be named, also added that most of the franchise owners whom he interviewed this year lamented that they were unable to sell even half of the Li-Ning apparel in their stores last year.



It was the first Chinese company making inroads internationally

Martin Roll
Brand Strategist
Author, *Asian Brand Strategy*

Consider that in 2010, the company's Chief Marketing Officer Abel Wu said of Nike, "We think we have a respectable competitor from the United States." In comparison, new Chief Executive Kim Jin-oon told *The Wall Street Journal*: "I don't think we're trying to compete with Nike." Clearly, the company's former sky-high ambitions have taken a hit.

Days of Glory

Founded in 1990 by Chinese sporting legend and gymnast Li Ning, who won six medals at the 1984 Olympics in Los Angeles, the company benefited from the national adulation of its founder. It also rode the start of the golden decade for the domestic sportswear industry in China. Until 2010, the company enjoyed annual growth of between 30% and 40%.

"It was the first Chinese company making inroads internationally and it was the first Chinese sportswear brand to launch on Hong Kong Stock Exchange," says Martin Roll, well known brand strategist and author of 2005 book *Asian Brand Strategy: How Asia Builds Strong Brands*.

"It was bold, very hungry, and it wanted to showcase to the world what a Chinese company could become," he adds.

In 2005, Li-Ning gained ground in international credibility through a strategic joint venture with AIGLE, a French company specializing in handcrafted outdoor sportswear, known for its chic designs and durability. In the same year, Li-Ning signed a strategic alliance with the NBA and became the first Chinese sportswear brand to appear in an NBA basketball court the year after. Upon winning over former Nike collaborators Baron Davis and Shaquille O'Neal, both players pronounced Li-Ning's designs as the 'coolest on the court'.

In 2008, Li-Ning signaled its ambitions by quietly planting its flag in Nike headquarter's backyard, opening its design office in Portland, Oregon where the US headquarters of other major brands Adidas and Columbia Sportswear are located.

That same year Li-Ning stole the show from Adidas with founder Li Ning's Bird's Nest stunt at the Olympic Games. The Olympic effect caused the company's stock to jump by more than 3%, registering an increase of about 54% in profits.

By the time Li-Ning opened its first retail store in the US in February 2010, there was a palpable buzz about the Chinese 'Nike'. Sneaker fanatics waited in line for five hours to be among the first to own a pair of BD Dooms, basketball shoes named after NBA star Baron Davis.

Making the Change

In July 2010, optimism was in the air when Li-Ning announced its transformation with a new logo and a more upscale product line-up. It also changed its marketing slogan from the tagline 'anything is possible' to 'make the change', indicating the company's desire to move away from being seen as piggybacking on Nike's fame. Its old logo, which bore an uncanny resemblance to Nike's famous swoosh, was stylized to look more like the Chinese character 'ren' (human) as well. Leo Wang, an analyst at China Market Research Group adds that while a logo similar to Nike in the first stage of its development offered

the impression that it was of Nike's standard, being put under the global spotlight at the Olympics probably made Li-Ning more aware of the need for brand positioning.

The company also hiked prices by nearly 10% for shoes and about 20% for clothes to reflect the higher quality of their products, a move that would soon thereafter plague sales figures.

Wang says that the aggressive expansion of distribution channels and sales in 2011 is the main factor in the company's persistent inventory woes. Li-Ning's company spokesperson confirmed that in December 2011, the number of stores was at its peak of more than 8,255. In comparison, Nike had about 7,500 shops in China in 2011, while Adidas is estimated to have about 7,800 shops in 2012.

"In 2011, there were a lot of franchises and new distributors because Li-Ning was very optimistic about future sales, which didn't turn out as expected. Although they had inventory overhang from the Olympics, the main problem comes from 2011," says Wang.

Within six months, orders for 2011 were rumored to have fallen by 6%. JP Morgan and the like had dumped the company's shares and Li-Ning had allegedly closed between 500 and 600 stores.

When its revenue fell for the first time in 2011 in comparison to the year before from RMB 1.1 billion to RMB 385 million, the effects of the brand repositioning were evident. Between 2011 and 2012, the company also shuttered 1,821 stores, slightly more than a fifth of its then-network of 8,255 stores.

Course Correction

In January 2012, Li-Ning received a much-needed injection of capital of about \$115 million from US private equity firm TPG and Singapore sovereign fund GIC. Following the news, Li-Ning's shares climbed by more than 10%.

Li-Ning spokesperson Siobhan Zheng highlights several strategies the company is implementing to fix its issues.

Firstly, in July 2012, the company unveiled a transformation plan, with man-

agement changes as the first step. Former Chief Executive Zhang Zhiyong was replaced by TPG executive Kim Jin-oon, who was instrumental in turning around Daphne Holdings, a Chinese women's shoes retailer. By this year, the company had replaced the five top senior management roles with new hires from companies like Levi Strauss a US-based denim and casual-wear company, and General Mills Taiwan, whose parent company General Mills is a US-based food processing company with a stamp on many of the nation's most popular snacks.

The TPG arrangement seemed to have boosted Li Ning's shares by 4%, even after news that Chief Financial Officer Nicholas Chong had resigned in October 2012.

Six months after the plan was unveiled, the company launched a channel revival plan that would focus on buying back inventory to improve the mix of products displayed in stores, weeding out less profitable distributors and working more closely with distributors in general.

Zheng says the core aim of the plan is to transform Li-Ning from a wholesale to a retail business model. She clarifies that "much of the plan involves handholding with distributors and sub-distributors (i.e. distributors who also stock other brands), for instance, helping them do better promotions, store displays and achieving more efficient supply chains to achieve the effect of the retail business model." For example, the new retail model will include faster product replenishment so that distributors aren't saddled with unsold products for long periods of time.

Zheng adds that the stores under the pilot project of this retail business model performed significantly better. The only challenge, is the increase in the amount of work since Li-Ning has never implemented such a scheme, she says.

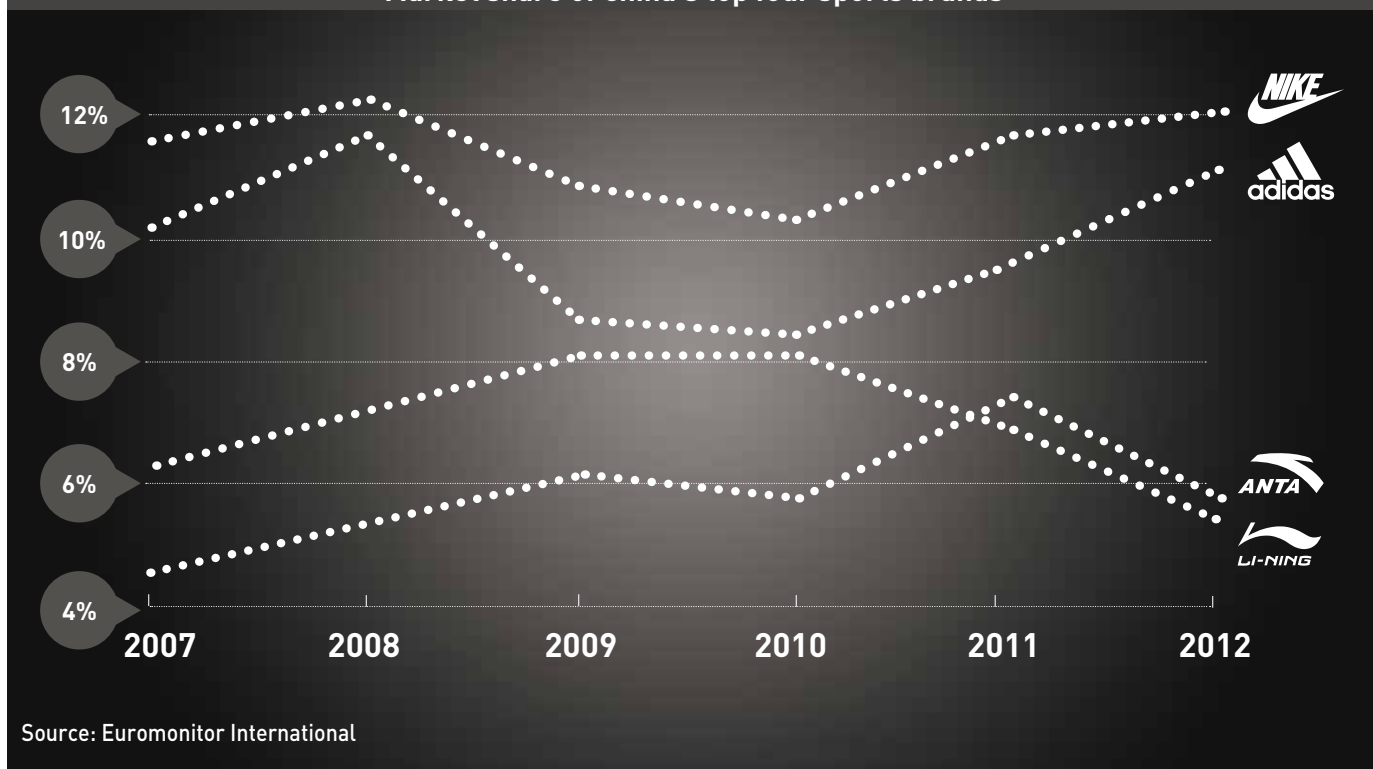
Woes or no, Li-Ning still managed to sign a multi-million dollar contract with NBA star Dwayne Wade, which many analysts highlighted as a bright spot in the company's current state.



NBA star Dwyane Wade of the Miami Heat with company founder Li Ning in Beijing in October 2012

The Brand Race

Market share of China's top four sports brands



“We chose Wade because he’s not the tallest, and strongest, but he’s gotten to where he is today through sheer hard work. That is a story which resonates with Chinese consumers appreciate a strong work ethic,” Zheng says.

Mixed Responses

While presenting the interim results, Li-Ning told investors that effects of the plans implemented last year had already taken effect, such as better inventory turnover and increased sell-out rates.

In the meantime, even the world’s largest sporting-goods maker is struggling in China. Eighteen months ago, Nike said in July this year that China sales will fall for the next two quarters, making it five in a row. Li-Ning’s domestic competitors, including ANTA and Peak, reported similar activity.

“The market has been oversupplied for too long. We believe the inventory issues of the industry may not be solved until next year,” says Wei Xiaopo, Head of Consum-

er Research at CLSA. “When you have a lot of inventory, when everyone is heavily discounting, and when you discount for too much for too long, it damages the brand and that’s hard to restore, especially when Li-Ning’s pricing is a bit higher than its domestic competitors,” he adds.

Other experts like Boston Consulting Group Partner Vincent Lui are more optimistic about Li-Ning’s capacity to turn things around.

Lui suggests that local sports brands are better off zeroing in on their ties to the market in the face of stiff competition from foreign brands. “I think it will be important for local sports brands to be able to connect with the sports heritage in the country, for instance, connecting to sports leagues and college students.”

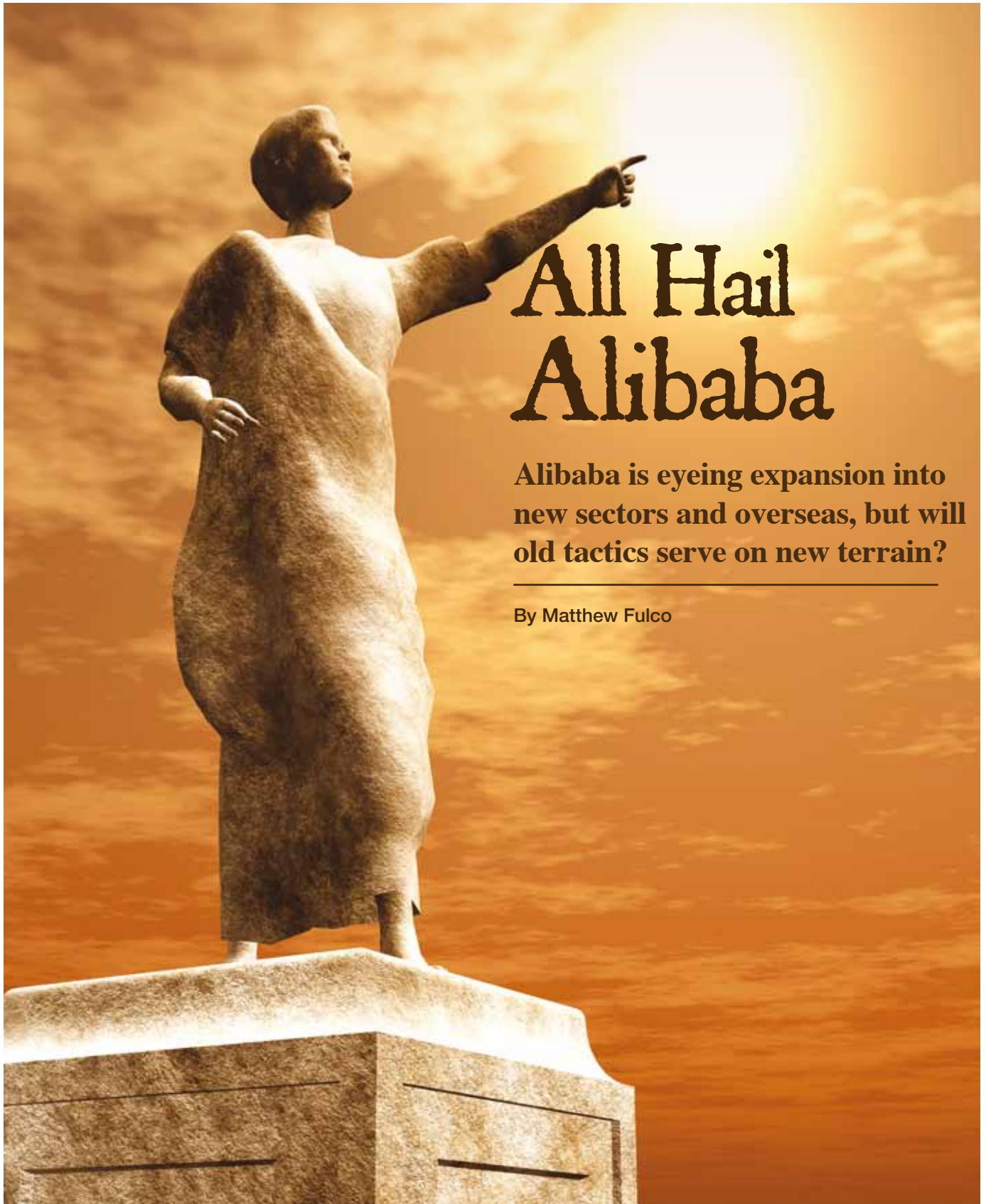
Lui hit the nail on the head, as Li-Ning’s Zheng emphasizes that “Li-Ning’s major focus is to return to sports, and to focus on China”. Without going into specifics, she revealed that Li-Ning would concentrate more fully on developing a

focus on sportswear as opposed to casual wear. Store displays, which use a roughly 70:30 ratio for displaying apparel and sports shoes respectively, will now bring the ratio to 50:50 to reflect the brand’s sharpened focus on sportswear.

But Wang of China Market Research Group notes that casual wear is ‘a market still growing at good speed,’ citing Adidas’ increased sales in China due to their marketing of NEO, a youth-oriented brand in the middle ground between sports and fashion.

Roll also pointed out that Li-Ning’s expansion has only been for less than a decade, while Samsung, another emerging market brand, took almost two decades to become the global brand it is today.

“I think Li-Ning still has the opportunity to create magnitude of unheard proportion, they have the NBA affiliation and that is a fine class of sportswear brands to be in... But they need to get their story right quickly—inventory overhang and consumer perception can kill a company.”



All Hail Alibaba

Alibaba is eyeing expansion into new sectors and overseas, but will old tactics serve on new terrain?

By Matthew Fulco

If Jack Ma has his way, the sun will never set on Alibaba's empire. The billionaire entrepreneur's internet giant rules China's e-commerce roost, with 500 million registered users and RMB 1 trillion in total 2012 sales from Tmall, its business-to-consumer (B2C) site, and Taobao, its consumer-to-consumer (C2C) online store. Built into those sites is Alibaba's secure online payment system Alipay, which holds nearly half of China's RMB 13 trillion third-party payment processing market.

To stay at the top, Alibaba is expanding into sectors outside of its traditional wheelhouse. With Beijing's blessing, it added RMB 5 billion to the coffers of its nascent micro-lending business in July. After stepping down as chairman, Jack Ma is now spearheading the development of a RMB 100 billion national logistics network to bring the small and medium-sized companies that are Alibaba's bread and butter deeper into the e-retailing giant's folds.

Despite its lofty ambitions, Alibaba's fortunes are far from certain. Bold expansion into unfamiliar terrain can flop, as the company experienced during its abortive foray into internet search with Yahoo!. At the same time, the finance sector, paramount to Jack Ma's growth strategy, remains one of China's most controlled. The e-commerce playing field is also shifting to mobile where rival Tencent dominates with its powerful WeChat platform.

Newly acquired stakes in Sino-Weibo's micro-blogging service and the mapping firm AutoNavi may help Alibaba shore up its weaknesses in mobile ahead of an expected listing on the Hong Kong Stock Exchange and potentially New York as well. The Hong Kong IPO value has been estimated at different amounts between \$60 and \$130 billion, according to a Morgan Stanley note released in February of this year. Alibaba's new Chief Executive Jonathan Lu said last July that the company was ready to float, but did not specify when or where it would list its shares.

Should the mammoth IPO, touted to be bigger than Facebook, come to pass,

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Ma won that vote of confidence because he established himself early on as a leader in the construction of China's internet

Edward Tse
Chairman Emeritus
Booz & Co. Greater China

founder Jack Ma would come one step closer to realizing his lofty ambition for international fame. Ma told shareholders in an annual general meeting in 2009 that their needs were secondary to his preeminent goal. "If Alibaba cannot become a Microsoft or a Walmart, I will regret it for the rest of my life," he said.

The Rise

Working out of his Hangzhou apartment, former English teacher Jack Ma launched Alibaba.com in 1999 as a business-to-business (B2B) website that connected foreign buyers with Chinese suppliers. Alibaba raised \$25 million from major

institutional investors the following year, including Softbank, Goldman Sachs and Fidelity.

"Ma won that vote of confidence because he established himself early on as a leader in the construction of China's internet," says Edward Tse, Chairman Emeritus of Booz & Co. in Greater China.

Ma also secured his funding before the dotcom crash of 2000, which sullied the reputations of internet start-ups, says Porter Erisman, who worked alongside him as Alibaba's Vice-President of global communications from 2000-2008. "It's hard to imagine such a large investment would have come in immediately after the internet bubble burst," he says.

Alibaba also expanded gradually, a tack which bested the breakneck growth of certain early competitors. The e-commerce firm 8848, named for the height of Mt. Everest's apex, became an initial market leader at the dawn of the Chinese internet era. Also founded in 1999 as one of China's first widely used e-commerce platforms, *Time* and *Forbes* both named it as one of China's top websites in 2000.

After the 2000 dotcom crash, 8848's funding dried up and its misallocation of resources among immature B2B and B2C businesses hastened the platform's demise in 2001, says Tse of Booz & Co.

Alibaba also side-stepped the crash by calling for reinforcements in 2001 when the company hired former GE human resources executive Savio Kwan. As Chief Operating Officer, Kwan established a more effective HR structure when Alibaba was growing too quickly and lacked an organizational chart, says Erisman. "The HR systems helped Alibaba to succeed where other companies failed."

With HR systems fortified, the e-commerce retailer launched its third-party payment service Alipay in 2004. By holding payment for a transaction on its sites in escrow until the buyer received the purchase, Alipay became a secure online payment system at a time when few Chinese consumers used credit cards, and now processes 8.5 million transactions daily.

In the mid-2000s, Taobao had one major rival to challenge, but its attractive

price point ultimately won it the market against eBay, the leading US-based C2C e-commerce platform. eBay eventually withdrew from China in 2005 because their business model of charging sellers to list their products proved too costly to Chinese users, says Erisman.

“Taobao allowed people to start a new business from their home with an internet connection for virtually nothing,” he says, adding that Taobao’s TV marketing campaign, an avenue ignored by eBay, also bolstered its brand and established trust with the consumers.

Van Gao, who with his wife Angeline Li operates a women’s clothing e-store they call Feerique on Taobao, earned RMB 9.2 million in revenue last year. “The payment system makes buyers feel secure that they won’t be cheated,” he says.

With eBay taken care of, Alibaba focused on its next platform: Tmall. Julia Zhu, a former Alibaba product manager and owner of Observer Solutions, a Washington D.C.-based consultancy that advises US investors in China’s e-commerce sector, says that Alibaba’s well-designed and easy-to-scale platforms have been vital to its growth, and Tmall is no exception. Founded in 2008, the B2C website has grown at an exponential rate and is on track to overtake Amazon by revenue in 2015 to become the world’s largest internet retailer, according to Euromonitor. Such scale has opened doors to other business avenues.

Easier Money

Alibaba established a micro loans business three years ago that has since extended over RMB 100 billion in credit to more than 320,000 small e-commerce firms and entrepreneurs. In July, the Chinese Securities Regulatory Commission authorized Alibaba to expand funding for its lending business by RMB 5 billion, highlighting how powerful the company could be in answering the fierce demand for financing from small enterprises.

Alibaba’s prospects in the lending business are promising, says Duncan Clark, Chairman of the Beijing-based technology consultancy BDA. “With the

push from the central government to reform the financial sector and promote SMEs and the private sector, I think there are some favorable tailwinds for Alibaba in this area at the moment,” he says.

Teng Bingsheng, Associate Professor of Strategic Management at Cheung Kong Graduate School of Business, agrees Alibaba has Beijing’s backing for now. “The government wants to do some experimentation,” he says, adding that the new financing channel may put pressure on banks to up their small and medium sized enterprise lending.

But Tse of Booz & Co. points out that Alibaba’s forays into financial services face some entrenched opposition. “A non-bank getting into a banking activity is by definition a gray area. Alibaba could be seen as encroaching on their territory.”

For now, Alibaba’s micro-financing business is a non-threatening 0.1% of the total credit provided by China’s banks.

Martin Liu, Associate Professor of

Marketing at Nottingham University’s Ningbo campus, is also skeptical of ‘the Bank of Alibaba’. “The government may be supporting Alibaba’s lending business now, but in China, a lot of things are not set in stone,” he says. “I don’t think it [the lending business] will fulfill its promise.”

Alibaba’s lending business has been made possible by utilizing its massive data stores, which are unique in their size and scope in China.

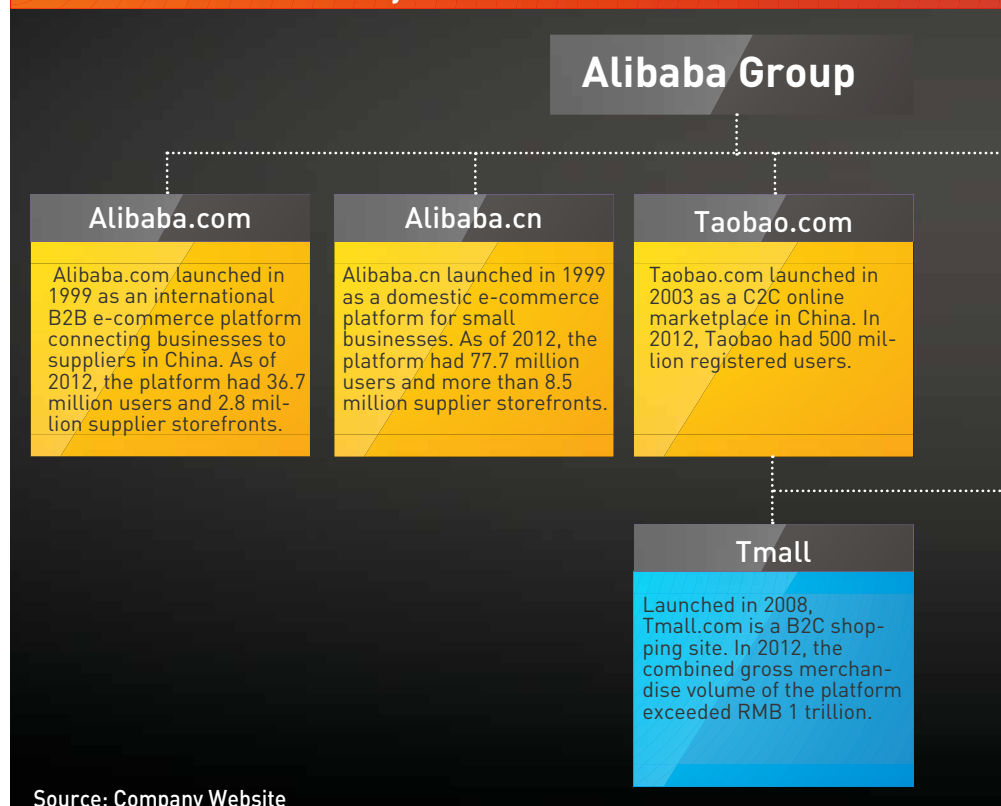
The Big Data Advantage

Alibaba’s expansion into Big Data will place the company on more familiar ground as it aims to use its vast data collection accumulated over 14 years to make its different platforms more competitive.

Big Data refers to the relatively new technology that allows for the processing of vast amounts and categories of data at higher speeds than ever before. Western companies have been leveraging Big Data increasingly over the past several years, and

The Ali-Empire

The reach of Alibaba's many business arms



in China, no one's in a better position to capitalize on the technology than Alibaba.

Big Data will allow Alibaba to understand consumers' behavior in the past and to some degree predict how they will act in the future, says Clark of BDA, making it a great asset in developing product roadmaps as well as understanding credit risks in its lending business. "It's a very serious advantage," he says.

Big Data will also be instrumental in the development of its national logistics network in which Alibaba and its partners will invest up to RMB 100 billion over the next five to eight years. Jack Ma will serve as CEO of the Alibaba-led consortium, which is called Cainiao Network Technology. Cainiao aims for its smart logistics system, which will include its own national network of warehouses, to deliver online orders to customers in 2,000 Chinese cities within 24 hours.

Cainiao will use Alibaba's location data to select prime locations for ware-

houses and optimal delivery routes, says Zhu. The completed network will provide a logistical infrastructure that Chinese SMEs badly need, ultimately lowering their costs of doing business, she says.

The logistics network will also strengthen Alibaba's hand against rival Jingdong Mall (JD.com, which previously used the URL 360Buy.com), which is the second-largest e-commerce firm in China and has a dedicated logistics network of its own. "The prevailing view is that the quality of the products on Alibaba's sites is not as reliable and the delivery not as consistent as on 360Buy," says Tse of Booz & Co.

But Zhu of Observer Solutions believes Jingdong is outmatched against the new Cainiao consortium. "Since they operate the logistics network alone, there is a limit to how much they can scale it up before they run out of cash," she says.

Alibaba owes its ample cash reserves to many things, not the least of which is its American investor Yahoo!.

Missed Opportunity?

Jack Ma seemingly made a major strategic miscalculation in Alibaba's business relationship with Yahoo!, likely squandering the chance to make Yahoo! China one of the nation's leading search engines.

According to Erisman, the primary reason Alibaba chose to partner with Yahoo! in 2005, in which Alibaba exchanged a \$1 billion investment in Yahoo! China for Yahoo!'s 40% stake in Alibaba Group, was to add search engine advertising for SMEs to its e-commerce portfolio. For its part, Yahoo! hoped Alibaba could breathe new life into its ailing China business. Yet according to Erisman, Ma mistakenly allocated resources to marketing that should have been first used to develop the technology of the Yahoo! search engine, which led to an inferior product that prompted users to migrate to Baidu and Google.

Political friction stemming from China's requirement that Yahoo! censor its search results also contributed greatly to the unraveling of the Alibaba-Yahoo! tie-up. "Their partnership was really doomed once Alibaba became more important to the Chinese economy and Yahoo!'s role as an investor became a liability and threat to Alibaba's operations in China," Erisman says.

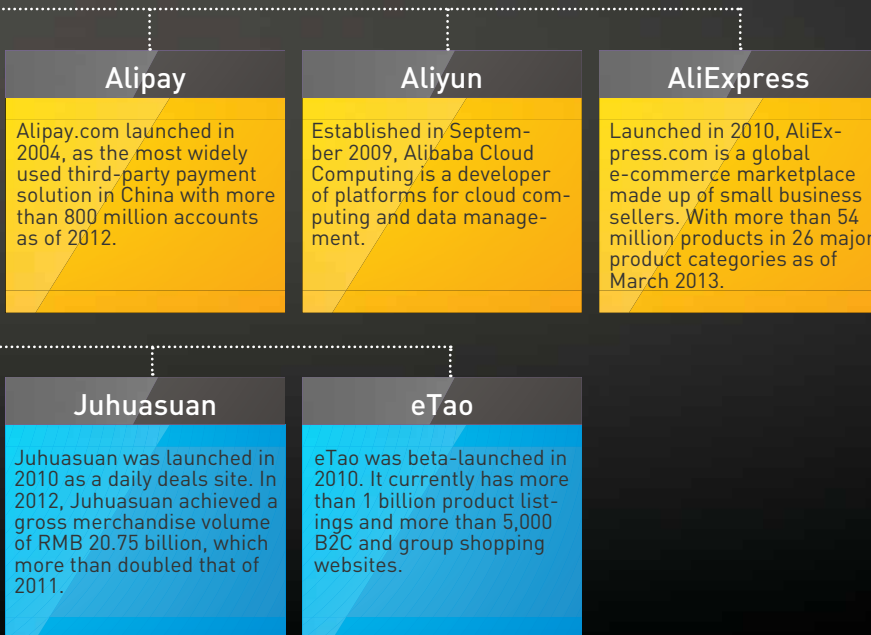
The doom manifested this month when Yahoo! folded its China email service, the latest of Yahoo!'s planned China operation closures.

But it wasn't all for nothing, says Tse of Booz & Co. "The cash Alibaba got from Yahoo! was quite critical in supporting Alibaba's subsequent businesses such as Taobao. Yahoo!'s stake in Alibaba continues to appreciate given Alibaba's good performance," he says.

An Empire at War

Paramount to Alibaba's long-term prospects is its ability to recalibrate its business for the mobile era. Rival internet giant Tencent has a formidable mobile ecosystem that includes the tremendously popular WeChat voice and text messaging application.

Tencent aims to use WeChat to expand



its operations in e-commerce and has developed a mobile payment center on the app as a rival to Alipay. In early August, Alibaba cut off access to WeChat blocking quick response (QR) codes, which can lead an online shopper to complete a transaction via WeChat's payment system when scanned by a smartphone, and penalizing violators by lowering their ratings on its sites.

"Alibaba is feeling extremely threatened by WeChat," says Kevin Der Arslanian, an analyst and tech-industry specialist at the Shanghai-based China Market Research consultancy. In his view, a weak social-media footprint in mobile presents the greatest danger for the e-commerce giant's future prospects. "As they are getting close to the IPO, it could affect the price of the stock," he says.

To strengthen its mobile internet portfolio, Alibaba recently invested \$586 million for an 18% stake in Sina-Weibo. "They needed something quickly and Weibo is the only platform that can compete with WeChat," says Zhu of Observer Solutions.

"Mobile is one of the key wins Alibaba needs to get," says Der Arslanian.

At the same time, Alibaba must not neglect its government-relations strategy as it becomes involved in the sensitive social media sphere, says a businessperson familiar with China's relevant government policy, who prefers to remain anonymous. "Any firms that work in fields that deal in information that could be critical of the regime—the press, book publishers or social media—need to be tightly controlled by Beijing", he says, adding that Alibaba's investment in Weibo will require the company to "increasingly collaborate with the government".

James McGregor, Chairman of APCO Worldwide's Greater China region, says a firm like Alibaba can reap all the success it wants as long as it behaves. "So they [government officials] basically came to them and said, 'you can make money as long as you behave and if you don't behave, you're toast.' So they all learned how to behave, meaning you don't put out information that challenges the government

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Alibaba is feeling extremely threatened by WeChat. As they are getting close to the IPO, it could affect the price of the stock

Kevin Der Arslanian
Analyst
China Market Research

and if people who are your users do, you delete it.”

Luckily, Alibaba's status as a powerful private company has turned out to be a political asset, says the businessman. "If anything, it's a good example for Beijing of successful private enterprise, and if it becomes strong abroad it's a nice vector for China's soft power."

A Global Powerhouse?

Aside from recent extensions into Hong Kong, Macau, and Taiwan, analysts ex-

pect Taobao and Tmall will next expand to Southeast Asian markets with high ethnic Chinese populations, such as Singapore and Malaysia.

Further international expansion has yet to be mapped out, although a massive IPO would provide Alibaba with ample liquidity to develop a more global network and make overseas acquisitions in developed markets, Tse of Booz & Co. says. Alibaba launched English-language AliExpress internationally in 2010 and eyed the US market in particular. That same year the company announced a \$100 million (RMB 6.2 billion) investment plan, which included the acquisition of California-based tech company Vendio Services Inc.

Unfortunate for further US expansion was Taobao's presence on the US Trade Representative's Notorious Markets list through the end of 2012, which highlighted it as a platform where dealing in counterfeit goods was prevalent. Taobao has tried to clean up its image in the US since, but is likely now in temporary retreat mode from the world's largest economy.

The Middle East, Africa and Southeast Asia offer greater opportunity for the expansion of Alibaba's B2B businesses, Der Arslanian says. Compared to the US, where eBay and Amazon dominate, "there is still plenty of low-hanging fruit in emerging markets", he says, adding that "It would be hard to adapt for Western markets where a trend of niche-market platforms is emerging," citing UK-based SoJeans, the first European-based e-store to specialize in denim, as one of the more successful examples of that trend.

While Alibaba must overcome major hurdles to expand globally, its potential should not be dismissed just yet. Jack Ma has faced down plenty of skeptics from the beginning and prevailed. In 1995, he first approached government officials in Beijing for support in building an internet for China and was rebuffed. The government bureaucrats had no interest in partnering with an unknown entrepreneur. "At the time, nobody believed people in China would buy anything online," says Zhu of Observer Solutions. ■

Conversations

"The take up of digital reading is faster than we thought, but it's not actually happening particularly at the expense of print."



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Andrew Rashbass

*Former Global CEO of
The Economist Group*



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Philip Kotler

*S.C. Johnson & Son Distinguished Professor of
International Marketing at the Kellogg School
of Management at Northwestern University*

"Marketing has a much better and higher standing today in corporate boardrooms than in earlier times"

"China is addicted to growth. China has to change from a producer mentality to a consumer mentality"



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James McGregor

*Chairman of APCO Worldwide
Greater China*



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Junheng Li

*Founder & Head of Research at
JL Warren Equity Research*

"The trick is, even if you choose not to invest in Chinese companies, you cannot avoid investing in the Chinese economy"

Thriving in the Age of Digital Media

How *The Economist* has managed to stay relevant in the digital age

By Neelima Mahajan



The last couple of years have been some of the most tumultuous for the world of media. First, the web disrupted the traditional model of print advertising and publishing houses started to bleed. Disruptive businesses, such as classifieds website Craigslist, started drawing away advertisers from traditional print publications further denting their business model. The web forced publishers to question the relevance of traditional journalism and news delivery as new websites did a better job of breaking news online.

If the disruptive impact of the web wasn't enough, today publishers have to contend with a multiplicity of platforms, such as mobiles and tablets that are once again changing the mode of news delivery. Also, increasingly hyperlocal journalism has come into prominence.

Combined, these disruptive forces

have led to several casualties. *Newsweek*, a very popular news magazine for over eight decades, suffered a fatal blow and finally discontinued its print edition in 2012.

Funnily enough, one publication—*The Economist*—has somehow bucked the trend of decline in print. *The Economist*, a magazine launched in 1843, has actually seen its print circulation grow in this challenging time. At the same time, it has also launched successful online and digital models that are also growing.

How has *The Economist* managed to buck the trend and stay relevant to its readers? How has it continued to grow its readership and circulation across platforms? Andrew Rashbass, former CEO of *The Economist* (he was still with the company at the time of the interview—he is now the CEO of Thomson Reuters' news agency and media business), attributes this to

something he calls 'lean-back 2.0' thinking. During a recent visit to China, Rashbass sat down with *CKGSB Magazine's* Neelima Mahajan and explained how *The Economist* has continued to do well.

Q. In the last 10 to 15 years, the world of media has undergone the biggest disruption ever. The Economist, a brand that is 170 years old, has been able to weather the storm and actually come out stronger whereas most other brands have been hit very hard. How have you really managed to stay both relevant as well as profitable?

*A. As a company we are very lucky. Darwin said about evolution, that it doesn't seek particular goals, it's just that people who happened to be better, the organisms that are best placed, survive. A lot of our success comes from things that are innate in the DNA of *The Economist*. The very*

first article ever written in *The Economist* in 1843 was an article about Brazil. Back in 1843, no one was very interested (in Brazil), so the circulation back then was incredibly small. What (has happened) is that we have become relevant. It is not that *The Economist* has changed to become something different. *The Economist* has always talked about issues around globalization, the interweaving of politics and economics and innovation and science and technology and social trends, and *The Economist* is all about those connections. Then the world has kind of moved in our direction and that's why we are relevant.

Q. How does your readership vary across the different platforms you are present in—print, online and digital, and how do you see those numbers changing? I'm sure the scales will tilt at some point.

A. A few years ago we identified that digital would be a big issue for us. We had a realization that the distinction was actually not between print and digital, but between what we call 'lean-back' and 'lean-forward'. Reading is fundamentally a 'lean-back' experience. It's something where you physically lean back, you spend a lot more time, it's immersive, you exclude distractions and you concentrate on this thing in front of you. People who are reading our digital editions, are actually reading, if anything, longer than they are reading in print. In the case of the web, however, that's much more a 'lean-forward' experience. It's much more interactive: people are coming not just to hear what we have to say, but to meet each other, to share, to participate, to discuss and to debate.

In terms of the reading experience I had assumed that there would be a migration from print to digital. Our research showed us a few years ago that people expected quite a fast migration from print to digital. The take up of digital reading is faster than we thought, but it's not actually happening particularly at the expense of print. We are moving from a single platform world of print to a multi-platform world, (where) some people are reading print and some people are reading digital. We actually charge a premium if you

want to receive *The Economist* both in print and digital. Of all our new subscribers, half are choosing to buy the premium offer, and of the remaining half, roughly a quarter (25%) are choosing digital only, 25% are choosing print only and 50% are choosing to have both. This multiplatform world that we are seeing (has) been a bit of surprise to us.

If I'm travelling, I'll pick up my phone and read (*The Economist*) on my phone or on my iPad. But actually, I still like print, and that's not determined by age. Clearly, which digital devices you have is a bit to do with sometimes your age, sometimes wealth and various other drivers. But print actually remains something that young people enjoy. Young people brought up in the digital environment actually find print a bit of a treat. If you asked me a couple of years ago before I had the data, how long do I think print has, I probably would have given you a somewhat shorter time span than I would today. There does seem to be even when they are choices, a distinct need and a distinct joy that people get out of the printed word.

*Q. And is *The Economist* an aberration here because for other publications we are seeing the tilt clearly towards digital now?*

A. It depends on what need you are meeting. *The Economist* has been this ritual pleasure, this immersed reading experience. If you look at the *New Yorker's* numbers you'll find something similar. Newspapers have gone the other way, and newspapers actually were never really a reading experience. Their basic selling point was 'we bring you the news'. Today for domestic news, you don't go to newspapers. You get it online. So they have had particularly different experiences.

What isn't quite clear is what would happen to glossy magazines like the *Vogues* of this world. They still remain quite powerful in print. It isn't clear how those experiences will migrate if they do. I don't think the issues that *Newsweek* has faced, has very much to do with digital. That's changed the business model side of it. But I think the engagement that it has with people's lives, the issues they have had around

that—they have not particularly to do with a digital transformation. *The Economist* is perhaps a particularly good example of the phenomena I'm talking about.

*Q. The Economist as it stands today straddles two different worlds—the traditional print, that it has known for almost two centuries, and the new digital world that most publication still trying to figure out. The way you deliver news, analyses and opinions across these two platforms is very different. In print, it's very one-sided, just giving people what you think. And in digital it's all about interactivity. How did the transition pan out at *The Economist* because digital means a whole new way of thinking around content?*

A. Yes, so, it does and it doesn't. We see two very distinct sides to digital as I said earlier—'lean-forward' and 'lean-back'. In terms of the 'lean-back' kinds of digital, we believe it is possible to enjoy digital in a 'lean-back' way in the same way it's possible to watch a film on your iPad just the way you used to watch it on TV. So those things can have more similarity to the old world than perhaps the new world. In the case of the web, you are absolutely right. For us it was a recognition that our readers have something powerful to say in their own right and that they are perhaps not quite as interested but relatively or cumulatively as interested in what each other have to say as they are in what we have to say. Therefore, the reason why it was a little bit easier for us is because our audience is so extraordinary: the audience is a meeting of peers. It's not that we sit on Mount Olympus and give out all these wonderful words of wisdom and everyone at the bottom listens. We've always recognized that our audience are themselves incredibly well-read, travelled and experienced people who want to have an opportunity where they can communicate with each other and with us. So we are more of an anomaly in that than in the other areas we were talking about just before.

Q. Talking about 'lean-back' and 'lean-forward' and 'lean-back 2.0', what really led to your concept of 'lean-back 2.0', and

why do you think the future lies there?

A. It was a realization that actually came out of a pre-iPad, pre-tablet, pre-Kindle thinking. It was the realization that came more than 10 years ago that actually *The Economist* as it stands as a magazine doesn't really work on the web if you just try to (transport) it. And yet your point about the continued success of *The Economist* as a magazine, we realized that even before the Kindle or the iPad came along (that) it was meeting a need, (and) our demographic, our audience was getting younger year by year. Yet the web is taking off and everyone was saying that digital is the future, so we did realize there was something about what *The Economist* did which wasn't about the media that it was in or wasn't overtaken by the web. Even before these digital reading devices came along, we had already identified that there was this special place for reading in people's lives. As soon as we saw in the first case in 2008, the Kindle, and subsequently the iPad, we immediately saw them as devices that would allow this state of mind, this kind of mental pleasure that people get that could be accomplished in a digital way. In a way it wasn't that we had a great realization about 'lean-back' after these devices came about. We already realized that there was a distinction between the 'lean-back' and 'lean-forward', originally it was in print and web. And then we realized that this '2.0', this new kind of 'lean-back' was coming about through digital media.

Q. You still derive a huge chunk of revenues from subscriptions. How do you manage to do this at a time when most other publications which were still heavily advertisement-dependent, are really facing a hard time because ad revenues are down and subscriptions are unable to make up for the shortfall?

A. We have always recognized that *The Economist* has the potential to be very valuable to people and in order to invest in quality journalism, we need to have a business model that sustains. We are a private company. We don't have easy access to the equity markets. We don't have some



We have always had to make a living. We (realize that we) have to deliver something of value to people and charge for it

rich owner who is subsidizing one part of the empire, or other parts of the empire, (which is one) of the ways in which media works in other companies. We have always had to make a living. We (realize that we) have to deliver something of value to people and charge for it. That's always seemed a much more straightforward model to us, than some of these more convoluted ways that people have to make money. So it isn't that we have discovered subscriptions that some others have started to do. We've always been that way.

Q. How does the advent of online advertising change your advertising model because advertising works differently in print and online?

A. There's no question that if a company has been dependent historically on advertising for their profitability in a digital world and in an online world particularly, that is very difficult because there isn't just profit to be made by publishers compared with others in the online world. It's about a couple of things. One is about going even

more strongly on the subscription side. Secondly, to make sure that you capitalize on as much digital advertising as you can. Thirdly, while you continue to have a viable and successful print product, you continue to get as much advertising as you can. (You also need to recognize) the way in which clients are looking to reach audiences are shifting and make sure that you as a publisher provide the products and services that those clients need to be able to engage with audiences in new ways around content marketing and more innovative ways of marketing alongside advertising.

Q. From your standpoint and the kind of trends that you are seeing in the market today, what is the prognosis for print, and what is the future for publishing?

A. The underlying issues that people are facing is not paper versus digital, it's actually the fact that online competitors for certain publications, for instance, are doing the job better, then they were doing it. It has nothing to do with paper.

Q. What do you think to be the next big disruption in media?

A. The one that hasn't yet played its way through in publishing is the impact of local, social and mobile. You know the way they talk about "SoLoMo" (social, local and mobile). People haven't yet innovated in ways which really take those three things and create something that is truly a media or a news media experience. We are beginning to see it in Twitter. We are beginning to see it in some of the stories as they break in a different way (than how) news is being gathered and disseminated. But no one has yet turned that into a competitor for mainstream media permanently, (and not just) over one particular event. If somebody cracks that, I think that will be a huge disruption. But if I really knew what the next disruption was going to be, then I guess it wouldn't be nearly as nearly disruptive. That is not the nature of disruption to be able to guess in advance. ■

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(To watch the video log on to CKGSB Knowledge: <http://bit.ly/13A6hCd>)



*Philip Kotler (born 1931) is the S.C. Johnson & Son Distinguished Professor of International Marketing at the Kellogg School of Management at Northwestern University. He received his Masters degree at the University of Chicago and his PhD at MIT. He has authored over 50 books on different aspects of marketing, including *Marketing Management*, the most widely used marketing textbook in business schools worldwide. He has published more than 150 articles in leading journals, including the *Harvard Business Review*, *Sloan Management Review*, *Journal of Marketing*, *Management Science* and the *Journal of Business Strategy*. He has introduced new concepts such as social marketing, turbo-marketing, megamarketing, and nation-marketing.*

The Four Ps Model of Marketing is Still King

An interview with Philip Kotler, the Father of Modern Marketing

By Neelima Mahajan

Philip Kotler, the S.C. Johnson & Son Distinguished Professor of International Marketing at Northwestern University's Kellogg School of Management, is widely regarded as the Father of Modern Marketing. He trained as an economist at the University of Chicago, learning from the legendary Milton Friedman. He later did his PhD at MIT under the guidance of Nobel Prize winning economist Paul Samuelson.

Kotler rose to the forefront in the field of marketing in 1967 when he authored the seminal textbook *Marketing Management*. The book cut through the clutter by introducing rigor and mathematical analysis to the field of marketing. Ever since, the book became the marketing Bible for MBA students. More than four decades have gone by, and 14 editions of the book have been published and Kotler's popularity has grown.

One of Kotler's biggest contributions to the field of marketing was popularizing the idea of the Marketing Mix, also known as the Four Ps of Marketing, an idea first proposed by an academic Jerome McCarthy in 1960. The Four Ps stand for 'product', 'price', 'place' (i.e., distribution) and 'promotion' (i.e., advertising). According to Kotler, "(The) Marketing Mix is the set of controllable variables that the firm can use to influence the buyer's response."



With the rise of e-commerce, the idea of 'place' doesn't have the same relevance as before

These four variables help a company develop a unique selling point as well as a brand image.

With the rise of the internet and the advent of new concepts like social media, e-commerce and digital marketing, critics started questioning the relevance of the classic Four Ps model of marketing. Some proclaimed that the Four Ps model is dead. Take 'promotion'. Many brands like Google, for instance, never really advertised, yet they became so popular. The rise of social media itself started to bring into question the classic notion of 'promotion'. Similarly with the rise of e-commerce, the idea of 'place' doesn't have the same relevance as before.

Yet Kotler chooses to staunchly defend the concept. In this interview he explains why the Four Ps are still relevant, how the marketing landscape has evolved and the impact of digital media.

Q. As someone who literally laid the foundations of the study of marketing, how do you view the changes in the marketing landscape over the last five decades?

A. I published the first edition of *Market-*

ing Management in 1967. My aim was to put the marketing discipline on a solid social science basis by introducing strong economics, mathematics, organizational theory and psychological theory. Every three years, I revised the book to bring in the latest new concepts and theories. Now the book is in the 14th edition, and probably one could map the changes in marketing by analyzing the 14 editions of *Marketing Management*. (See 'The Evolution of Marketing'.)

Q. What is your evaluation of the state of the marketing function in organizations today—is marketing getting enough share of mind in corporate boardrooms today?

A. Marketing has a much better and higher standing today in corporate boardrooms than in earlier times. Initially marketing was seen as mainly an advertising function or more broadly as a communications function. Then marketing opened companies' eyes to seeing the consumer as the center of the profit-making universe. Marketing provided the means of getting deeper insights about buyer motivations, beliefs, values and perceptions. Today the marketing function is in the hands of Chief Marketing Officers who manage broader functions, including the responsibility of identifying new market opportunities and assessing their size and feasibility. There are still companies that take a narrow communications view of marketing but they are often outperformed by competitors who take a broader view of the power of contemporary marketing thinking and planning.

Q. The world has been both literally and figuratively taken over by the Millennials. How well have marketers adapted to this new audience which thinks differently? Do you see a dissonance between the so-called 'Old School' marketers versus the 'New School' marketers as they try to address this new audience?

A. The best marketing group is one consisting of traditional and 'New School' marketers. We still need traditional advertising and 30-second commercials to communicate the big picture of a com-

pany's market position and promise. We also need to use social media to deliver shorter and longer individual messages to different customers and prospects. Every 30-second commercial should mention the company's websites for customers to get further information. And all the social media messages should be tied to the big-picture brand message.

Q. How are social media and other digital marketing channels changing the DNA of marketing? How are they redefining the ways in which brands connect with customers and the attributes of 'emotional bonds' and 'trust'?

A. Digital media is the best thing to happen to marketing in recent times. Now messages can be customized for distinct groups and individuals. By analyzing Big Data, one can identify the best prospects and the appropriate messages to deliver.

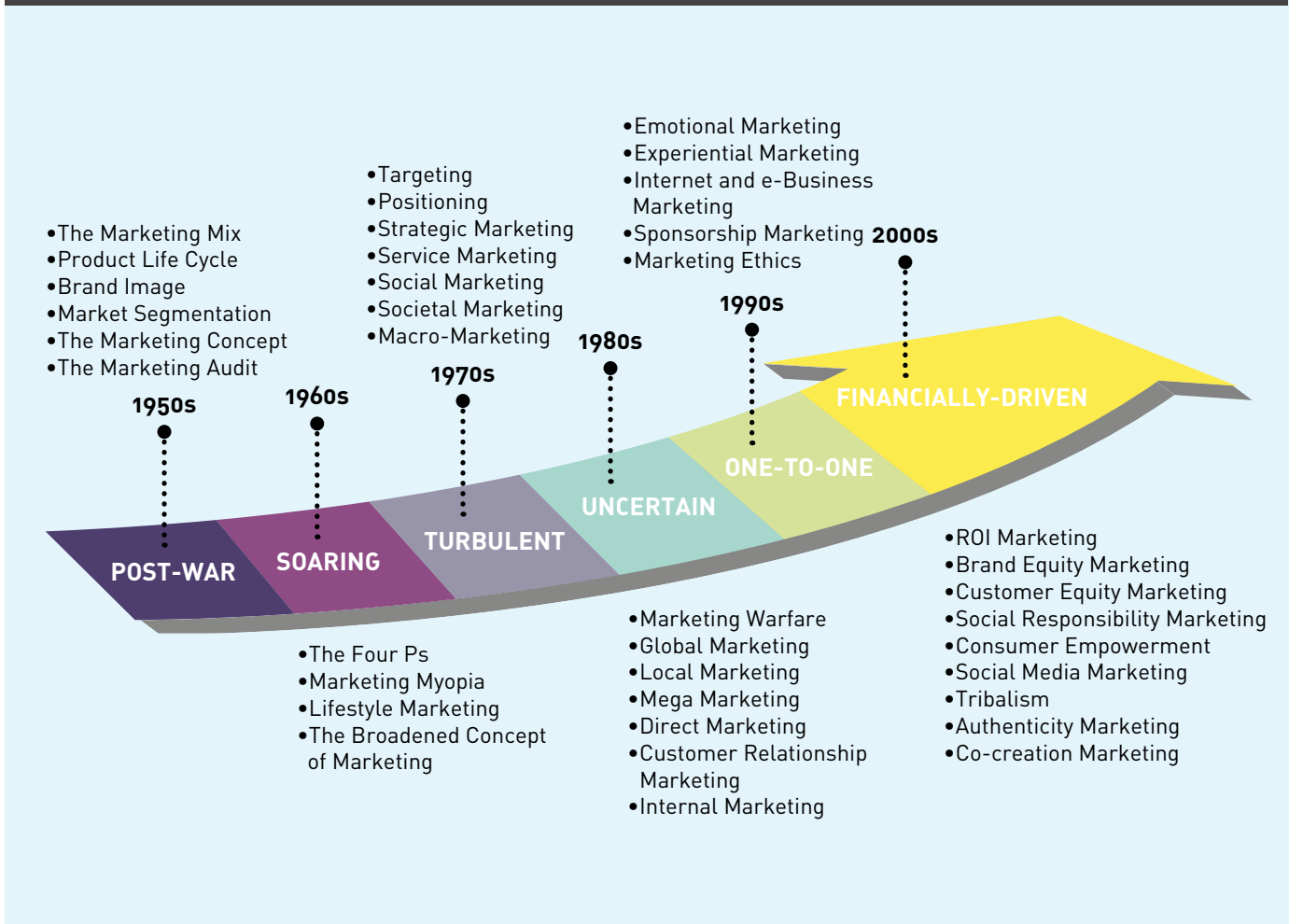
Q. While technology is helping marketing become more personalized and adaptive, there are also concerns over privacy. How can companies get around the problem?

A. I think that the privacy problem is overstated. Companies are trying to know enough about a group or individuals to deliver relevant messages. The fault with old-fashioned mass media was that it would deliver a single message to the whole audience with only perhaps 1-2% of the audience interested in the message. Most of the audience would dismiss the message or even see it as an interruption. Now most messages on digital media have more relevance to the buyer's interests.

Q. Thanks to social media and other forces, the locus of control has gradually shifted away from the brand owners to the consumers. Some argue that in this environment, the need for a separate marketing department will gradually vanish. Yet others have proclaimed that traditional marketing is dead. What are your thoughts on that?

A. I wouldn't invest in any company that eliminates its marketing department. I grant that brand control has moved from the company to the customers. But

The Evolution of Marketing



a marketing department must listen to what customers are saying and even get its voice into the conversation that's going on. Marketing provides a framework for planning and integrating the Four Ps (product, price, place and promotion) and for coming up with new marketing ideas and initiatives.

Q. Given how marketing has evolved over the last few decades, where do you think the Four Ps model of marketing, the bed-rock of marketing study, stands today?

A. The Four Ps model of marketing is still king. Some people have added other Ps (packaging, people, physical evidence, etc.). Others have suggested using the Four As (availability, affordability, acceptabil-

ity, awareness) as a prelude to using the Four Ps. All of this is welcome, including the possibility of someone coming up with a radically different model for marketing planning. All contending models fight in a market place that will determine whether a new model works better than the preceding one.

Q. Which company, to your mind, is an exemplary marketer in today's day and age?

A. I am very impressed by companies such as Harley Davidson, Lego, Nike and Starbucks. All of them have succeeded in building a loyal following of enthusiastic customers who are even encouraged to help co-create the company's new offerings.

Q. Going forward, what else are you working on and how does that tie in with your past research?

A. The financial crisis of 2008 has cut deeply into people's incomes and wealth, leading to sluggish demand and posing the question to companies as to how they can grow. I just published with co-author Milton Kotler *Market Your Way to Growth: Eight Ways to Win*. It presents the best findings and cases on how some companies have continued to grow using innovation, international expansion, stronger branding, mergers and acquisition, and four other ways to grow. It came after my earlier book with co-author John Caslione called *Chaotics: The Business of Managing and Marketing in the Age of Turbulence*. 



China's Self Examination

APCO Worldwide's China
Chairman James McGregor on
China's identity shifts

By Suzanne Edwards

James McGregor is Chairman of global communication consultancy APCO Worldwide's greater China region and a renowned China author, first with *One Billion Customers: Lessons from the Front Lines of Doing Business in China*, published in 2005 and more recently with *No Ancient Wisdom, No Followers: The Challenges of Chinese Authoritarian Capitalism*, published in October 2012. After serving as the Taiwan bureau chief for *The Wall Street Journal* from 1987 to 1990 and China bureau chief from 1990 to 1994, he spent seven years building Dow Jones' media business in China as CEO of Dow Jones' China, establishing CNBC China, a Chinese language form of *wsj.com*, Dow Jones' Chinese-language newswires, Chinese stock-market indexes and the first weekly business-television show in China. He has been actively involved with the American Chamber of Commerce in

China (AmCham) for more than a decade, serving as chairman in 1996 and currently chairing the Chamber's US Government Relations Committee. McGregor is an esteemed member of the Council on Foreign Relations, the Atlantic Council, the Asia Society, the National Committee on US-China Relations and a board member of the US-China Education Trust.

Q. You've experienced China in many different contexts: journalist, businessman, advocate, critic. How have these various chapters of your China life impacted your ideas about China's economy and political system?

A. I came here from Taiwan in 1990 after Tiananmen, and it was a very bleak time, and I was able to travel all across the country. I was the only journalist from *The Wall Street Journal* so I had the whole country to myself. China was trying to figure out

this huge shock that had just happened after this elation of change in the 1980s, and it was trying to figure out where it would go. So there was a lot of interesting talk even out in the provinces. I would run into people who had been involved in the demonstrations and were now starting to do business in the provinces. I was from *The Wall Street Journal* so they were all welcoming me and asking: 'How can you help us get foreign investment?' After Deng Xiaoping's *nanxun* [southern tour] things really started rocketing here. I moved on to the business side of Dow Jones and was building media businesses, and in those days there still were not a lot of rules and restrictions on the media business, so we were doing cooperations with newspapers, magazines and whatever. If I had to point to a turning point, it would probably be the Olympics. In the run up to the Olympics there was a lot of hope,

and a lot of activity and China went out of its way to do positive things with the world, to have a positive image. At the opening games, there was such pride in the room at being Chinese, at what they'd accomplished and all of this glory that the world was seeing. It wasn't very long after that that things started really turning sour. I think what happened is you have the global financial crisis, and there was kind of a reaction here that the foreigners need China more than China needs foreigners, and part of that was a payback for all the less than 'bright bulb' congressman that come in and shake their finger at officials and say, 'You should do this, you should do that.' So there was a lot of 'The China Model is superior, you should listen to us.' Since then, I think China is just kind of scrambling to see what it becomes because it's a very big player in the world, but it is still very local in the way the politics work and the way they think about policy. I think China now is at a real turning point. That whole evolution has been fascinating to watch.

Q. On one hand, we hear of political rhetoric in China on liberalizing the economy and there have indeed been some policy actions that seem market-driven. But on the other hand, we've also seen political discourse that emphasizes the need to return to Maoist roots. To what extent do you see contradicting behavior from the top?

A. Whether the Party now is using its traditional tools and motivations to move things towards the future, we don't know. This is still unfolding. It's a very unusual time. I think China doesn't want to be what it used to be, it doesn't want to be a poor country that's not a player in the world. It doesn't want to be a country where the politics are eating the place alive like what happened in the Great Leap Forward and the Cultural Revolution. I don't think it knows what it wants to be. Remember, China has never joined the world before, this is the first time, and all of a sudden China is a global power and it is connected all over the world. But it still wants to be China, and it doesn't want the foreign



People's expectations are so high here because they have been through such an unusual time

forces and foreign ideas to change China. Of course they will change China, but China is also going to change the world. Never before has a system like China, with the velocity and the size and the power, come in contact with the world, and there is a bit of an incompatible interface between the world as it exists and China as it exists.

Q. You have advocated for fair US trade policy toward China, China's World Trade Organization (WTO) membership being one of many examples of this. But you have also been fairly scrutinizing, if not critical, of top-down economic policies, particularly in your most recent book, No Ancient Wisdom, No Followers. What led you to switch gears from advocate to critic and write the book?

A. The reason I wrote the book was that I was very strong with AmCham for many, many years, lobbying in Washington for fair-minded trade policy with China for MFN [most favored nation status] and then the WTO, and after China had been in the WTO for 10 years, I decided I would have the standing to go back and look at what had happened and where it was going. What we say in the book is not much dif-

ferent from what Chinese entities are saying, they just say it in very couched terms and we say it very directly; that this system has run out of gas. It cannot continue growth under the current system, and they need to rejig the system to keep growth going and that is now what [Premier] Li Keqiang is saying every day. If you are going to continue to go down this same road, then you are just digging your hole deeper. It's not unlike America with all this deficit spending and not fixing our finances for all those years, we just made the problem worse, and that is where China is at right now. They are in a real pickle right now because China is addicted to growth. China has to change from a producer mentality to a consumer mentality. One of the things you have to do if you want to build a strong brand or economy is, [because] you can't order people to take money out of their pocket and spend it. You need people to feel comfortable about government, about government policy, about the direction of the country, about the safety of their own assets and their families. So the Party has to regain and strengthen its bond with the people.

Q. In your first book, One Billion Customers, you outlined some fairly specific takeaways for navigating China's business environment. Of course, much has changed since 2005. Could you describe some takeaways for non-Chinese entrepreneurs in China that still apply in 2013?

A. A lot of what I wrote in there is still quite relevant. For instance, if you are a business and you are doing business with a state company, remember you are dealing with a political entity and not a commercial entity. It's a reward system for people who are running it because it's about their political career. Another example was the need to recognize that people here are moving very fast because, number one, it's like a gold rush, the thinking that you have to make your money now because it might not last. The difference today is there are a lot of people that think there was a gold rush and they missed it, so there is a sort of creeping desperation for the future. For anybody under 40, this is basically their

standard of life, this exponential growth every year where life changes so fast and wealth is created so fast so that now, if you just go to college and get a decent job and get married and live frugally for a while to save and buy something, that's considered a horrible life, whereas that's a normal life anywhere else. So people's expectations are so high here because they have been through such an unusual time.

Q. When would you say was the height of the imperative on foreign companies to get in on the action in China? How would you describe that imperative now? What has changed?

A. Foreign companies go through periods of being gaga about China. When things are good they look at China as better than it is, and when things are bad they look at China as worse than it is. Some of these foreign companies that came here and had big market shares are now focused on market survival these days as much as expansion. There are more and more regulations that favor locals. It's tougher and tougher for foreign companies here so their attitude is less and less positive and more and more cynical. These foreign companies have to be here because of the growth market, but in some ways China is losing its best friend. The foreign business communities, in their home countries, have been the strongest supporters of China, but they've got such an onslaught against them that they are less and less positive when they go talk to their governments.

Q. At times it seems like the China-US relationship is endlessly fraught with complications. Could you describe what you think the Obama administration is getting right, and also getting wrong when it comes to China policy?

A. I think Obama is getting it about right, right now. He and Xi engaging personally for a couple days is a very good thing, as they did in California this year, because they can meet as humans. Both these guys have a lot of domestic headaches, and they can talk about the relationship between the countries without a whole big set of deliverables and a thousand aides and ev-

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I have faith in the Chinese people and their ability to adapt, but it may not be a straight line

.....
everything else hammering away the usual official meetings. I would really hope they would do this every year, because if these two countries talk to each other at the presidential level one-on-one for a couple of days every year, it'll be hard to get into real conflict. And that's important. If you look at the US and China, we don't really have any real inherent conflict. Our economies are complimentary, our people get along very well, and just because China is rising and America is rebuilding itself, doesn't mean that there has to be a big cataclysm as a result of that. It's like a marriage where you have 500 children, you might be kind of tired of each other but you better get along because you can't have a divorce. And that's pretty much where the world is with China and the US.

Q. You've given analysis on China before in terms of what's known as 'the middle income trap'. Could you describe what that means and how China is coming along in terms of overcoming this crucial point?

A. Well this is the core of what they are starting to call "Li-cenomics". China has to overcome the middle income trap, which is reaching \$5,000 or \$6,000 GDP per year per capita and your low-cost labor starts to get expensive and so you are

no longer a low-cost producer, you have to then innovate and create your own products and develop your consumer market more and that is where China is right now. That's a very hard thing to do because the people that made money in the first stage don't want to take their hands off the steering wheel. I think it was 101 countries in 1960 (that) had reached that level, and by 2008 only 13 had surpassed. It's a hard thing to do, and I believe China will do it. I don't think China will be a place with a veneer of rich people and a lot of poor people. They have done that for a long time, but in the day and age of Weibo and other social media, I think people will know what's going on and they are not going to tolerate it.

I have faith in the Chinese people and their ability to adapt, but it may not be a straight line. If you don't have change from the top, you're going to have change from the bottom, because the system is not as flexible and it can crack.

Q. You've said that China's entrepreneurs don't need a lot of direction, they take risks and are adventurous. Could you share an example or story that typifies that characterization?

A. I am on an airplane going to Guangzhou in about 1992, and this guy sitting next to me has a ragged sweater with holes in it and tennis shoes, and he's writing up figures on cardboard from a cigarette carton, and he has a gym bag on his lap that he is kind of holding in a sort of protective and precious way. So I start talking to him and asking him what he does. He's basically a guy that didn't even graduate from grade school, and he goes around the country making money trading foreign exchange, and arbitrating the prices. You know, those people that used to be out in front of the hotel saying, "Change money, change money." He goes around and he buys money from them and he goes to another city and sells it at a different rate. He lived in a massage parlor in Guangzhou, and was just traveling around the country with suitcases of money arbitrating. If you don't give Chinese people a business opportunity, they will make one up for themselves. ■



Wall Street 101

Junheng Li, author of *Tiger Woman on Wall Street*, on the merits of analytical thinking

By Ana Swanson

US investors still have little confidence in Chinese companies. That was the conclusion to be drawn from 2012, in which only two Chinese companies—Vipshop, an online retailer, and YY Inc, a social media platform—listed shares in the US. It was the lowest yearly total since 2000, according to data provider Zero2IPO.

Corporate governance problems and the outing of fraud in the past few years continue to dent investor confidence in Chinese companies. And with good reason, says Junheng Li. The gaps in cultural understanding and operational standards between the US and China make it nearly impossible for many American investors to understand precisely what they are investing in.

A Shanghai native who was educated in the US, Li is the founder and head of research at JL Warren Capital, a leading equity research firm. Prior to founding JL Warren, Li worked as a senior equity analyst at hedge fund Aurarian Capital Management. She also authored *Tiger Woman on Wall Street: Winning Strategies from*

Shanghai to New York and Back, which describes her life experiences and unique investment strategy. Li discusses why China has been such a minefield for investment, and how investors and Chinese society should respond.

Q. Your new book discusses the difficulties that US investors have in assessing the reality on the ground in China. What are the main hindrances to investment between China and the US?

A. The obvious obstacles are corporate governance and transparency. The lack of corporate governance in China is a serious challenge for minority investors, which is every US investor. The managers are not looking out for minority investors—they are looking out for themselves and their big shareholders, including local governments and other interest groups.

Q. How do you suggest investors perform due diligence?

A. As a US investor it's your responsibil-

ity “not to trust, but to know”. “To know” means going to warehouses, touching the product with your own hands, and building local contact networks. That's the only way to avoid getting burned. In China, you just have to overdo the amount of due diligence you would normally do in developed markets. See with your eyes, ask questions, don't just nod along and sign up for anything management tells you. Not that all managers lie intentionally, but many are naturally positively biased. Just like most parents think their kids are the smartest and cutest, most managers think their business is the winner, although the reality might be different.

Q. What do you suggest if American investors aren't able to do that?

A. I always say that it's better not to make money than to lose money. If investors really can't get access to accurate data and information, then they are better off not investing at all. The problem is, even if you choose not to invest in Chinese com-

panies, often you cannot avoid investing in the Chinese economy. For so many multinationals—Yum! Brands, Apple, BMW, Coach, Swatch, Starbucks, the list goes on and on—much of their business and their growth is coming out of China. So that’s why people hire us [her firm, JL Warren Capital]. You have to have local expertise, local contacts—including contacts among government officials, because China is a very policy-driven economy. That’s the only way to bridge the gap between an investor based in the US and targets thousands of miles away.

Q. What drew you to Wall Street?

A. The honest answer is money and mobility. I didn’t grow up with money—few people from my generation in China did. But I came to understand that money brings convenience and privileges. Not that I want to buy luxury brands, but I wanted the security money brings, such as the ability to raise my children in a less harsh environment than I was raised.

Also, if you don’t mind the toughness of the Wall Street working environment, if you are thick skinned enough to deal with the demanding work hours and expectations, you don’t have to be that brilliant to make a good living. As a comparison, say you want to be a dancer. You have to be one of tens or hundreds of thousands to perform in Lincoln Center. And even if you make it, if you become the principal dancer for the most acclaimed dance company in the world, you are still financially underperforming an investment banking analyst at the age of 23.

For me, I knew that it was a safe bet. I’m very comfortable with numbers, and I don’t mind working hard. You also have to be a bit of an obsessive personality, because you also have to be very attentive to detail. If you are okay working 80, 90 hours per week, then you will end up making a good living.

Q. What advice would you give to women who are interested in Wall Street?

A. On Wall Street, the market grades you first and foremost, not your boss. Investing and trading are results-driven, so they

are relatively gender and race agnostic. You are judged by your ability to make money, period. These days, I interview a lot of analysts. I like people who are honest, driven, and hungry, and who possess common sense rather than book smarts. When I interview people, I might as well be blind—I couldn’t care less whether the person is white, yellow, brown, black, or purple, whether they are female or male or anything in between. I don’t care if they show up naked or wearing Prada shoes. But I do need to hear that they are hungry and driven. I want a worker who gets things done.

There are so many books today like Sheryl Sandberg’s *Lean In* (see page 29), about how female employees have stalled. Maybe that is true for a large corporate environment, but it’s less so for more entrepreneurial sectors on Wall Street.

Q. The title of your book, Tiger Woman on Wall Street, alludes to the fact that you are a product of “tiger parenting”, growing up in Shanghai with a strict father. How did that style of parenting shape you?

A. It was sometimes a painful experience—I have memories of being made to kneel on a washer board for over an hour while learning my multiplication tables, for example, or being terrified when my father literally threw me into the pool to teach me how to swim. But, like I say in my book, my upbringing also gave me discipline, focus, stamina and strength. My father drilled into me the idea that “Where there’s a will, there’s a way.” That gave me the determination and the confidence to succeed. But my American education took that to a new level. It not only gave me confidence as a worker, but confidence as a leader. It encouraged me to think, to challenge the norm and dare to be different, and to lead my own life and my career.

Q. You went to Middlebury College in the US for your undergraduate degree. What was the biggest challenge for you in attending an American college?

A. The language and the cultural aspects are big barriers at first, but you master these eventually. In the end, the biggest

challenge was how to make choices and be a problem solver, rather than just memorizing everything. Fundamentally, it was the difference of living in a free society versus living in a command-based society. In China, people look up to the government like kids look up to the parents who take care of them. In Chinese schools, the curriculum is already set for you. In an American private education system, the relationship between students and teachers is more like customers and employees. Tuition is very high, so students demand their money’s worth, and teachers provide services. In China, teachers are the masters of the classroom and the student’s role is to take notes, memorize, and recite things back perfectly. We were not supposed to challenge and be creative. At least that was my experience.

Q. Do you consider that the biggest shortcoming of the Chinese educational system?

A. Yes—you are supposed to be a follower, not a thinker. You are supposed to memorize as opposed to imagine, think, or lead. I’ve seen many Chinese students who are so strategic with their academic career that they end up scoring high and graduating with honors, but they still haven’t experienced that challenge of making choices for themselves. So their ability to think and imagine is still limited.

We’ve talked about the Chinese education and business systems. Is there one aspect that is key to improving both?

It’s by far human capital. Chinese people need to learn to play the game honestly, and that starts with the schools. For the world to trust Chinese companies again after the recent scandals with corporate governance, it’s going to take time and education. I believe that schools are there to teach ethics first and foremost, before compassion, love, comradeship, and so on. Before workers can be productive, they need to be honest. Cutting corners, replacing good material with bad material to make profits, as in what happened with the Chinese milk scandal, it’s not acceptable. It’s not acceptable in China, it’s not acceptable in the rest of the world. ■

The Red Canvas

Who is making an impression on China's art scene as tastes and sensibilities evolve?

By Jessica Lee



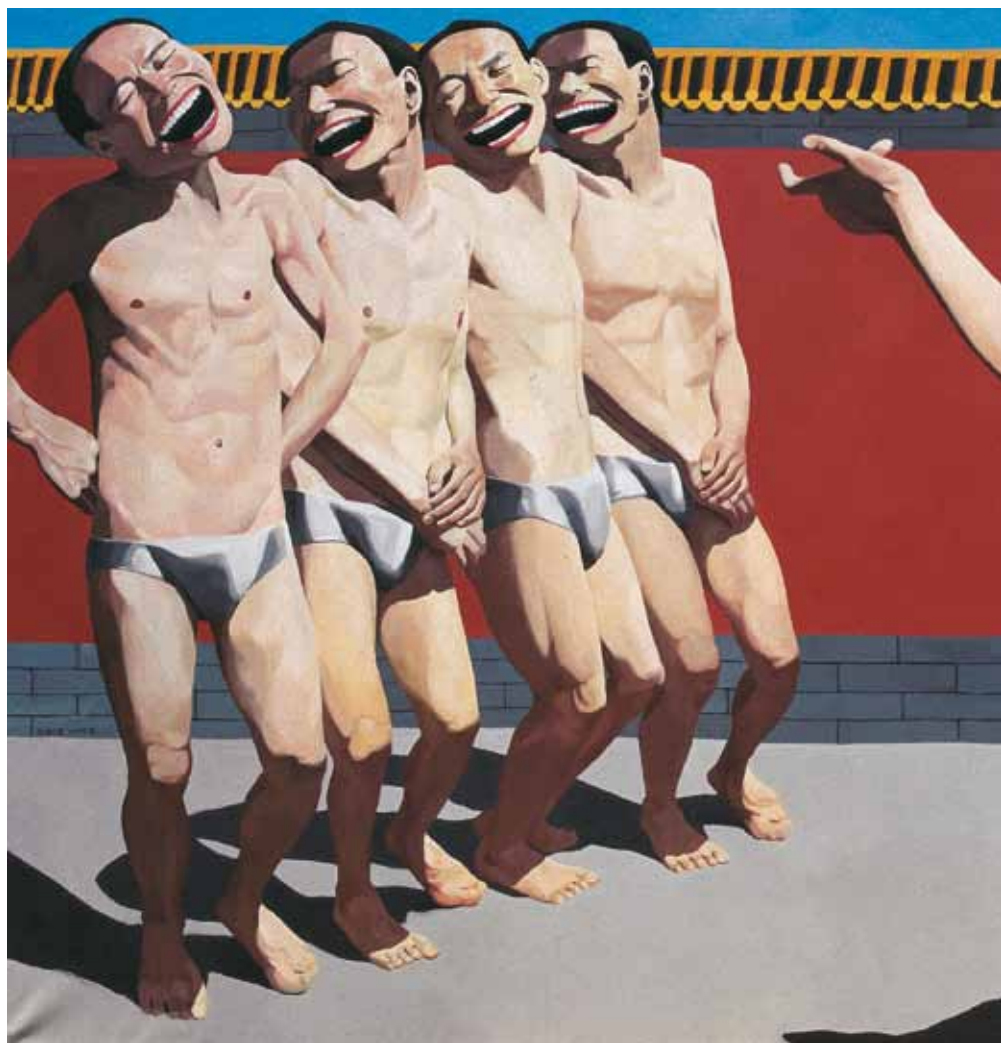
Comrade No. 17, Zhang Xiaogang, 1998

The terrorist attacks of September 11, 2001 on the World Trade Center towers and the Pentagon brought the world to a standstill. One unexpected commentator was Chinese artist Xu Bing. Xu gathered a bag of dust from Ground Zero in New York City to use in a 2002 installation for the National Museum and Gallery of Cardiff in Wales called *Where does the Dust Itself Collect?* Bing sprinkled the dust in a room over stencils of letters that wrote out lines from a 17th-century Chinese Zen Buddhist poem. Removing the stencils, the floor of the exhibit contemplated: “As there is nothing from the first, where does the dust itself collect?”

In the past decade, the Chinese art scene has progressed from ‘budding’ to ‘thriving’. In 2008, Christie’s auctioned Zeng Fanzhi’s *Mask Series No. 6* for \$9.7 million, breaking records worldwide for Asian contemporary art sales. On the who’s who in China, artists can seemingly be measured in a broad spectrum, between the likes of Fanzhi, whose *Mask* series are at once titillating and frightening in their deliberately vulgar and subversive faces, and Zao Wou-ki, whose oil paintings, remarkable in their quiet power, have only recently been discovered by art collectors in the Far East.

Eike Stratmann, a German expat whose background in art led her to work in art procurement for the Shanghai 2010 World Expo, highlighted Guangzhou Academy of Fine Arts’ recent graduate Sun Yu as a favorite. When asked why she included Yu, Stratmann says the artist’s portraits of lost men unfold under closer inspection. “[At first] they don’t seem to care what’s going around them—mostly their eyes stay closed or the eyes are painted so vaguely that they never seem to look out of the painting—but when you have a second look and come closer, you will discover more and more color. The longer you look at [them], the more you can see subtle irony.”

Potent and varied subject matter seem to come forth all at once. After decades of seclusion, China’s art scene has since been forced to reckon with the fall of the Soviet Union, the rise of the information



Execution, Yue Minjun, 1995

age, and globalization. Art historians have noted that the deluge of Westernization in the advent of the digital revolution and a flattening world was at once a blessing and a tragedy for Chinese artists. There was—and in some ways, is—a need deeply felt by artists throughout China to assert themselves against a national psyche that has Westernized so quickly and so intensely. And it is with this context that China’s seminal art genres, Cynical Realism and Political Pop, took shape.

Political Pop is perhaps best summarized by the proliferation of Mao’s image in contemporary Chinese art as an Andy Warhol silkscreen painting akin to the American artist’s Marilyn Monroe or Campbell Soup series. Cynical Realism is

most recognizable in famed Yue Minjun’s iconic laughing men, which make their strongest statement in his piece *Execution*, which sold for \$5.9 million at Sotheby’s London in 2007. The West’s rather expensive fascination with the stark, and at times sensational, depictions of Chinese life have preceded a healthy evolution in China’s own art procurement market.

As the Chinese art scene has matured, the culture of artists and Chinese art collectors themselves have slowly migrated past the deliberate political caricatures behind Cynical Realism and Political Pop to more subtle themes.

This shift is well illustrated by the recent discovery of Zao Wou-ki among Chinese buyers. Zao’s abstract oil paint-



ings do much less to thrust themselves in the eye of the viewer and more to gently draw them in. The total transaction value of Zao's paintings at public auctions is an estimated \$98.5 million, according to Hurun Report's 2012 ranking of Chinese art.

Is success in China determined by critical or financial success? In Zao's case, he has it all: highly priced work and regard in art's most well-known enclaves. Alain Juoffroy, famed French poet and art critic said of Zao's work:

"The works of Zao Wou-ki clearly reflect a Chinese view of the universe. Their distance and haziness represent a focus on the contemplative mood itself, as opposed to the thing contemplated, an approach that has come to be accepted by the young

stars of our art world as well as by society at large."

In the West, critics can play a significant part in buoying up artists because success is traditionally tied to relevance, or the level of discussion surrounding the artist. In the art world, intellectual notoriety can be crucial in leading to more exhibitions and purchases from collectors. China's enfant terrible Ai Weiwei, for instance, may be the most visible Chinese artist on the global stage. Ai has secured solo exhibitions in some of the world's most venerated art spaces in the past five years, including Duisburg's Museum DKM (2010), Munich's Haus der Kunst (2009), Tokyo's Mori Art Museum (2009), and Groninger Museum in Groningen (2008).

But now that many mainland buyers can outbid collectors from elsewhere, there can be other factors aside from political dissidence and statements that may determine the fame, or notoriety as it were, of an artist in and of China. As Chinese collectors grow increasingly bold in selecting works from emerging artists, a lack of discussion and clout no longer precludes the possibility of success.

"Viewing art is a very personal experience. For collectors, there really is no guarantee that a piece will appreciate in value, so what we try to do is stress to our clients to work with someone with a 'good eye'. But what you're really looking for is evolution—you don't want the same smiling face in each painting," says Megan Connolly of ChART Contemporary in Beijing, which accommodates buyers with varying degrees of wealth.

One artist that has provided such evolution is Zhang Xiaogang. Though his portraits can be largely characterized as gray and bi-chromatic, his variations on his seemingly nondescript faces continually force the audience to come to terms with the fact that these subjects have character in spite of themselves. A painting by the now renowned Sichuan Fine Arts Institute alumnus used to go for about \$200 in the early 1990s; the latest sale at Christie's went for over \$2 million.

"In the last 20 years there has been a pivot from politically charged art to more socially charged pieces," says Connolly. "What is happening now is that there is a desire for a more minimal approach to art because there has been an over-saturation of consumerism. Artists are returning to traditional Chinese materials in a bold contemporary way to examine the impact of social issues, like modernization or the one-child policy."

When China first opened its doors, it seemed to Western critics that Chinese artists were merely responding to Western traditions. In the last decade, however, the art scene has metamorphosed far beyond that as Chinese artists increasingly contend with themselves above all else, and this is a trend that art enthusiasts are responding to with piqued interest. ■



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China and Inspiration

Charles Sampson, CEO of Young & Rubicam Advertising
China on which books made China and marketing come alive



I came to China in 2001, and had no idea what the country was about because I'd never studied China or Chinese, so I was really starting from scratch. I recall being in the airport in Hong Kong and perusing one of the shops when I saw a book whose title led me to believe it was just the thing to introduce me to China: *The Chinese* by Jasper Becker.

The book was really quite academic and took me through all the social strata of Chinese society and the different facets of the culture. Coincidentally Jasper and I have since become friends.

Living here over the past 12 years I've read numerous books on China, some great, some not so great. The longer you're here, the more you encounter books that are often written by someone who comes and goes, but I love books about Chinese culture and stories from those who've been here, lived here and have a deep love of the country. Peter Hessler's *River Town: Two Years on the Yangtze* stands out well in this regard. What I love about his style of writing in particular is that he really gets deep into the lives of the people he writes about, he goes and lives in these communities and it shapes his writing to great effect.

For a slightly more humorous read, I enjoyed *Mr. China: A Memoir* by Tim Clissold. His book is hilari-

ous. As the story goes, he was given \$400 million for a business venture in the 1990s in China and promptly lost it in 18 months, and his recounting of the journey is relatable and insightful.

As far as my work in China is concerned, there are certain books on the advertising industry that are universal and timeless, and those books guide my work just as much here as they did anywhere else. Right at the top of that list would be Jon Steel's *Truth, Lies, and Advertising: The Account of an Art Planner*. It's a brilliant book about how advertising work in which he debunks quite a lot of myths about the business.

In more entertaining territory there's *Inventing Desire: Inside Cheat/Day: The Hottest Shop, the Coolest Players, the Big Business of Advertising* by Karen Stabiner. She captures some of the craziness that sometimes ensues in this industry and I could easily relate to it, a very funny read.

One book that I reference and return to even today is Richard Hall's installment in the Brilliant book series on various topics related to personal education. His was called *Brilliant Presentation*. He's an inspirational guy to me who took a really holistic approach to presenting and what it takes to be an effective communicator. I go back to that book every six months or so at least.

For leisurely reading, I'm a sucker for any books on running ever since I took up marathon running. *What I Talk About When I Talk About Running* by Haruki Murakami is one I particularly enjoyed. As comes through in his book, running is one of those things where when you do it, you really find out more about yourself. ■

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by Charles Duhigg

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by Phil Jackson and Hugh Delehanty

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- No. 10 **Crazy Rich**
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Source: *The New York Times*

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