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# Unstable Investment?

**China's top companies often use Variable Interest Entities, but now Alibaba's IPO is shining a light on this legal grey area**

- How multinationals can stay ahead of their local competitors
- The capability is there, but why are China's e-cars still stuck on the starting grid?
- Can Samsung maintain its grip on China's smartphone market?

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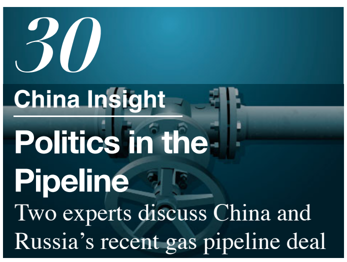

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# Out into the World

Come September and everyone's attention will be on Alibaba and its much awaited initial public offering (IPO) at the New York Stock Exchange. While the world is probably obsessing over the size of the IPO (Alibaba's IPO is very likely going to be the biggest IPO the US has ever seen), my attention will be on an important, yet less talked about issue: the company's complex legal structure. Alibaba has what is known as a variable interest entity or VIE structure. Many Chinese companies that seek to list in the US use this structure. Others that have done it include Baidu, Sina, JD.com and Renren.


What the VIE does essentially is split a company into two entities. The first entity based in China—and owned by Chinese citizens—obtains the licenses to operate in a particular sector. The second entity will be an offshore holding company, which as the nomenclature suggests, is based outside China. Foreigners can buy shares in this company. The two entities are connected by a series of service contracts, which effectively give the foreign entity operational control and revenue.

The upcoming Alibaba IPO has brought this complex structure into sharper scrutiny. Do read our cover story on page 22 to understand how VIEs work and the realities of this high-stakes game.

In this issue we have turned the spotlight on China's dealings with two other BRIC economies. In our story on page 38, we look at how India's newly elected Prime Minister Narendra Modi may usher in a new era in China-India business relations. Will this be Silk Road 2.0? There are challenges of course, but we hope so. In another feature on page 30, we brought in two experts to analyze the China-Russia gas pipeline deal. At $400 billion, this is clearly a big deal. We look at how both the countries stand to gain from this agreement, the impact on China's relations with Russia as well as implications for geopolitics and global energy issues.

In keeping with our mandate of providing our readers insights on different sectors in China, this time we take a look at the slow takeoff of electric vehicles in China, and how policy is helping or getting in the way. Turn to page 34 to read more. Elsewhere in the issue we take a look at the growing appetite for robots in China (page 14). Only recently China surpassed Japan to become the biggest buyer of robots in the world. This has far reaching consequences for various sectors in the economy—from manufacturing to healthcare and food processing. The trade-off is that China is losing the low-cost advantage of human labor due to rising automation. Can robots help China regain what it's losing? Time will tell.

Multinationals in China don't have it so easy anymore. They are facing increased scrutiny from the government and the media, and at the same time competition, especially from local companies, has become much more fierce than they could ever have imagined. How can they continue to compete and flourish in a terrain that is becoming increasingly tough? We brought in two experts, including our in-house strategy expert Teng Bingsheng, to share their insights on this complex issue (page 18).

While on the theme of multinational companies in China, please turn to our interviews section. This time we bring you two interviews with the China heads of two multinational companies: Daniel Kirchert of luxury car company Infiniti (page 50) and Allen Wu of UK-headquartered semiconductor manufacturer ARM (page 60). Both these executives talk about their operations in China, navigating the terrain here and dealing with competition.

We look forward to hearing from you. Please write to us at: ckgsb.knowledge@ckgsb.edu.cn

Happy reading!

*Yours Sincerely,*

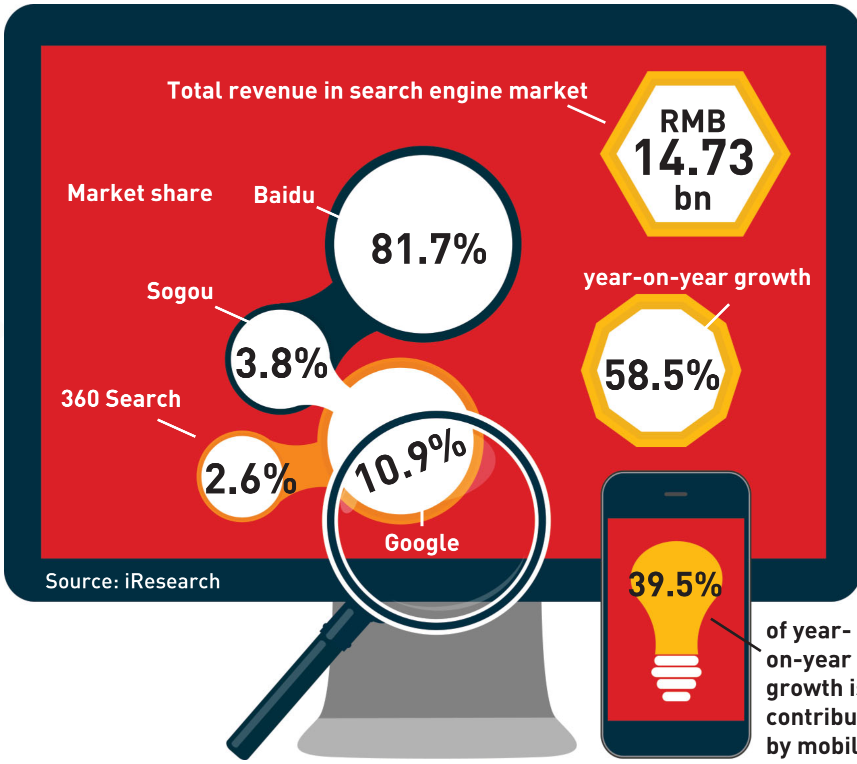
Zhou Li
Assistant Dean, CKGSB

*For more insights on the Chinese economy and business, please visit the CKGSB Knowledge site:* http://knowledge.ckgsb.edu.cn/


The stats you need to know
[from June and July 2014]

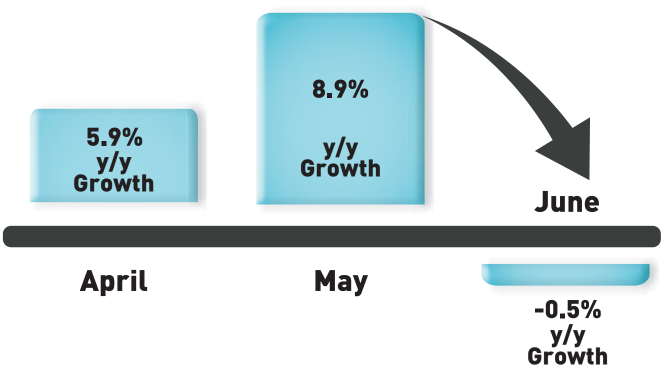
## In Search of Growth

July stats on China's search engine market show mega growth and a victor in Baidu




## Weak Signal

June showed a
**0.5%**
decline in telecom services revenue growth
*y/y: year on year

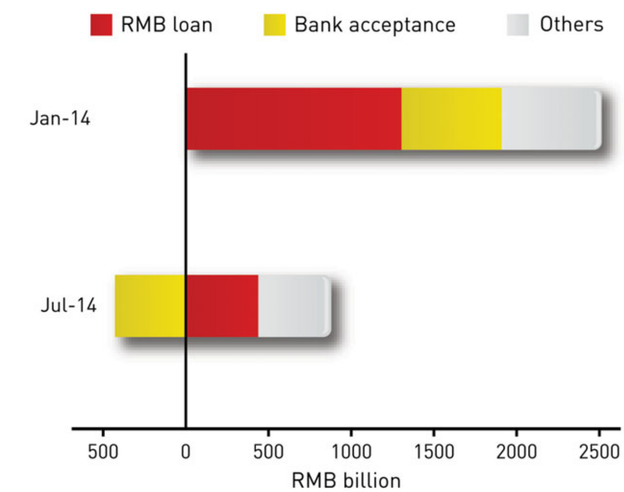




Source: Ministry of Industry and Information Technology

## Where Has the Money Gone?

July credit data showed a big decline in new renminbi loans amid banks' concerns over China's slowing economy and problems in the property market. Bank acceptance, a form of off-balance sheet financing, was affected by regulatory tightening of shadow banking activities. Still, most economists expect a rebound in lending in August

**Total Social Financing* Growth**




*This is the broadest measure of new credit issuance in China

Source: CEIC, HSBC

## Flight of Money

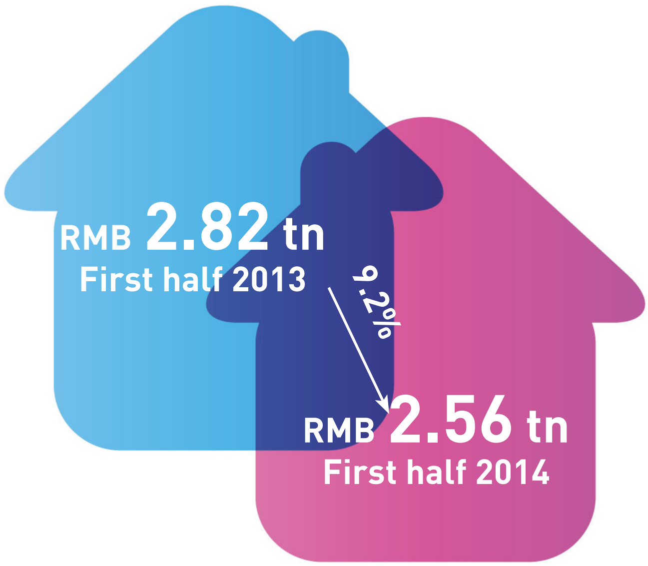
There was a huge net outflow of non-foreign direct investment (NFDI) in Q2 2014 compared with a strong net inflow in Q1, possibly reflecting a rush by investors to get money out of the system in fear of an economic hard landing

Q2— an NFDI net outflow of **$77.2 bn**


Source: State Administration of Foreign Exchange

## Home Not-So-Sweet Home

**The total contracted sales* for China's residential property market are on the decline in 2014**

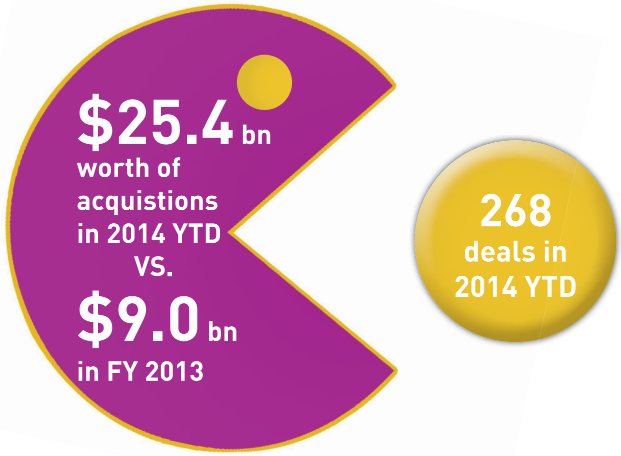



*A sale in which the property title is transferred after a set number of payments have been made

Source: National Bureau of Statistics

## Tech Feeding Frenzy

**In 2014, China's leading tech companies are at the front of the sector's voracious appetite for acquisitions**




**Tencent, Lenovo and Alibaba**

are the leading acquirors with a combined total of **$16** bn

in, or **63%** of, total acquisitions in 2014 YTD

Source: Dealogic

## Giants Among Buildings

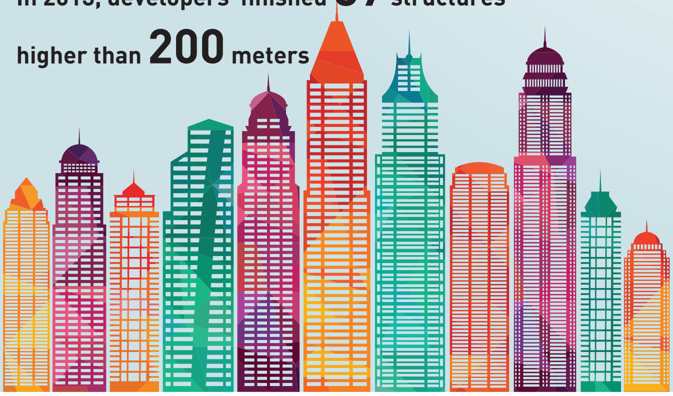
**According to the Chicago-based Council on Tall Buildings and Urban Habitat, a non-profit organization that maintains a database on tall buildings, China's cityscapes are set to house more and more of the world's skyscrapers**

By 2020, China may be home to the world's **10** highest buildings,

including Suzhou's **700**-meter Zhongnan Center

In 2013, developers finished **37** structures

higher than **200** meters



## Steely Resolve

**Beijing is determined to reduce steel production capacity to cure industry glut and air pollution after last year's whopping 779 million tons of output**


*The amount by which steel production capacity must be reduced by September 2014

Source: Ministry of Industry and Information Technology

# Finding Green Profits

In 2013 China extended its lead in the global clean energy race by investing a massive $56 billion in the sector, according to Bloomberg New Energy Finance. Officials in Beijing have for the past four years adjusted upwards multiple targets for clean energy projects in a bid to develop Chinese firms into market leaders and, more recently, taken effective measures to curb torrid pollution levels. Much of the investment in clean energy projects is directed by the state, so private capital looking to enter the sector has often flowed into stocks. Despite lots of media noise about a booming renewable energy sector, however, turning a green profit is not a simple process. Here we take a look at the performance of sub-sector indices of leading listed Chinese clean energy companies for the first six months of the year compared to their performance in 2013, as compiled by research provider SinoCleanTech.

Note: The percentage changes in the graphs for First Half 2014 and Full Year 2013 reflect the movement of the index for that sub-sector.

## WIND POWER

First Half 2014: -6.3%

2013: 48.5%

2013 investment: $28 bn

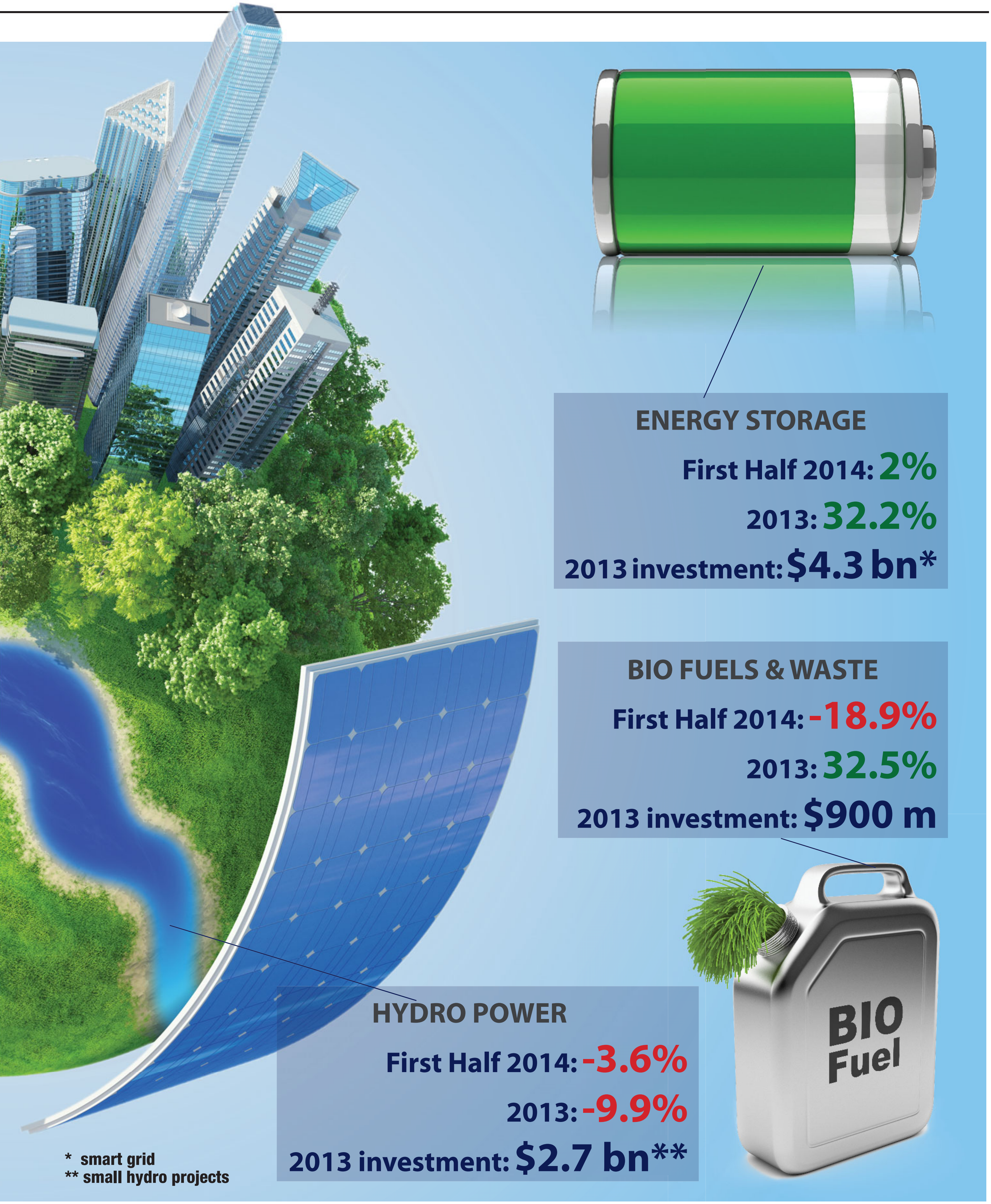
## SOLAR POWER

First Half 2014: 16.5%

2013: 76.9%

2013 investment: $22.6 bn

Source: SinoCleanTech, Bloomberg New Energy Finance


ENERGY STORAGE
First Half 2014: 2%
2013: 32.2%
2013 investment: $4.3 bn*
BIO FUELS & WASTE
First Half 2014: -18.9%
2013: 32.5%
2013 investment: $900 m
HYDRO POWER
First Half 2014: -3.6%
2013: -9.9%
2013 investment: $2.7 bn**
BIO
Fuel
* smart grid
** small hydro projects

# Buying Brain Power

**Chinese tech firms are stocking up on patent purchases, but is it anything more than share price padding?**

By Douglas Bulloch

The leadership in China knows that innovation is its future, the key to higher living standards and long-term growth... They are doing everything they can to drive innovation, and China's patent strategy is part of that broader plan." *– David Kappos, former Under Secretary of Commerce for Intellectual Property.*

Kappos' grand statement in a 2011 interview with *The New York Times* may not have captured the far more practical, and sometimes cynical, driving forces behind Chinese high-tech companies purchasing large amounts of patents and patent families from both partners and competitors. In acquiring vast swaths of patents, so do these Chinese firms acquire the means to inflict debilitating litigation on foreign competitors.

Lenovo—which acquired IBM's personal computer business in 2005—purchased and licensed some 2,500 issued and pending 3G and 4G patents from Unwired Planet in March. This closely followed the purchase of 3,800 patents from NEC and complements their on-going efforts to purchase Motorola Mobility. Alibaba has recently purchased 102 US patents to add to its portfolio of over 1,500 Chinese patents and upwards of 300 US patent applications. However, efforts are not always successful; Huawei failed to secure the purchase of 3Leaf patents as long ago as 2011 because they were deemed crucial to US national security.

The pattern of purchasing patents has become a clear trend for leading Chinese companies. This is not a coincidence, according to Xiang Wang—Asia Managing Partner and Head of China IP Practice for American law firm Orrick, Herrington and Sutcliffe—instead "this reflects the maturity of Chinese companies going global and is the right thing to do". In this case, maturity takes the shape of one's capacity to bring legal pain to competitors.

## Not a 'China Syndrome'

In fact, the trend of acquiring patents extends well beyond Chinese companies, as Chris Bailey, Deputy Country Manager, China, and IP Consultant for specialist IPR Law and Consulting firm Rouse, makes clear: "Any company, whether it is China-based or US-based or anyone else, if they want to be a major technology company, and particularly if they are operating in the US, they are very likely to be subject to patent infringement... [and] they will probably infringe patents." The common factor here has less to do with Chinese companies than with the high-tech sector in which they operate. High-profile US companies like Google, Facebook and Twitter have also travelled along this same path of patent acquisition, having possessed only a handful before listing.

> Indeed, there are a lot of patents and IP around communication and also smartphone design
>
> Laura Chen
> Tech Analyst
> BNP Paribas Asia

And while direct purchases of patents hit the headlines, Bailey makes clear that is not the only way in which technology is acquired. "Very often there are purchases of technology but they are not done by pure patent purchases; they are actually mergers and acquisitions," he says. Which, rather like Lenovo's purchase of IBM personal computers, brings in patented technology as part of an on-going concern, but looks like a different kind of transaction altogether.

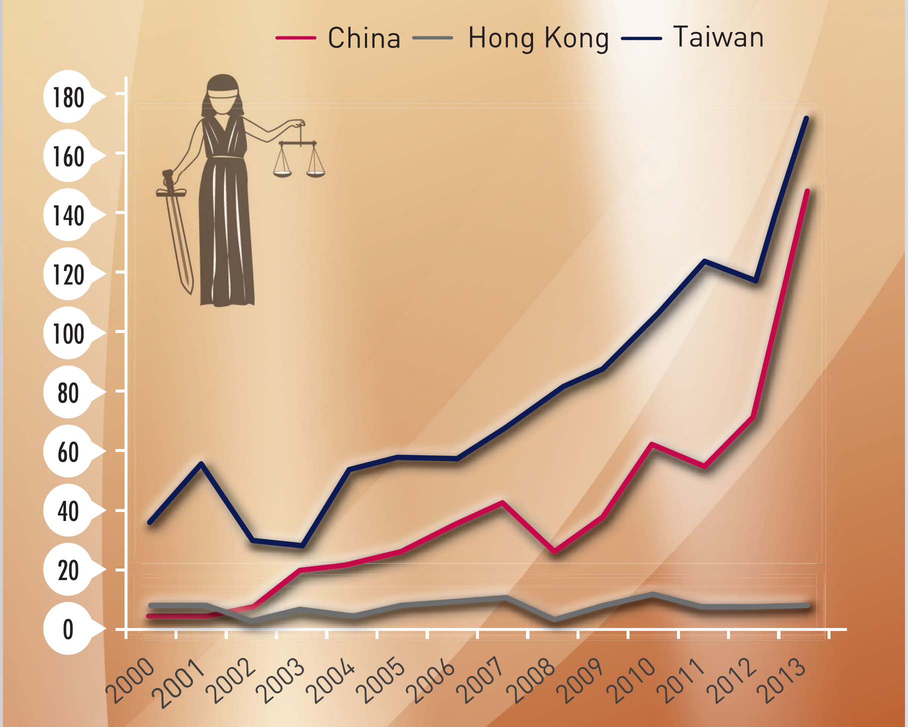
Although the Chinese companies most obviously engaged in this practice are all tech companies, some parts of the tech sector are more active than others. The significance of patent purchases for market analysts, for example, "depends on the companies' strategy and policy. For the PC industry—like Lenovo, the biggest– there is not too much concern. But talking about the smartphone market, indeed, there are a lot of patents and IP around communication and also smartphone design. That is why Lenovo is keen to buy Motorola Mobility, and that deal could provide patent protection [in] overseas markets," says Laura Chen, Tech Analyst, BNP Paribas Asia. This neatly reinforces Bailey's point that the practice has less to do with China, than with the growth of Chinese companies into international markets where patent disputes are potentially more hazardous.

## Buying the Haystack

It is often overlooked that patents do not necessarily give the owner the means to utilize inventions, although they do however provide the right to exclude others from doing so. But unless the patent captures the key element of a product or method that cannot be designed around in a commercially viable way, it will never become a 'killer patent'. Indeed, it may never be commercialized at all, which explains in part the fashion for purchasing patents in bulk. "A competitor who infringes a single claim is the same as if he infringes the entire patent which could have 100 claims or more," says Wang, "as long as you have one single claim that can catch the competitor, assuming the claim can withstand a validity challenge, you have won the battle. Therefore, as an investment, when you acquire patents you really cannot necessarily tell with absolute certainty that of 10,000 patents acquired, maybe only 100 are good in legal battles. In order to get those 100, you have to acquire all 10,000." According to Bai-

## Whose Idea Was It?

**Patent dispute cases with at least one party from region**




Source: Chinese American Lawyers of the Bay Area

ley, the numbers are similarly stark when considering patents generated by organic research; "you're doing pretty well if more than 2% to 3% of your portfolio is actively being commercialized."

Fortunately, patents give rise to more than simply an ability to exclude others from using a specific piece of technology. They also provide opportunities for cooperation and cross-licencing, opening up the use of technologies that you don't own in exchange for the use of some that you do. Alternatively, they might simply provide a stream of license revenue or, more controversially, they may offer the chance of revenue through pure litigation and patent trolling. Each of these activities is supported by the harvesting of large amounts of patents. Furthermore, the different types of patents—in the US there are 'utility' and 'design' patents, which correspond in China to 'invention' and a mix of 'utility model' and 'design' patents respectively—all similarly offer opportunities for defensive legal protection, and more aggressive legal action.

### Moving Targets

The first and most likely trigger for sourcing significant numbers of patents in isolation relates to an impending IPO. When a company goes to market, not only must they protect their own technology, they must also protect themselves against litigation inspired merely by their listing. "As soon as YouTube was bought by Google, all the music studios found it was worth suing. It wasn't when it was a start-up," says Bailey. By the same token, a Chinese company listing in the US brings the possibility of litigation in the US courts, so while "a company is not going to be so amenable to suing Alibaba at headquarters in Hangzhou,… they'll find the New York subsidiary probably quite attractive."

None of which is to suggest that only the US is a highly litigious commercial environment. The number of IP-related cases in China far outstrips that of the US—some 40,000 cases between January and April this year, compared with nearly 8,000 for the whole of 2013 in the US—although this might be partly explained by higher levels of routine infringement in China; either way, both the costs and the awards are much lower in China. For this reason alone, "the value of a US patent is many, many, many times greater than the value of a Chinese patent", according to Bailey.

### The Lure of Exclusivity

Litigation is about remedies. Sometimes this comes in the form of damages, sometimes a decision on what constitutes a fair price. In patent law it may also mean injunctions on the sale of competitor products.

In the past, individual patents might protect entire products, or perhaps just the critical technology that made the product a market leader, but highly complex modern tech products contain a great many individually patented technologies. In these cases patents delineate ownership and revenue streams for many different patent holders, all disguised behind the headline brand. Smartphones carry the added complication of highly differentiated software applications, as well as being the point-of-sale for an extensive range of online services. Between all these competing interests, IP law plays referee, but one single infringement might hold up the entire packaged product.

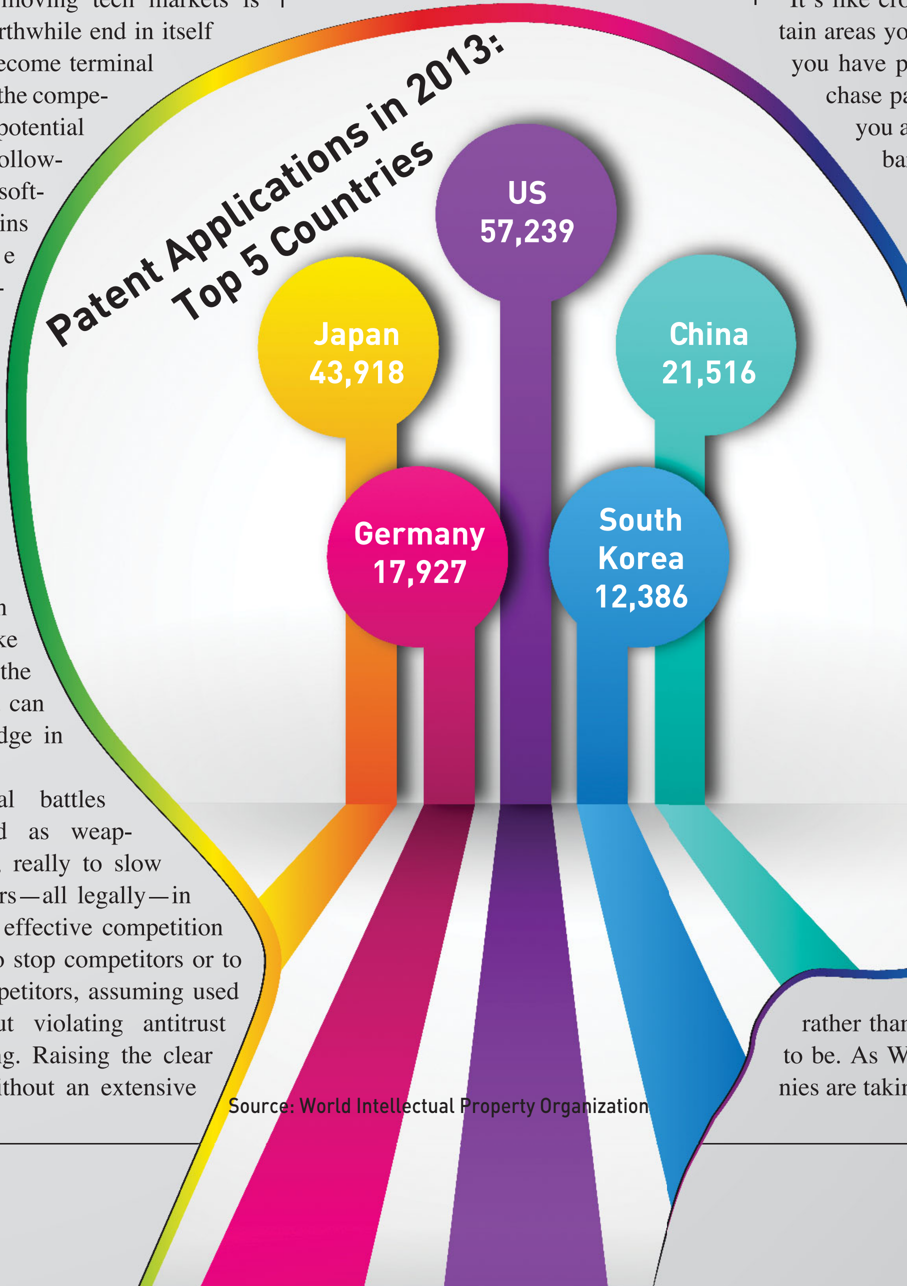
By comparison, "automotive is also a complex area… there is a similar amount of interconnectivity, a similar amount of complexity, but there seems to somehow be a little more cooperation", says Bailey, adding that "you wouldn't see Valeo or Bosch suing Mercedes, whereas in the technology space that seems pretty normal. I mean—Apple and Samsung—Apple also purchases Samsung components." The interoperability of the technology space is particularly conducive to 'patent wars', where headline companies both cooperate extensively while simultaneously litigating exhaustively.

## Patents as Weaponry

The most controversial element of these 'patent wars' is the extent to which patent law provides opportunities for commercial competition to advance not in the market place for products, but in the courtroom. This highlights the opposition between competition law and IP law, where the former attempts to prevent monopolies, and the latter to protect them, in the form of exclusive rights. Patents, therefore, protect legal monopolies, and the profits they generate. It is therefore, little wonder that competitive gains are often made in court.

But even without absolute victory, patent cases serve an even more cynical purpose. Preventing the sale of a competitor's product in fast-moving tech markets is potentially a worthwhile end in itself as court cases become terminal time suckers for the competition, and the potential revenue from follow-on services and software apps remains blocked. "The commercial value of litigation is so clear," says Wang, "sometimes controversially, people ask… what is the real purpose behind all this? Keep litigation going? And take advantage of the litigation so you can get the upper edge in battle?"

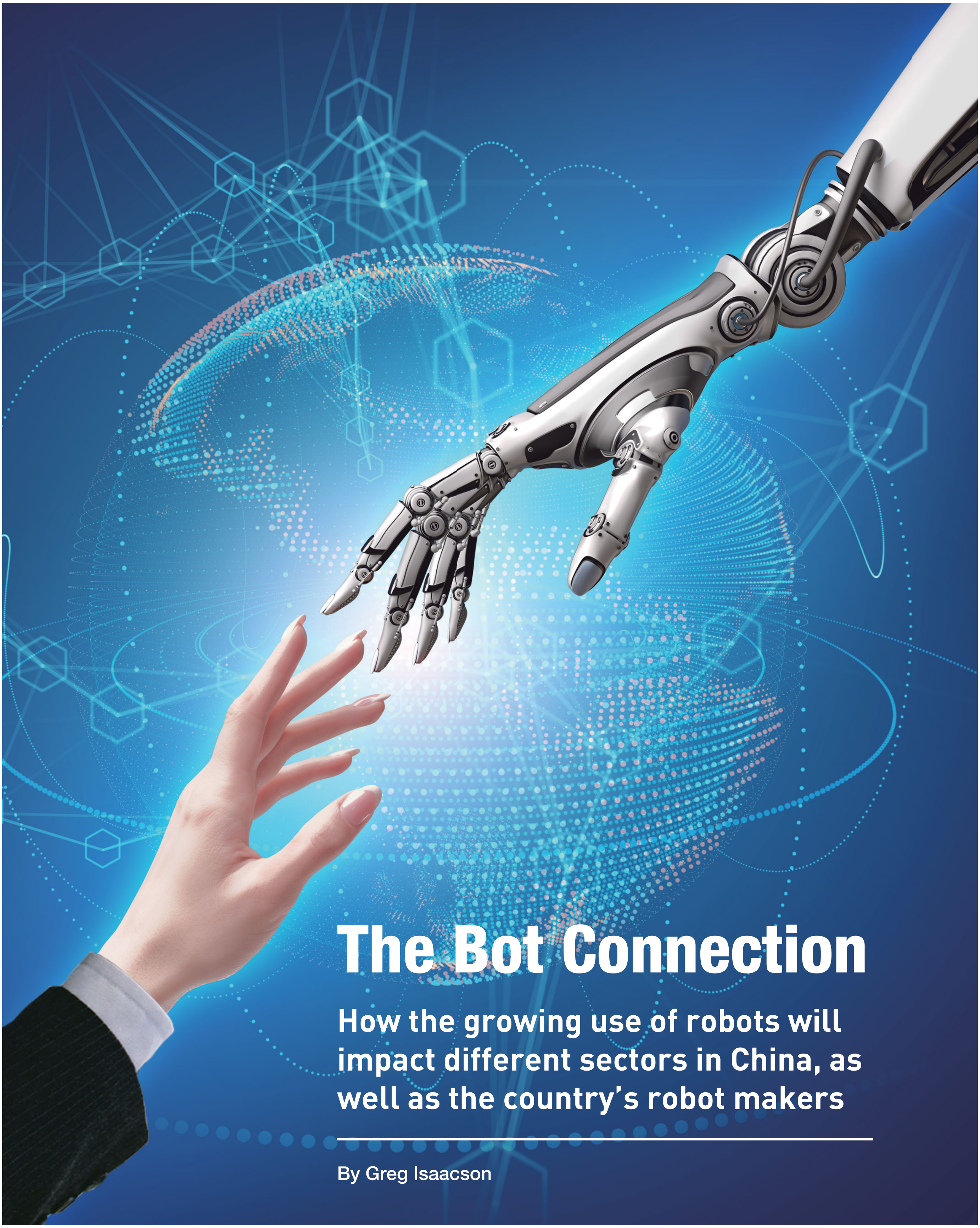
"These legal battles are being used as weapons to compete, really to slow down competitors—all legally—in fact it is a very effective competition weapon either to stop competitors or to slow down competitors, assuming used properly without violating antitrust law," adds Wang. Raising the clear prospect that without an extensive and well-managed patent portfolio, a commercial newcomer may find itself held up long enough to lose their innovative edge and essential early branding opportunities. From the market perspective, some high profile patent cases are simply assumed to be strategic contests framed as disputes over technology. When asked specifically about Apple and Samsung patent wars, Chen observes, "I think there is more of a competition perspective. Maybe there is some argument between the two, but more important for them is to strengthen their industry leadership, and I think it will not be the only case." Furthermore, she explains that for Chinese companies, entry into the US market carries the greatest risk of crippling litigation, which explains why "when they go overseas, they start with emerging markets."




## Prudent Preparation

The evolution of what has become a technology ecosystem—and the consequent growth in IP it has engendered—happens to coincide temporally with the story of China's expansion into high technology manufacturing, but in this, as in many other things, China is just playing catch-up. Chinese companies have certainly been acquiring large numbers of technology patents, but this resembles more a strategy of imitation than one of commercial predation; recognition of what they must do if they want to expand internationally, particularly into the US. As Bailey says, "It's like crossing the bridgehead. In certain areas you can't play in the US unless you have patents. So being able to purchase patents in a relevant area gives you at least a foothold, gives you a bargaining chip."

Therefore, rather than challenging the global tech giants of Apple and Samsung, Chinese companies are merely adapting to an international commercial space whose contours are already well established. In the future, however, it seems unlikely that Chinese companies will increase the total amount of litigation in the ecosystem, rather than simply augment its biodiversity. It might be fairer to say that without significant patent portfolios, Chinese companies would remain forever companies in China, rather than the global titans they aspire to be. As Wang observes, "these companies are taking the right approach."



# The Bot Connection

## How the growing use of robots will impact different sectors in China, as well as the country's robot makers

By Greg Isaacson

It's a well-depicted scene: a skilled surgeon is performing delicate open-heart surgery in an amphitheatre filled with esteemed colleagues and eager-to-learn residents. The lights illuminating the procedure are bright and hot, calling forth small beads of sweat on the surgeon's forehead. The doctor says: "Scalpel." Only instead of human hands it's two robotic arms that extend a tray of tools in response to the surgeon's request. No, this is not a summer sci-fi blockbuster, but rather what's happening in China's foremost medical research institutions, and in full practice at Beijing's General Navy Hospital where robots are the first ones to crack open skulls for brain surgery.

Service robot application in healthcare is only going to increase with time, following the example of Japan and Osaka University's Actroid-F, a nursing robot with an eerily human appearance. When Osaka University and Kokoro Corporation tested the robot's effect on 70 elderly-care patients, only three or four said they didn't want it around, with the rest saying that the robot's presence was "pleasant".

"In five years we could have robots working with doctors and nurses," says Song Xiaogang, Executive Vice-President of the China Industry Machine Federation (CIMF) and President of the China Industry Robot Association (CIRA).

It may be in services that Chinese robotics manufacturers can leapfrog ahead of cutting edge industrial robot technology and establish a foothold in the wider robotics industry.

"It solves the problem of labor costs and lack of labor in some areas. Less and less people would like to do that kind of job," says Song, citing elderly care as one area where there is less interest in the job market. Furthermore, China's leadership is eager to counter the categorical dominance of foreign robotics producers in China, who recently stole the show at the China International Robot Show.

While visitors to the exhibition oohed and aahed over an Italian robot with car-assembling capabilities, there was a tense atmosphere behind the scenes during a CEO panel on the Chinese robotics industry. Executives ruminated on the implications of China's newly minted status as the world's largest robotics market. Stefan Sack, CEO of Italian firm Comau Engineering, warned against letting small robot manufacturers pop up "like mushrooms", further fragmenting a market in need of improved integration and downstream supply chains. He warned fledgling domestic industry players: "Everyone wants to become a robot manufacturer because it sounds sexy. It will not be sexy."

In 2013, China purchased one in five robots sold globally—a total of 36,560 units—unseating Japan as the world's largest buyer of robots according to the Germany-based International Federation of Robotics (IFR). Rapid automation of manufacturing and services highlights opportunities for both Chinese and foreign robotics companies.

But China still lags far behind more developed countries both in the production and use of robotics. The country has only 11 robots installed per 10,000 manufacturing employees, in contrast to South Korea, which has 396.

## 2,4,6,8 Everybody Automate!

China's status as the fastest-growing market for industrial robotics means that relatively virgin robot territory could be set for some serious growth.

Robot sales grew 36% on average per year from 2008 to 2013, according to the IFR report, with the auto sector retaining its role as the main driver of the automation boom with 60% of all auto production depending on robotics. Liu Jianshuo, Sales Manager at Beijing RHJ Robotics Technology, says automobile manufacturers are his company's biggest customers, with welding robots leading the charge.

But packing robots are also holding their own. Liu Yang, Sales Manager at Swiss mechatronics company Stubli's Hangzhou office: "Pallet packing robots in the food packaging industry and electronic assembly industry are selling best."

As for the future of the automation boom, cars will have their place for at least several more years to come. Market research firm Transparency Market Research forecasted in 2013 that major growth would be seen in pharmaceutical production as robots are increasingly used for washing, labeling, packaging and other end-process tasks.

There are a number of reasons that companies are incorporating robots at ever greater adoption rates.

"When you introduce automation in robotics, it commands, it requires, it will dictate a sort of improvement of the whole process," says Arturo Baroncelli, IFR President.

Simply put, robots improve efficiency. "2013 was a very, very strong year for robotics, which is interesting because it wasn't a great year for a lot of other machines like machine tools. So I take that as a sign that China is automating, even though they're not automating to increase capacity, they're automating to improve efficiency," says Morten Paulsen, Head of Japan research at CLSA. Were capacity the aim, we wouldn't see such a gap between machine tools and robots, he adds.

Furthermore, when put to certain tasks where robotics can guarantee a level of precision and safety that humans can't, robots increase productivity. Swiss power and automation technology company ABB released reports going as far back as 2010 detailing how the use of robots in welding increased productivity by 60%.

But in the macro-economic sense, firms adopt robotics in manufacturing to save on the costs of labor wages, which have risen rapidly in China. In fact, there are several aspects of China's workforce that necessitate a serious evaluation of what part of production can be automated.

## A Losing Wager

China's workforce shrank for the first time in 2012 with the working-age population falling by 2.4 million people to 920 million by 2013. State media reported in February this year that labor supply has fallen to half of demand in Beijing. According to local government agencies, the city will have only 218,000 people available against 556,000 new positions that will open up in the first six months of this year. China may be arriving at what is known as the “Lewis turning point”, whereby a country runs out of surplus labor, driving wages up.

One company that has been hit hard by rising wages is Foxconn Technology, the Taiwanese manufacturer of Apple’s iPhones and iPads, best epitomized by its city-sized factory complex in Shenzhen. Foxconn saw its labor costs rise by 16.5% in 2009, by 25% in 2012, and promised to double wages again in 2013, though whether or not that hike has taken place has yet to be confirmed. What has taken place is a steady increase in the minimum wage in Shenzhen, which already has the highest minimum wage requirements in China. At the very end of 2013, Shenzhen’s Mayor Xu Qin announced that the hourly minimum wage requirement would go up 13.5% to RMB 16.5 an hour. Thus the same cost pressures that are prompting companies to evaluate other manufacturing locations such as Southeast Asia are also pushing companies to automate.

Foxconn, for instance, is building an army of robots to supplant an ever-more expensive human workforce. It’s hard to know how many robots Foxconn has and how sophisticated they are, because the company’s “Foxbots” are made and used exclusively in-house. However, ABB told analysts at CLSA that Foxconn may be producing more robots than the rest of the Chinese industry players combined.

## Feeding the Machine

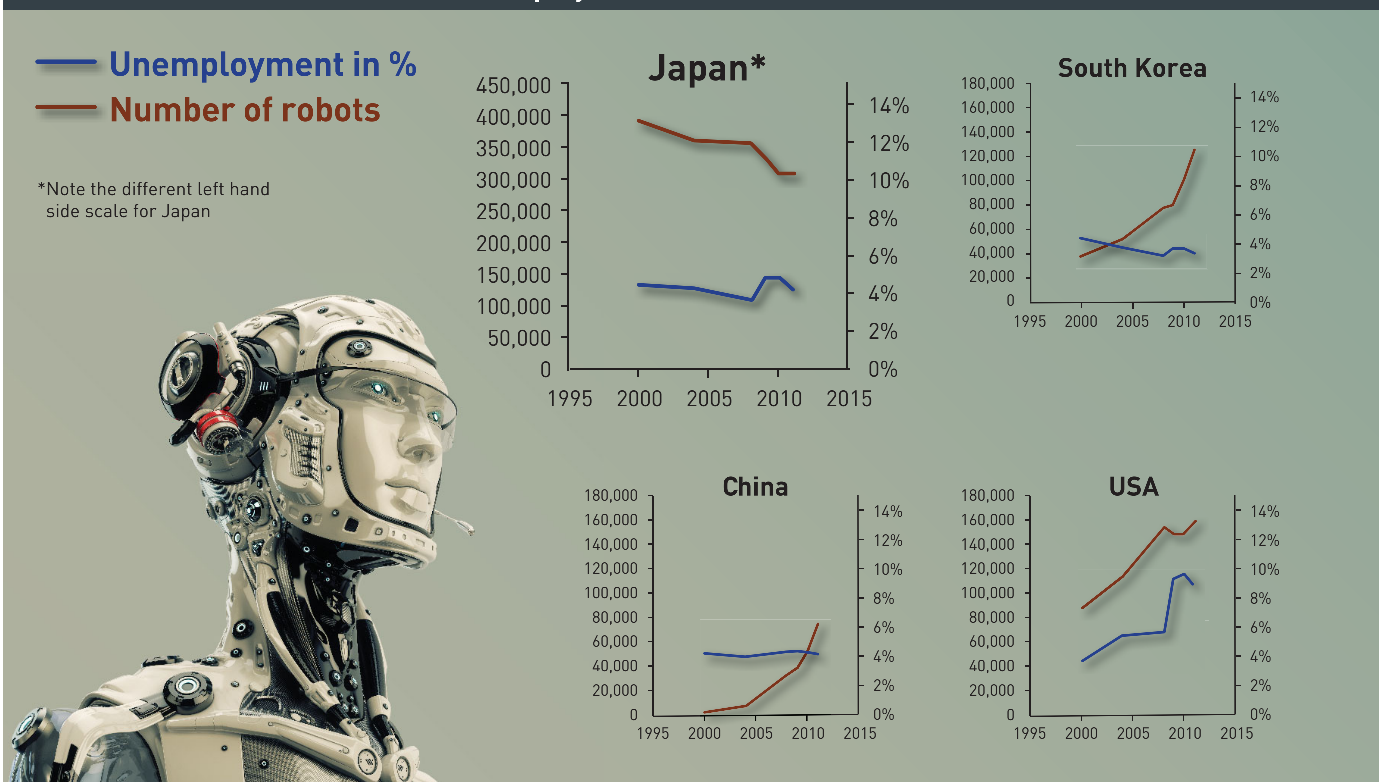
The global industry for factory robotics is largely dominated by four firms—Fanuc (Japan), ABB (Switzerland), Yaskawa (Japan), and Kuka (Germany)—which provide two-thirds of global supply. The dominance of Japanese and Western firms is mirrored in China, where foreign providers control some 90% of the market according to IFR data.

That dominance appears likely to continue for some time. Paulsen argues that three factors are holding Chinese robot-makers back, preventing them from posing a serious challenge to foreign providers, at least for now. The first is technology: “There’s a pretty significant gap,” says Paulsen, between Chinese and foreign-produced robots and automation equipment in terms of speed and precision.

Another challenge is that many of the key components of domestically-made robots are imported. Sophisticated parts like servo motors, controllers and software are mostly bought from Europe and Japan. “What’s left of the robot is basically the iron casting and the assembly,” says Paulsen. “So it’s a robot that’s made in China but without in-house production of key components; it will be difficult for these companies to gain a real price advantage and technological edge compared to foreign competitors.”

Branding represents a third roadblock

### Man and Machine
**Rate of unemployment vs. number of robots in use**




Source: International Federation of Robotics for Chinese firms. Customers, including both Chinese and foreign partners in joint ventures, are reluctant to stray from the big four global providers with their long histories and well-established brands. But that may change over the next five to 10 years, with Chinese robotics firms like Guangzhou-based GSK, Wuhan Huazhong, and Beijing CND emerging as potential domestic leaders.

Paulsen predicts that one or two of these companies will eventually take their place among the big four global robot-makers in China. These companies are well-managed, forward-thinking, and profitable, he argues. They also enjoy a high degree of state subsidies and support via robotics research institutes.

China's leading domestic provider of industrial robots is privately-owned GSK. GSK's management claims the company accounts for 30% of the Computer Numerical Control (CNC) machine tool units produced in China. But the country's leader in CNC systems may in fact be Wuhan Huazhong. Founded by a group of state-owned enterprises and private venture capitalists, the company claims a 66% share in the high-end and a 30% share in the mid-end domestic CNC markets. Overall, even this market as a whole is dominated by Fanuc and Germany's Siemens.

If the supplier landscape is changing, so is the nature of robot work. Traditionally, robots have been employed mainly in the automotive and electronics manufacturing sectors in China.

The automotive sector, which is dominated by large multinationals, accounts for 60% of current demand. But Song sees huge potential growth in robot use in a wide range of manufacturing industries: food processing, chemicals, home appliances, and construction materials, among others.

"It's very vast sectors of manufacturing," Song says. Already, 25 of the 36 manufacturing sectors identified by the government use Chinese robotics in production. Song said he believes that virtually all production can be robotized, quipping that marketing and R&D are the only sectors truly immune to automation.


## The New Factory Floor

Anxiety over job security as it relates to automation is propelled primarily by the workers. Neelie Kroes, Vice-President of the European Commission, even demanded that robot makers reassure the public that their machines will not usher in a dystopian, jobless economy when launching a robotics research fund in June of this year.

Various advocates, however, discount that scenario, claiming that automation actually creates new jobs that are more productive, more interesting and better-paid than the jobs that robots destroy. Robot application comes with its own labor demand, such as in their design, programming, operation and maintenance.

Instead of replacing humans entirely, except where there are tremendous safety benefits, robots will increasingly be seen working alongside humans on assembly lines. In more developed economies, "collaborative robots," or "co-bots", those that work alongside workers, are changing the nature of factory work. The co-bots take on the dullest and most repetitive tasks, freeing their human counterparts up to focus on more interesting and creative work. Such collaborations will ultimately raise China's manufacturing game, not degrade it. No matter how efficient manufacturing in the US becomes, nowhere else in the world can compete with China's infrastructure or manufacturing ecosystem.

But robot-human collaboration calls for some risk management that companies will have to deal with. Weng Yueh-Hsuan, a research associate at Peking University Law School, argues that the development of man-machine collaboration calls for more regulation. "From a risk regulation perspective, I believe we will need a legal framework to deal with the new machine safety for human-robot co-existence," Weng says. "I think a sound domestic labor policy guideline will be necessary to China, in order to ease the tension relationship between robot and human workers."

China's factories can only benefit from more robotics adoption and better application, and what we've seen so far is that jobs are rather enriched by automation.

"I think there are other dynamics at work in China. It's to get a different cost curve, get better economies of scale and improve quality. Those would be the main drivers," says Paulsen. "Manufacturers are putting more capacity in China than they're taking out on the net level." Robot adoption can help China solidify its status as a top manufacturing destination. As Baroncelli repeats, this is the way manufacturing is going regardless, so China best be on board.

"It's not a question of using or not using robots," he says. "In a growing economy, you must do things with robots. End of the story."


Teng Bingsheng

# Face-off!

## Experts provide strategy tips on navigating the competition between Chinese and multinational companies


Adil Husain

By Suzanne Edwards

**Meet our two experts: Teng Bingsheng, Associate Dean and Associate Professor of Strategic Management CKGSB and Adil Husain, President and Founder of Emerging Strategy, a market intelligence firm.**

### Aggressive defense of market share

"Chinese companies have been attacking some of the core markets held by multinationals, from shampoo to office furniture, you name it. Chinese companies are marching into segments that used to be dominated by multinationals and they believe that if they push hard enough, then following the theory of destructive innovation, multinationals will retreat to the next level, and then they will attack the next level in order to force the multinationals to retreat again. What I observed was that some of the leading multinationals decided not to do that, rather they would enter the core market of Chinese companies in order to have the battle on their turf. For example, P&G started a shampoo product selling for 9.9 yuan, which is exactly the price local shampoos were selling for, and the market will be the small cities, not the strongholds of P&G previously, but really the turf of Chinese companies. By entering these markets and using low prices, the target is to attack Chinese companies and lower their profitability levels so that they won't be able to attack the core market of P&G, which are the large cities."

**Teng Bingsheng**

### Studying a Rising Competitor

"If they [Xioami] can produce a phone that is almost as good as Samsung at a much lower cost, that will produce a great challenge. Even if the phone is not as customized as the iPhone, they still have a great OS [operating system], a great price point and great specifications. They are giving good bang for the buck, basically. The Xiaomi phone is a way for the company to get into consumers' hands and to grab a larger share of wallets for services that can be sold through the phone and build loyalty for repeat customers. That strategy of getting into the customer's pocket through the phone and then staying there by the virtue of the apps is not unique to Xiaomi but they are executing on it fairly well compared to Android competitors. Among Chinese companies Xiaomi is unique so far in its ability to undercut its foreign competitors on the device front in terms of pricing because it has been able to come up with a great overall package of not just the device, but also the quality of the experience."

**Adil Husain**

## Stick to a "skimming strategy"

"Leading multinationals like Apple need to realize that in the future competition will be fierce and certain segments are essentially reserved for Chinese companies. In other words, if they try to compete down the pyramid at that level, they won't be able to compete because they don't want to position themselves in a way which would eat into their profitability level significantly. They probably have to stick to a 'skimming' strategy, [whereby] they still get the top of the pyramid to stick to the segment that is most profitable. People want the best quality and the best brand name and they are willing to pay a premium for these products rather than aiming lower and buying a cheaper Chinese brand."

**Teng Bingsheng**

## Dealing with increased regulatory scrutiny

"It is very hard to avoid. This is selective punishment, something very Chinese, and it's everywhere. It's not just about targeting multinationals. If you are singled out as the scapegoat, it will be very hard to deal with the situation. In China you would probably have to know which way the wind is blowing and try not to stick your head out too much because as we say in China, 'the wind will blow [away] the tallest tree.' Be a bit more humble and down to earth. In some areas that would be hard to do as one or two multinationals dominate the market, so then you would have to be tactical about what you do, so for example involve some powerful local Chinese partners in some peripheral areas in order to build this political foundation. I don't necessarily recommend an overall partnership, they'd better go for a plan and well-placed approach in specific areas, so having a partnership in marketing or R&D and developing a perception that you are working closely with Chinese firms but in reality you will not give anything that's sensitive."

**Teng Bingsheng**

"Accept that some of these things [investigations] will happen irrespective, and have a plan to deal with [them]. Overinvest in your compliance and internal controls functions to make sure you are staying ahead. Have crisis management and government relations people who can come in and help sort this out if and when it blows up because, despite best efforts, there might still be scrutiny. It may turn out that some company is the first one to get into trouble for something it assumed everyone was doing or tolerating but it's going to happen. So if you know that there are things going on in the organization which you might accept as a way of doing business in China but that wouldn't pass the test of 'What would happen if this got published on the front page of a newspaper?', you've got to make a decision about if it is really worth it. 'Are we doing something that if brought to light and exposed in the public sphere would expose the company to not only legal trouble, but even bad word of mouth? [If we are] then maybe we shouldn't be doing it."

**Adil Husain**

**Teng Bingsheng**

"Multinationals have to have better control of their operations in China because when competition heats up, you can no longer have so much of that traditional approach where you are outsourcing your activity such as distribution channels. More multinationals are taking them back and terminating the licenses, opening their own stores to have company-owned stores. You want to make sure that you control the value chain and you know what is going on to be able to offer the value that you want to.

"Multinationals need to be very careful with their intellectual property (IP) because this is probably their single most important asset in China, but they also need to involve some local partners so that their IP can meet local needs better because right now, [although] some multinationals do have the best technology, right now that doesn't translate to the best product for the market. Some business to business (B2B) products are like that, such as water cleaning and some industrial products… it is not easy to use and the after-sales service they provide is not as good as the local competitors and they charge a high price for the after-sales service. So if they can be more open-minded and involve some [local partners], that would be helpful. IP protection is slowly getting better; it is still a concern for multinationals but it may not be number one, which it used to be."

## Top survival tips

"They may not be doing enough localization within the Chinese market. They may be localizing for China but it's a big country and there are single provinces in China that are larger than many European countries, so running your China operations from Beijing or Shanghai, sometimes companies can get a false sense that if something works in big city like that it's going to work everywhere but that's not true. So more customization and tailoring for needs and tastes, whether its food or fashion or user needs between the tier-one cities and the tier-four and five cities.

"Being careful and cautious about the terms of the partnerships they enter into with Chinese companies, whether they are state-owned enterprises or others, because getting out of a joint venture is a lot harder than getting into it. Sometimes companies take the view that they need to play in a certain space and perhaps the easiest way to get in is through a joint venture or partnership but there needs to be better scrutiny of potential partners and there also needs to be an exit plan if it doesn't work out. In hindsight, what can companies learn from those who have gone before them? Ask: do the short-term benefits outweigh the potential risks? Sometimes they may, sometimes you just need to get in [as] the opportunity is so great, but companies need to have a better sense of what they are committing to in order to get the best value for themselves and for the partnership. For example, does the [Chinese partner] company have subsidiaries that will compete with the joint venture?"

**Adil Husain**

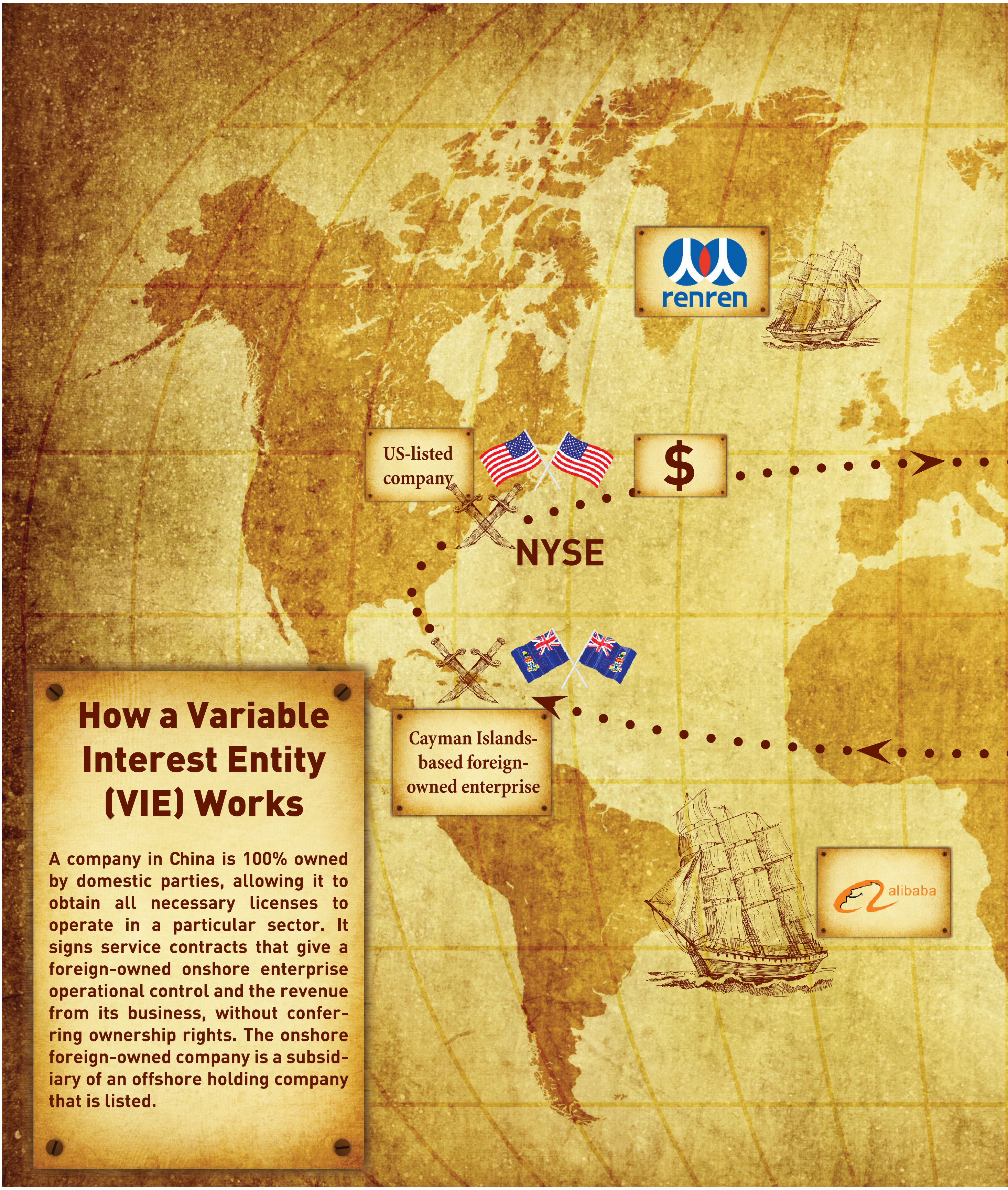
## Being realistic about "skimming strategies"

"Chinese have a better knowledge of what is going on elsewhere so they don't want to be treated as second-class citizens. In other words if some companies don't offer the best products or the latest models to the Chinese market with the best warranty policies, then Chinese consumers won't be happy. Multinationals need to be realistic that although they want to continue the skimming strategy, they want to make sure that the value they offer will be proportional to the price that they charge: it has to be reasonable in the eyes of Chinese consumers. The strategy adopted by luxury brands in China probably would not be sustainable, which is to charge an artificially high price."

**Teng Bingsheng**

# How a Variable Interest Entity (VIE) Works

A company in China is 100% owned by domestic parties, allowing it to obtain all necessary licenses to operate in a particular sector. It signs service contracts that give a foreign-owned onshore enterprise operational control and the revenue from its business, without conferring ownership rights. The onshore foreign-owned company is a subsidiary of an offshore holding company that is listed.



# AROUND THE WORLD...

...in a circuitous way, billions of dollars rely on an international game of legal cat and mouse

By Christopher Beddor

When the Chinese e-commerce giant Alibaba lists on the New York Stock Exchange in September, it could easily prove to be the biggest initial public offering (IPO) in US history. The floatation is expected to raise anywhere from $15 to $25 billion—potentially surpassing the previous record-holder, Visa's $17.9 billion launch in 2007.

The sheer size of Alibaba's IPO has drawn attention not only to the company, but also to its underpinning legal structure: a variable interest entity, or VIE. The function of a VIE is to allow Chinese companies to bypass restrictions on foreign investment. This investment structure has been in use for nearly two decades and yet remains obscure to investors who are out of the loop.

"I normally have to ask [investors]: 'You know this company is a VIE?'" says Fredrik Öqvist, Beijing-based Founder and CEO of ChinaRAI, a consulting firm that advises mostly European investment funds. "They say, 'What is that, and should I care?'"

> The VIE remains in a legal grey area, still unproven in Chinese courts

While several large companies already listed in the US use VIEs, including Baidu, Sina and Renren, the VIE remains in a legal grey area, still unproven in Chinese courts. Its continued legal haziness may be in part because the Chinese government is reluctant to tamper with one of the few channels that allow Chinese companies to tap foreign capital. Thus in an extreme scenario, Chinese companies could simply walk away with foreign investors' money.

Investors and regulators are watching to see how big Chinese companies like Alibaba play ball with VIEs, keenly aware that their actions could have huge ramifications on both sides of the Pacific.

"These mega-deals may dictate the future of the VIE," says Drew Bernstein, Co-Managing Partner at the accounting firm Marcum Bernstein & Pinchuk. "If you have one of these mega-deals blow up and the VIE gets put to the test—and it doesn't get favorable results—given the amount of money at stake, we're talking about deals that would be sizable enough to move governments." Hence, the Chinese government isn't about to mess with a lifeline to foreign capital, even if legal ambiguity is what keeps it flowing.

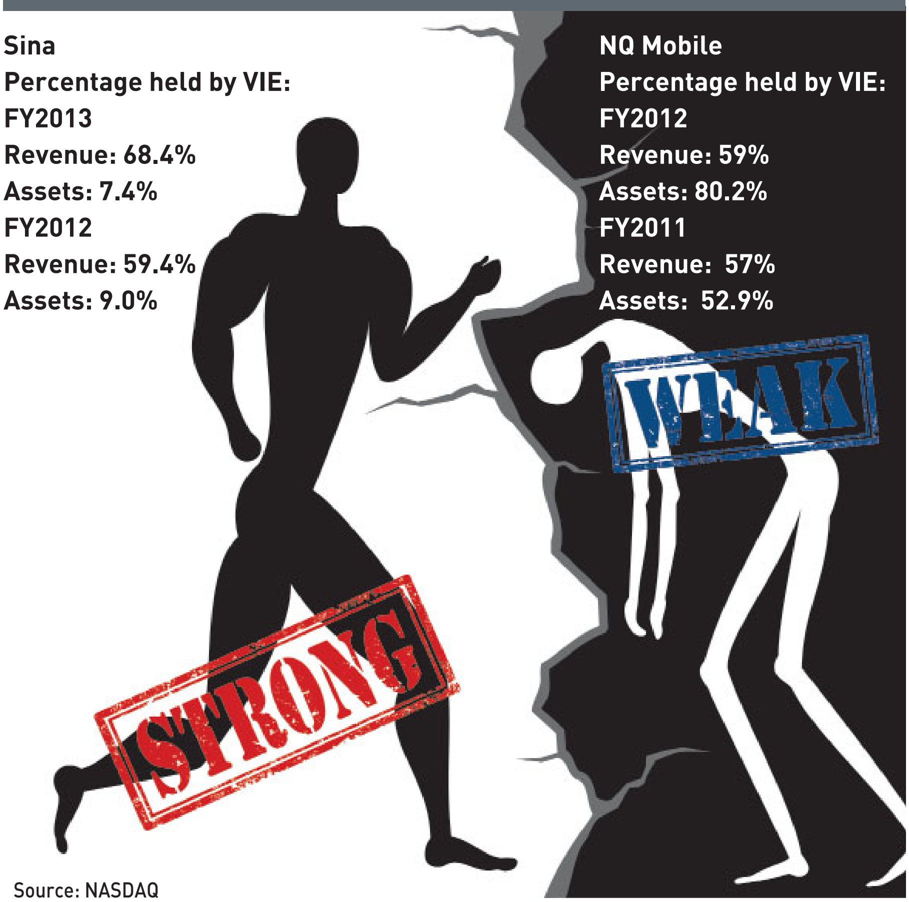
### Like the Real Thing

VIEs were created to circumvent China's heavy restrictions on foreign ownership of companies in "sensitive" Chinese industries, among them technology, finance, education and the media. During the late 1990s, the restrictions prevented fast-growing Chinese tech companies from accessing foreign capital, either through public stock markets or private investors such as hedge funds.

The most basic VIE structure gets around those restrictions by first establishing an offshore holding company—usually based in the Cayman Islands—which will either list on foreign stock markets or be controlled by a private investor. This holding company then establishes a

## Not Every VIE is the Same

**What the investor has control over varies from stock to stock**




Source: NASDAQ

wholly foreign-owned enterprise (WFOE) in China.

While WFOEs can do a lot of business in China, they are foreign-owned and therefore cannot obtain the licenses and permits necessary to operate in sensitive industries. To do that, a mainland Chinese company (or series of companies) is set up, usually owned by local Chinese managers, to hold the licenses, along with enough revenue and assets to pass muster with regulators.

Finally, the WFOE gains de facto control of the mainland company through a slew of legal contracts. These agreements are engineered to mimic actual ownership: the mainland company promises to send part of its revenues and assets to the WFOE, and by extension, the foreign investors.

"It's ownership—not ownership through assets, but ownership through management contracts," explains Bernstein. "Essentially you don't own the company, but you own the equivalent of the economics of the company."

The first major company to list on American stock markets using the VIE was Chinese internet firm Sina in 2000. The structure has since taken off, and today around half of all Chinese companies listed in the US use VIEs—including every firm that listed in 2014, notes Öqvist. This is impressive growth, especially for a structure that poses so many risks to investors.

### Illegal Intentions

The first companies to use VIEs were mostly "asset-light" tech start-ups; as they matured these companies began accumulating valuable land, buildings, brands and intellectual property. In theory, foreign investors own part of these assets.

However, the Chinese government has never explicitly said VIE structures—and specifically the contracts that bind the mainland company to the WFOE—are legitimate. In fact, it may technically be illegal.

Steve Dickinson, a China-based attorney at the law firm Harris Moure, notes that Chinese law contains a clause that deems all contracts "concealing illegal intentions in a lawful form" to be invalid. Because VIEs are designed to bypass laws on foreign ownership, that could void every structure.

With such a weak link underpinning investors' claim on assets, it was perhaps inevitable that the structure would be tested. By coincidence, the first large company to do so was Alibaba.

Over two periods in 2009 and 2010, the company's co-founders, Jack Ma and Simon Xie, quietly transferred Alipay, an online payment system, out of Alibaba's WFOE and into a mainland company that they privately controlled. The two argued that Chinese regulators were clamping down on internet finance; only by moving Alipay to a wholly Chinese-owned company could its future be secured.

However, they declined to inform Alibaba's foreign shareholders of the move until 2011. The biggest of these, Yahoo, was livid and publicly lashed out against Ma. At the time, Alipay was thought to be worth around $1.7 billion of Yahoo's 39% investment in Alibaba.

Ma and Xie quickly settled with Yahoo and another major investor, Softbank of Japan. Among other things, Yahoo would receive 37.5% of Alipay's equity if it ever floated on the stock market. Still, the dispute left an enduring mark on Alibaba's reputation.

"It will be a question for Alibaba [during its IPO]: how much do people really trust Jack Ma?" says one legal expert who works with investors and Chinese firms. "He's done this before, and with some big shareholders that had big stakes in the company. What's going to stop him from doing it again?"

The answer is "nothing" in legal terms. But the company has made recent adjustments to its investment structure to build more investor confidence by enlarging the pool of assets from which they could draw returns. In August, Alibaba and Alipay's parent company, Small and Micro Financial Services, agreed to lift a $6 billion cap on Alibaba's share of the proceeds if Small and Micro goes public or is sold, according to a regulatory filing.

Under the revised agreement, Alibaba will receive 37.5% of the pretax income value of Small and Micro. The Chinese company previously received 49.9% of Alipay's pretax income.

But confidence-boosting aside, the fact remains that legally, VIEs are not problem-free solutions to foreign ownership restrictions in China.

### Courting Trouble

The original Alipay dispute was never tested in Chinese courts, but other VIE cases have played out to reveal a theme

> " [It's] not ownership through assets… essentially you don't own the company, but you own the equivalent of the economics of the company
>
> Drew Bernstein
> Co-Managing Partner
> Marcum Bernstein & Pinchuk

of disapproval checked by a lack of far-reaching implications.

The most significant involved a Hong Kong company called Chinachem. It was one of the first to use a Chinese VIE structure in 1995 when it established a mainland company to acquire a stake in China Minsheng Bank. Two years later, managers at the mainland firm broke contract with Chinachem and asserted that they were the sole legal owners of the Minsheng shares.

After more than a decade of courtroom battles, in 2013 the Supreme People's Court ruled that the mainland company, not Chinachem, was the legitimate owner of Minsheng shares. The VIE contracts were designed to illegally circumvent Chinese law and therefore invalid, the court said.

Yet crucially, the court also seemed to recognize the slipperiness of the issue. It demanded the mainland company repay Chinachem its initial investment plus 40% of the value of Minsheng's current shares and dividends. For a stake worth around $1.26 billion, that was no small sop to investors.

China's civil law system is structured in a way that court decisions have no binding legal precedent, giving the Chinachem ruling little other than symbolic significance. Other VIE cases have resulted in similar rulings.

"[The VIE] simply doesn't work—I can't be more straightforward than that," says Bernstein. He adds that in all his consulting trips to China over the past 13 years, he "can't recall a single incident where foreign shareholders were able to get control of Chinese assets in an adversarial proceeding in which there was a VIE involved."

## Waiting to Pounce

The US Securities and Exchange Commission (SEC), the agency charged with protecting American investors, has seemingly joined Chinese courts in frowning upon, but not full-on assaulting, the VIE issue.

"These middle and micro-cap companies that tested the VIE [in Chinese courts], they've never really been important enough to rise to government levels," says Bernstein. "But if you have a company like Alibaba that decided to essentially void the management contracts, that probably would."

> "
> Once you start getting up to 20% or 30% of assets, and all the revenue is running through the [mainland company]... you get more worried
>
> Fredrik Öqvist
> Founder and CEO
> ChinaRAI

Around the time of the Alipay dispute the SEC began scrutinizing VIEs.

It has since delivered comment letters to almost all Chinese companies listed in the US, often drilling into their VIE structures. Yet every company has eventually received a sign-off on their operations, suggesting the SEC is looking more to highlight the risks to investors than ban the structure outright.

"The SEC clearly understands the VIE structure: they've asked many, many pointed questions about it, and you can see the [list of] risk factors [in investor documentation] get longer and longer," says Alan Seem, a Shanghai-based partner at the law firm Shearman & Sterling who has worked on several Chinese IPOs in the US. "But as long as Chinese law firms are willing to opine that the use of VIEs as listing vehicles does not violate Chinese law, and the SEC doesn't get a different message from the Chinese government, then I believe they'll continue to allow VIE companies to list."

As for investors, they need to understand that not all VIEs carry equal risk, says Öqvist of ChinaRAI. Among other things, his firm researches how much of a company's assets and revenues are held in WFOEs (safer for investors), and how much in mainland companies (less so).

"As long as you have a VIE in which assets in the [mainland company] are below 10%, and all the key intellectual property is in the WFOE, the risk goes down quite significantly," he says. "Once you start getting up to 20% or 30% of assets, and all the revenue is running through the [mainland company], then you get more worried." Some say that there is a trend towards "better" VIE structures. Alibaba and JD.com, a Chinese e-commerce company that listed on the NASDAQ in May, are "certainly two of the best VIEs we've seen so far," says Öqvist.

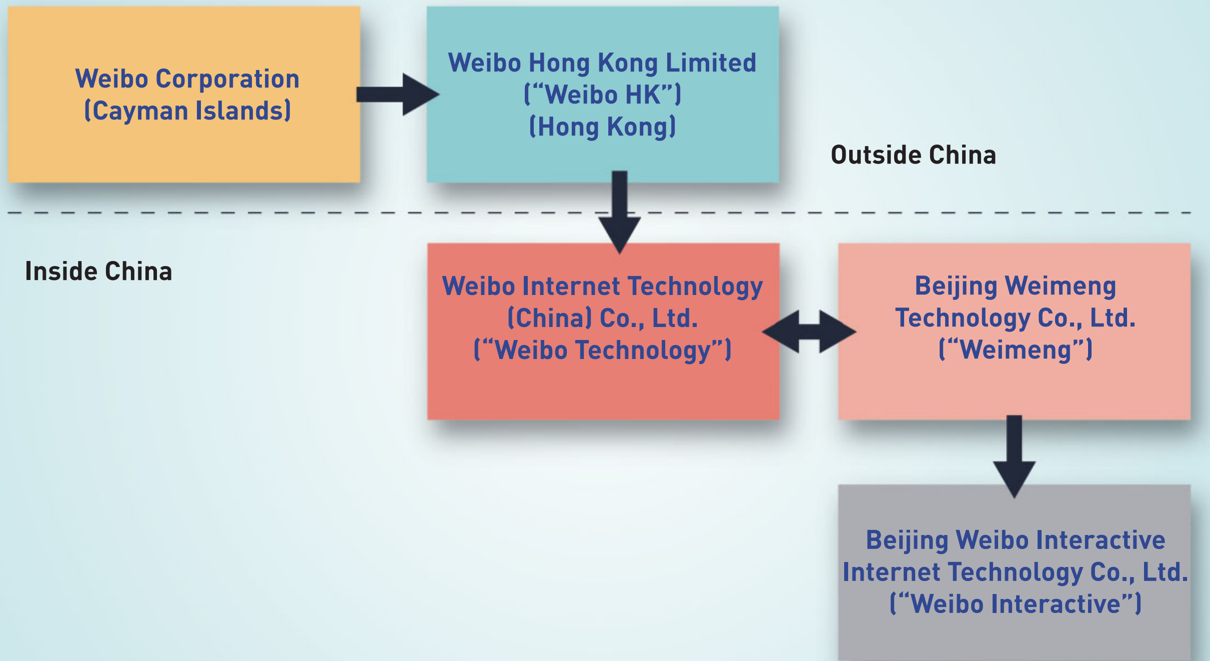
After the Alipay dispute, Alibaba may have come under pressure to restructure its VIE. According to public filings, its current structure places just 7.5% of its assets in mainland companies, compared with 65.5% for New Oriental Education, considered one of the worst VIEs. Öqvist adds that according to its most recent filings, Alibaba has actually run regulatory risks by placing so much of its business in the hands of the WFOE.

Ultimately, many investors view VIEs as simply one risk of many that comes with the territory of investing in Chinese firms, says Seem. Much of the decision to invest inevitably comes down to a question of trust.

"Frankly, that's a lot of the reason [investors] go to the [pre-IPO] roadshow,

## Split Across Borders

A Breakdown of the VIE structure used by Weibo Corporation in its 2014 IPO




Source: Form F-1 Registration Statement, Weibo Corporation, US Securities and Exchange Commission

to get a sense of how well they can trust the management team and founders," says Seem. "Because ultimately if the [Chinese] management decides to go rogue—regardless of whether you have the ability to enforce a legal judgment against them, at that point you've already lost."

### 'A Hot Potato'

For all investors' precautions, the future of the VIE will largely depend on the actions of the Chinese government. Despite the occasional rumor, no government agency has explicitly stated VIEs to be either legal or illegal—a remarkable fact, given its huge scale.

With so much capital riding on the VIE structure, legal experts say regulators are unlikely to suddenly ban VIEs, not least because many Chinese officials have stakes in the listed companies. So why doesn't the government simply make VIEs legal? In part, says one analyst, because conservatives in the government are nervous about opening the floodgates to

> If the [Chinese] management decides to go rogue… you've already lost
>
> Alan Seem
> Partner
> Shearman & Sterling LLP

foreign investors in ostensibly protected industries. Another reason is that officials can use the murky status of VIEs to their advantage.

"The fact that [Chinese search engine] Baidu is completely illegal and could be shut down tomorrow means that Baidu is very easy to control by the Chinese government," says Dickinson. "So the government actually prefers that Baidu is illegal, because they can use the threat to control Baidu."

What's striking is how many analysts and legal experts think that until the precise legality of the structure is made clear, some sort of major VIE dispute is bound to erupt—potentially burning investors and sucking in American and Chinese officials.

"In some senses it's a hot potato," says one legal analyst who preferred not to be named. "As long as this all holds together and nobody goes rogue and tries to violate the VIE contracts, then it all works. But if it doesn't, then there's a loss of trust and the whole thing falls apart."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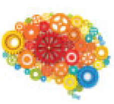

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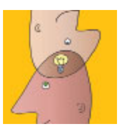

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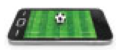

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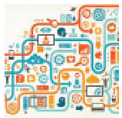

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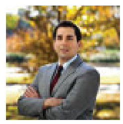

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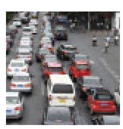

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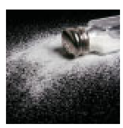

### Cracking A Salt Monopoly

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# Politics in the Pipeline

Anthony Liu

## Two experts with different backgrounds explore the impact of China and Russia's $400 billion natural gas deal

Martin K. Dimitrov

By Suzanne Edwards

In May of this year, China and Russia finally signed a deal 10 years in the making. Russian state-owned enterprise Gazprom and Chinese state-owned enterprise China National Petroleum Corporation (CNPC) signed off on the construction of a pipeline from Russia to China that would deliver Russian gas to the Chinese market over the next 30 years, all in all worth $400 billion according to initial reports. But uncertainty over the particulars of pricing and contributions from either side has raised several questions over the deal's ultimate impact on the two regions in play.

Further complicating matters is Russia's aggression in Ukraine, Russian President Vladmir Putin's own unstable political capital, and China's various other pipeline deals in Central and Southeast Asia. To wade through the aspects and implications of the pipeline deal for both countries, *CKGSB Knowledge* goes to the experts.

Firstly we have Visiting Economics Professor Anthony Liu from Cheung Kong Graduate School of Business in Beijing. In 2012, Liu received his Ph.D. in Economics from the University of California at San Diego.

Secondly we have Associate Political Science Professor Martin K. Dimitrov from Tulane University in New Orleans. Dimitrov is also an Associate at the Davis Center for Russian and Eurasian Studies at Harvard. Dimitrov received his Ph.D. in Political Science from Stanford in March 2004, and has since authored two books: *Piracy and the State: The Politics of Intellectual Property Rights in China* and *Why Communism Didn't Collapse: Understanding Authoritarian Regime Resilience in Asia and Europe*.

Despite approaching the issues from different angles, insights from either professor align on certain aspects of the deal as we know it today.

## Russia Needs the Deal More than China

"The whole timing of the deal of course reflects Putin's erosion of international standing, the fact that he is afraid that Europe will no longer be buying Russian gas and so he's looking for new export markets.

For Putin, it was extremely important to bolster his domestic standing by finding an alternative export market for Russian gas at a time when Europe was threatening to impose sanctions on Russia. So the conclusion of this deal gave him domestic political leverage.

China has the upper hand in this negotiation given the moment when the deal was signed—the idea was that the deal would be completed in time for Putin's visit, so it would have been embarrassing for Putin to go to China and come back home empty handed, and China knew this.

Russia is becoming increasingly export-dependent. Russia needs the cash and China may be able to keep the price low in future. But given Russia's history in terms of gas negotiations, I do not rule out Russia trying to increase the price in the future. But Russia, right now, is in a very weak position."

–Dimitrov

"Western countries reacted poorly to Russia's recent moves in the Ukraine, and imposed a series of sanctions on Russian firms which are beginning to bite. Certainly in the case of natural gas, which requires massive spending on capital infrastructure that may require years of sales to recoup, price certainty and risk avoidance are extremely important.

As a result, the perception is that Russia moved to decrease its reliance on European exports and was willing to give a bit more to China to assure itself of an independent trade partner and source of hard currency which has shown a willingness to overlook possible bad behavior."

–Liu

## For Better or Worse, China's Deal is the Region's Deal

"Initial reports are that China has gotten a good price, around \$360 per 1,000 cubic meters. This is around the price that Germany pays, \$366 per 1,000 cubic meters, which is already quite cheap for Europe.

Importantly, it is considerably lower than other East Asian countries currently pay. So that will set a new market level for energy imports to China. A second major supply of natural gas to China, liquefied natural gas (LNG) will now have to beat the price of Russian piped natural gas or suffer demand shortfalls from China.

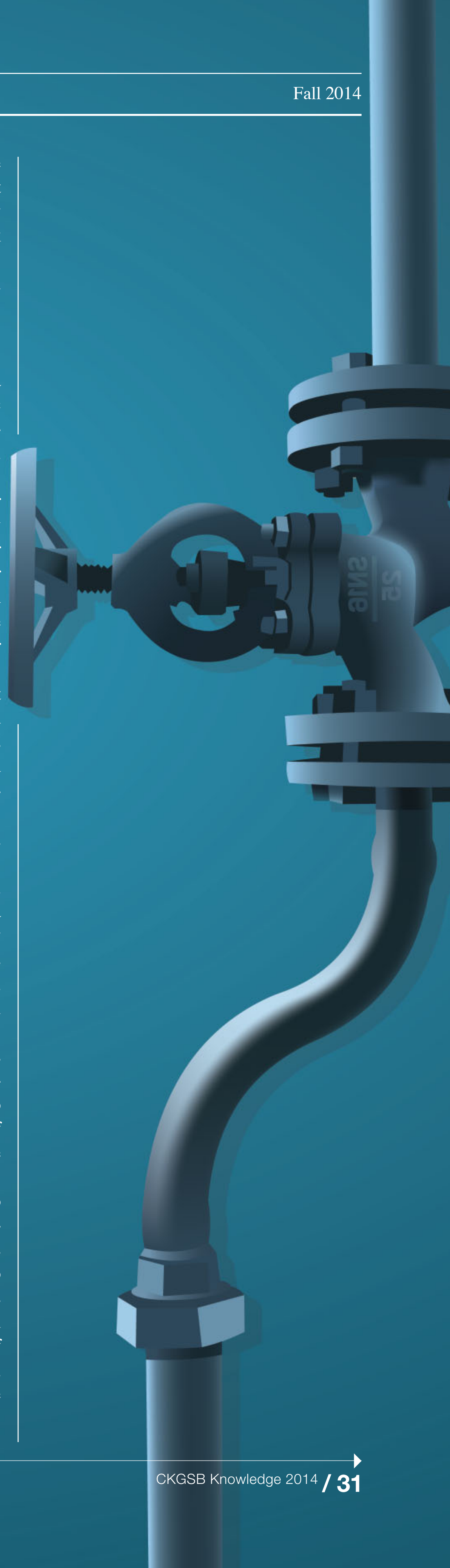
If the price of natural gas to other East Asian countries drops as well, this is a good thing environmentally. Cheaper natural gas means less reliance on coal, which will lead to less pollution and lower carbon emissions."

–Liu

"China's importing gas from Central Asia, [and] on June 15th the Central Asia-China pipeline became operational. This is very important, and 80% of China's natural gas needs can be met by this Central Asian gas, so this is something that China can and will use as leverage on Russia.

The fact that the price at which this gas will be delivered to China has not been revealed suggests that China has managed to extract a very good price and you know of course China knew that Russia wanted the deal more desperately than China wanted it.

One thing that will be interesting to watch is what is happening in Myanmar because there is a pipeline that's in the process of being built from Myanmar to China. So Myanmar would be quite nervous about this deal, but I think for these other countries in Europe, I mean given Russia's record of actually not delivering on deals on time, perhaps some of this nervousness could be alleviated.




Long term of course, China is the motor of the world, so to the extent that these other countries are competing for these natural resources, they would feel nervous that most of the natural resources are going to China and China can dictate the price. One important question to ask is 'will China use its access to Russian gas to renegotiate its prices from Central Asian suppliers?'"

-Dimitrov

## Will the Deal Impact Sino-Russian relations?

"The deal will ensure that powerful business interests have an interest in the ongoing relationship between China and Russia. If incidents threatening the relationship between the two countries occur, these business interests will help push each side to come to the table and at least communicate.

Since China has the money, some analysts think that it will have the upper hand, but I think having reliable energy supplies is a very important issue to it, giving Russia a strong hand as well."

–Liu

"The gas deal strengthens an already existing alliance between China and Russia at the UN Security Council. Does it mean that the two countries will no longer be rivals and that relations between the two countries will be amicable for the foreseeable future? Absolutely not, and I think one example of that is the pipeline that goes from Russia to Ukraine, this pipeline is used as a political weapon by Russia.

So frankly the pipeline doesn't change that much in the existing relationship. Except of course that at the time of signing the deal it gave Mr. Putin a major domestic political boost. "

–Dimitrov

## China Must Diversify

"China is very interested in diversifying. China is also extremely interested in reducing its dependence on oil that is transshipped in tankers.

There is a problem with piracy [in terms of shipping crude], and then another consideration is that the tanker routes go through the Strait of Malacca, and the Strait of Malacca is a choke point, there are lot of tankers that pass through, so the delivery of oil is slow.

Another consideration with tankers is should the relations with Taiwan deteriorate, which right now doesn't look likely but one never quite knows, then the tankers would have to go around Taiwan, they'd have to pass around the Taiwan Strait. So to the extent that China relies on oil, it cannot be entirely certain that it will have access to oil given certain contingencies in the future.

One element of the master plan is to move away from coal—using alternative energy resources such as solar and wind, producing nuclear energy—and beyond these resources China is very interested in natural gas because there are uncertainties with all of China's trade partners.

The other very interesting and recent development is [the] fracking that is happening in China. There is this joint venture between Sinopec-FTS International, and there are ambitious plans on the Chinese side in terms of producing gas domestically, so both of these developments could give China significant leverage over time."

–Dimitrov

"So the clearest benefit of a natural gas deal to China will be an ability to meet its ravenous energy needs without relying as heavily on highly polluting coal. It consumed 170 billion cubic meters of natural gas in 2013 and has targeted 420 billion cubic meters by 2020. The National Development and Reform Commission (NDRC) wants China to shift the role of natural gas in its energy mix from 4% now to 10% by 2020.

Although China has successfully begun the exploitation of its domestic shale gas resources, the Russia energy pipeline will go a good way to meeting these ambitious goals, possibly supplying as much as 10% of China's 2020 energy demand.

Environmentally, diversifying its energy mix is only a good thing for China. Natural gas is much less pollution-intensive and carbon-intensive than coal, so the increases in pollution won't be as severe as they would be if China used only coal to meet its energy demand."

–Liu

# Why Will China Be More Open To the Outside World?

By Xiang Bing, Founding Dean of CKGSB

Many may be surprised to learn that the Chinese economy is more open than the US and Japan in certain regards. Despite recent reports detailing the struggles of some well-known multinationals in China, the door to the Chinese economy will be open even wider in the future.

In a sign of how well integrated into the global economy China has become, its trade in 2012 was equal to 47% of its GDP—a figure close to double that of both the US and Japan. In another indication of economic openness, China is the second-largest market for foreign direct investment (FDI) after the US. Furthermore, China's growth is often explained away as resulting from exports, but the majority of Chinese exports have come from multinational companies (MNCs) in China: in fact, 2012 was the first year in a decade that foreign-invested enterprises contributed less than 50% of China's total exports.

China may manufacture many of the world's products, but its huge market has also been opened to global brands. High streets, shopping malls and convenience stores are stocked full of products from around the world. If foreign companies do not already have a presence in China, you can be sure that a strategy to enter the world's most populous nation is dominating boardroom talk—and for good reason: Cisco, for example, has contributed roughly 70% of China's internet infrastructure in the finance industry, while IBM, GE and Coca-Cola are among many MNCs to have prospered in China.

So why do many still think that China is comparatively closed economically? Undoubtedly the headlines politicizing minor trade disputes between China and the West get more play than they should, whereas, in reality, these small bumps in the road are to be expected. There has been concern that the anti-corruption campaign of China's new leadership will unfairly target foreign companies through the cloak of protectionism, but plenty of Chinese companies have been investigated too, and the overarching trend points to a reduction of the government's role in economic issues. As long as MNCs stick to the rules, the playing field between them, state-owned enterprises (SOEs) and private enterprises will be more level than ever before.

In fact, far from closing its doors to the West, there are several reasons why China will continue to open to the outside world.

China's new model of development with its emphasis on consumption and clean environment will need more input from other countries. China cannot afford to rely solely on its own green technologies given the growing strain on the country's ecosystem. Meanwhile, the senior care industry is set to explode in the coming years as China's population dividend comes to an end, and will provide ample opportunities for foreign companies. Likewise, the fact that the US spent around 18% of its GDP on healthcare in 2011, while China spent less than 6%, is evidence of another industry where further growth will undoubtedly open up the country. Other sectors that will require assistance from more experienced countries include financial services and the service industry.

The Trans-Pacific Partnership (TPP) free trade agreement is currently being negotiated by 12 countries that include the US, Australia and Japan—but, significantly, not China. As Washington proceeds with its "Pivot to Asia" strategy and strengthens ties with its allies in the region, this will pressure China towards further economic integration, and it has already responded by stepping up its own trade initiatives in Asia. The alternative, of course, is that China also applies to join the TPP: either route will lead to a more open Chinese economy. Meanwhile, the Shanghai Free Trade Zone, launched at the end of 2013 as a prototype with a view towards expansion and replication, is another sign that China is serious about opening up further, particularly with regards to foreign investment.

Technology, in particular, has had a far-reaching effect on China, and the country has embraced it. The internet has made China much more connected to the outside world—be it through groundbreaking trade partnership platforms such as Alibaba, or just simply by opening the channels of communications—and this is an area that continues to expand. For example, Tencent's WeChat has more than 400 million monthly active users, a growing number of which are based outside China, in key markets such as Brazil, South Africa and South East Asia.

Finally, Chinese companies are going global like never before, with examples seen from across the spectrum of SOEs, the private sector and even family-owned businesses. In addition, as the Chinese people travel outside their borders for work, study and vacation, they all return with a heightened awareness of knowledge, culture, ideas and products from overseas—and China becomes more global as a result.

China has been benefitting from its reform policies for more than 30 years and will continue to do so as those policies deepen. But these benefits are not unique to China and, as the door opens wider, the rest of the world can reap the rewards as well.

# Unplugged!

## The government money is there, the producers are capable, so why aren't electric cars happening in China?

By Sunny Oh

If official lip service and subsidies could affect on-the-ground change in China, the world's largest car buyer and maker would be at the forefront of global electric car adoption. But Chinese consumers have bought into luxury, not ecology—at times, there is little distinction between the two in terms of price—and a gaping lack of alternative fuel infrastructure in China isn't helping. A stroll through a popular shopping district in downtown Shanghai tells the story: not an electric car in sight, not even in proximity to public charging stations which largely stand derelict and unused. The publicized rollout of electric cars seems little more than hot air.

Unfazed, an enterprising Tesla owner, Zong Yi, recently built an entire network of charging stations from Beijing to Guangzhou on his own dime, a feat that only highlights the glaring failure of China's electric vehicle (EV) policy.

But it isn't for want of trying. Leading by example, a host of state agencies headed by the National Development and Reform Commission released an order in July that mandated at least 30% of all government vehicles purchased in the next two years be electric, plug-in or hybrid.

Since 2001, the country's leaders have demonstrated a keen awareness that battery-powered vehicles were inevitable. With battery costs falling, experts project electric cars to be price-competitive against gasoline-guzzling sedans a decade from now.

Looking to form its own green car industry, China exhausted an unparalleled set of measures from 2009 to increase the sales of homegrown new energy vehicles (NEVs), a category which consists of battery electric vehicles (BEVs) and plug-in hybrids (PHEVs). From sizable subsidies to relaxed license restrictions, the government has done much to prop up this nascent sector, short of handing them out for free.

So far, China's program to encourage EV adoption has met serious headwinds. "The actual progress and sales performance of BEVs and PHEVS so far has been very disappointing," says Ashvin Chotai an auto analyst at Stone Mountain Capital. In 2008, the Ten Cities, Thousand Vehicles Program, which later expanded to 25 cities, set the lofty target to have 500,000 electric cars on Chinese roads by 2015; the current number is closer to 70,000, most of it from sales to taxi fleets and local governments.

Solidiance, an Asia-Pacific consultancy, estimated that only 18% of electric cars sold in China during 2013 were for private consumption. The average Chinese driver is no closer to riding a battery-powered car now than 10 years ago.

## National Champion, Again?

"Battery electric vehicles are a huge opportunity for China and Chinese companies to leapfrog global automakers and hence build up a significant global competitive advantage," says Chotai.

From the dais, the stakes are high. Reduced reliance on foreign oil and a fall in tailpipe and carbon emissions are chief incentives. There would also be serious global kudos in store if China can get out in front of the global e-car race, particularly given the country's failure to self-actualize in the traditional auto sector.

Foreign auto manufacturers like Toyota and Volkswagen control the market for hybrids and internal combustion engine (ICE) cars, but plug-in hybrids and battery electric vehicles remain unexplored territories.

In an attempt to seize the opportunity, China has doggedly pushed domestic car companies to manufacture electric cars for the last five years—encouraging domestic car brands to develop and manufacture battery electric vehicles in the hopes of leapfrogging global automakers. "Electric vehicles are the future battleground for 21st century innovation," says Bill Russo, President of Synergistics, a Shanghai-based consultancy.

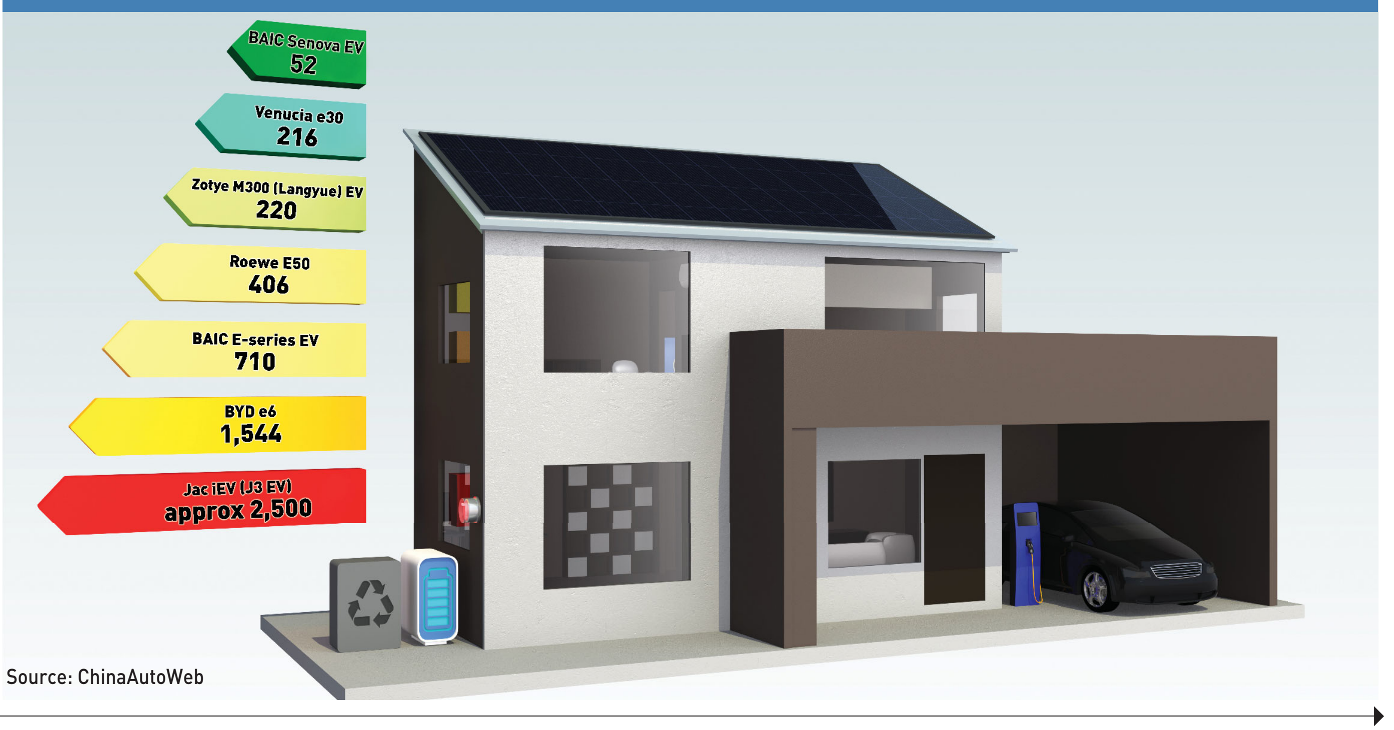
But China is wary of repeating mistakes made in previous efforts to develop the domestic auto industry over the last two decades. Chinese automakers remain bound to the technical expertise of foreign car brands, and even today, Chinese companies don't exactly stand toe-to-toe with German and American competitors.

Nevertheless, analysts feel that Beijing's laudable intentions have only shown the limits of what can be achieved by government fiat. Scott Laprise, an auto analyst from CLSA, says Beijing had thought "if it threw enough money at the problem, it would solve everything".

Beijing can either suck it up and open the e-car market to foreign companies in order to immediately address the ecological impact of gas-powered vehicles, or it can continue to hold onto the hope of fostering a global leader while exhaust plumes coat China's atmosphere with growing potency.

## Stuck on the Starting Grid

**Poor 2013 sales of electric vehicles in China show the lack of consumer interest**




Source: ChinaAutoWeb

### E-tours

Chief among the unresolved obstacles to a healthy NEV market is range anxiety. A limited driving range, inadequate charging infrastructure, a long charging time and few parking spaces with installed sockets mean the possibility of being stranded in heavy traffic is a real. A BYD Qin, a Chinese plug-in hybrid, can only drive up to 50 miles on its battery before it must start running on gasoline. In comparison, a gasoline-run car can go four to five times the distance.

To solve the issue of limited mileage, the government has directly funneled large amounts of R&D investment into battery technology and EVs. But according to Russo, much of this investment and the burden of innovation have fallen on domestic car manufacturers, many of whom have no interest in giving up their hard earned profits from foreign joint ventures, and investing them in unproven technology with little market demand to back it up.

It doesn't help that each municipal government is pushing for its own charging standard. Much like how China advanced its own mobile telecoms standard at the expense of international standards to encourage indigenous innovation, each city has developed individual power standards for charging stations in favor of its own auto state-owned enterprises (SOEs). If you buy an electric car in Beijing you cannot recharge it in a charging station in Shanghai. Russo says, "As national policy on EV cars is delegated to regional state governments, which try to compete against each other, there is little coordination on that level."

This infighting appears in other areas as well. Power utilities and electric car companies are fighting each other to determine if electric vehicles should use battery-swapping stations or battery-charging stations. With State Grid, which has a virtual monopoly on the national power grid that it is unwilling to yield, China has fallen far behind the targeted goal of 2,000 charging stations by 2015. "Considering the current market realities, infrastructure players are also pessimistic that the target of 2,000 charging stations by 2015 can be met as they do not see any immediate shift in demand within the next 2-3 years," said a Solidance report. Moreover, most of the charging stations have fallen into disrepair after years of being unused. Without electric cars stopping to top up their batteries, charging stations are a drag on power utility's profits, each of which can cause millions of renminbi in losses. State Grid last year cut its annual investment in electric car projects to less than RMB 1 billion after spending about RMB 3 billion in 2010 and 2011, according to an anonymous source quoted in a *Caixin* article out earlier this year.

### Consumers Ain't Buyin' It

Amid China's grand plans and ambitious policies, bureaucrats have lost sight of the fact that consumers retain the final say over the purchase of an electric car. Wang Tao, a resident scholar from the Carnegie Endowment, says the policy of setting arbitrarily high targets has been counter-productive and "not very sensible". He says the policy of sales targets have produced misaligned incentives whereby government officials try to fill their EV sales quota by encouraging purchases and not by encouraging the usage of electric vehicles.

The provision of subsidies to electric cars is one way that the government has misunderstood consumers. Although the high price of electric vehicles is a barrier to consumers, Scott Laprise says that "making vehicles cheaper would not change consumer's minds". The sizable RMB 120,000 subsidy each Chinese electric car receives does little to change what remains an unattractive purchase. Laprise feels domestic original equipment manufacturers (OEMs) have struggled, at least at that price range, to produce an electric vehicle that can compete against the foreign gas-powered competition. A BYD e6, including subsidies, costs RMB 369,800, much more than the price of an Audi A3 at up to RMB 280,000. Tesla's Model S is even more expensive at roughly RMB 371,000 before subsidies, though Tesla maintains that the model is intended as a luxury car. Still, customers have to wonder, for that kind of money what are they really getting?

Safety risks for one. Laprise recalls when BYD launched its F3DM plug-in electric hybrid in China to much fanfare in 2008, more shrewd industry watchers noticed Chinese consumers had little interest in purchasing an expensive, domestic car installed with unproven, and some say dangerous, technology.

Last year, two electric BYD taxis crashed and burst into flames, leaving their occupants dead. This prompted suspicions that electric vehicles are fundamentally unsafe. US consumers on the other hand have welcomed the market's leading plug-in, the Nissan Leaf, with June 2014 sales showing a year-on-year increase of 5.5% reaching 2,347 units.

Greg Anderson, author of the book *Designated Drivers: How China Plans to Dominate the Global Auto Industry*, points out that unlike the US and Europe, there is no "cachet" to owning a green car in China's lower-end market, even with air pollution being one of the most important issues of concern today for the Chinese people. Many "first time car drivers want to ride on the open roads", rather than being hemmed in by short-range limits, he wrote.

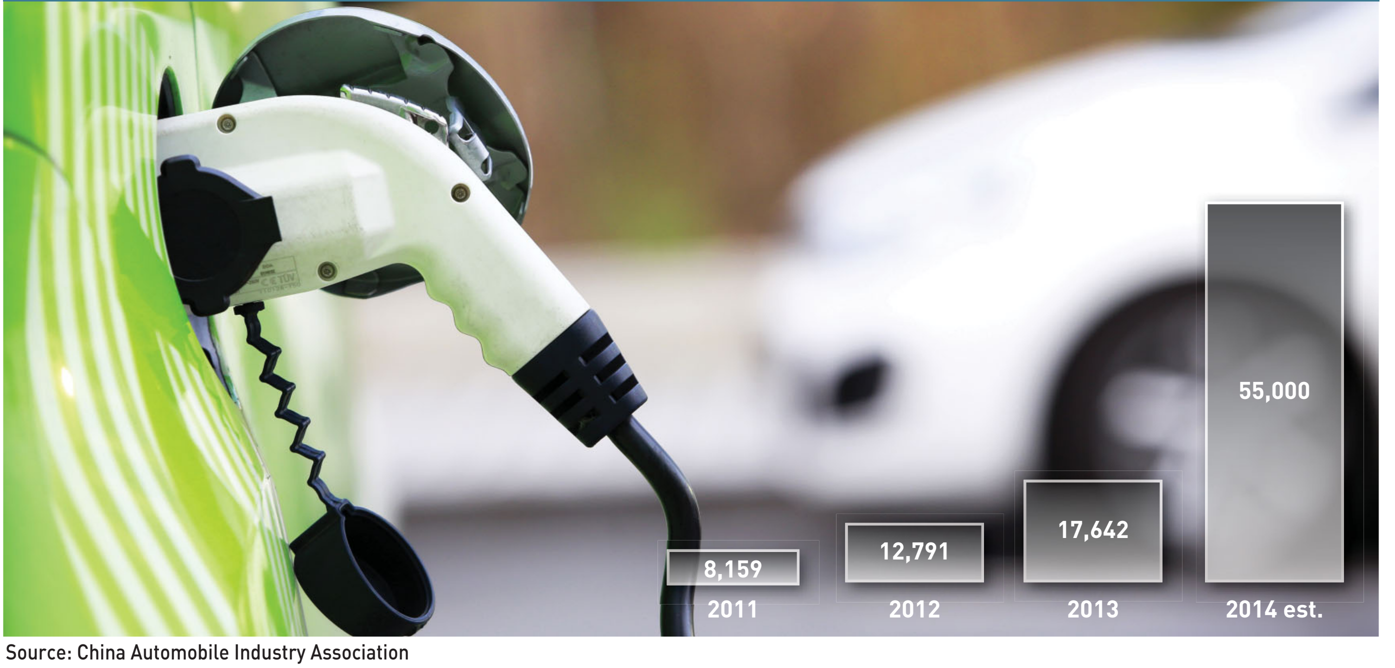
These innumerable barriers have cast doubt over whether domestic electric vehicles will be viable in China. Even senior officials have questioned the philosophy of putting so much emphasis on battery electric vehicles, says Chotai. As a result, China has now started concentrating on producing PHEVs for private consumption and BEVs for public fleet use.

There is evidence in other economies that shows electric cars are commercially viable. Even though government support in Europe and US lags behind that of China, car sales of plug-in electric vehicles in those countries far outstrip China's. Navigant Research forecasted that overall global sales of plug-in electric vehicles were projected to grow 18% annually.

Europe and the US rarely use subsidies, a crucial difference from China. They instead incentivize the purchase of electric vehicles through tax credits. Norway, the country with the highest number of EVs per capita, exempts electric cars from public parking fees, toll payments and also grants them the ability to use less crowded bus lanes. These policies have yielded rapid growth in these two markets.

## Moving up a Gear

China's annual new energy vehicles sales are set to soar in 2014




Source: China Automobile Industry Association

### Course Correction

Despite the impressive announcements of the country's ambitious economic targets, selective Chinese government policy, in an ironic twist, has sometimes stifled the rate of electric car adoption, such as lackluster support for hybrid vehicles.

Auto analysts agree hybrid vehicles are an effective bridging technology that could pave the way eventually for battery-powered cars. Hybrid cars are not hobbled by limited charging infrastructure, and could raise awareness and familiarity of eco-friendly cars. With years of development, hybrid vehicles like the Toyota Prius are more than a match for their counterparts with internal combustion engines.

But the central government's subsidies for hybrid vehicles are a paltry RMB 3,000; a miniscule sum when compared to the RMB 30,000 allocated to plug-in hybrid vehicles. Plus, most hybrid vehicles are manufactured offshore and thus subject to costly import tariffs. Last year, only 1,400 Toyota Priuses were sold in China out of the 315,000 sold globally.

But with hybrids being primarily dominated by Japan, China was naturally "unwilling to subsidize foreign industry", says Chotai. Beijing would be swallowing a bitter pill to resort back to the strategy of importing foreign car—in this case green car—technology through joint ventures. It is only recently that Chinese carmakers have partnered with foreign auto brands to develop new battery electric vehicles.

Russo of Synergistics also says that China's green car adoption program could have advanced much more quickly if it had imported foreign know-how in the form of lighter car bodies, engines and battery technology.

That is not to say China's government does not have a part to play in the upcoming rollout of electric cars. Russo says China is responsible for ensuring the proper charging network infrastructure exists, but that would entail it "going down the value chain", a role Beijing would be unwilling to undertake after investing heavily into fostering battery electric vehicle innovation.

Russo adds that China's government could exercise a key advantage over other countries. Chinese officials are able to align the incentives between local governments and auto companies and force them into adhering to a national strategy for EVs.

Luckily, recent regulatory moves suggest officials are slowly resolving bottlenecks in EV adoption. In May, Beijing set up a special commission with the mandate of solving bottlenecks in China's EV program, according to Namrita Chow, an analyst from IHS Automotives.

This has already yielded results. State Grid has agreed to allow private companies to use their own charging standards instead of submitting to a national one. This should give the sector a boost, increasing the number of electric charging stations and speeding up the deployment of new electric vehicle models. Furthermore it provides opportunities for companies like Tesla which also sell charging stations.

Though foreign original equipment manufacturers hold the final key to unlocking rapid growth in China's EV market and infrastructure, Beijing's continued desire to promote domestic electric cars leaves it in a "tricky policy dilemma", says Russo.

Unless government intransigence gives way to a more begrudging pragmatism, the eventual rollout of electric cars in China may be indefinitely postponed.

# CHINA india

## Will India's new Prime Minister Narendra Modi write a new chapter in this Silk Road saga?

By Ana Swanson

The ancient Silk Road was a treacherous route, beset by bandits, dangerous mountainous paths, and dizzying altitudes. The southwestern route of the road crossed through the Himalayas to link the ancient civilizations of East and South Asia. For centuries, intrepid traders braved the dangers to carry silk, medicines, jewels, gunpowder, and other precious goods between present-day China and India.

Today, the two giants of Asia might seem like natural partners—both have huge domestic consumer markets, and complementary specialties, with China excelling in manufacturing and India in services. But while trade between the two economies has risen sharply in the last decade, it remains relatively small given the countries' massive economies. Bilateral trade between India and China grew from less than \$3 billion in 2000 to \$65 billion in 2013—yet that number still seems minor compared to the \$569 billion in goods and services that the US and China exchanged in 2013.

Much of the reason for the modest size of trade has been India's economic challenges, including a stagnant economy, copious red tape, and a weak manufacturing sector. "Right now, the dominant view in China is that they see India as discombobulated, and well behind them in terms of development," says Christopher Johnson, the Freeman Chair in China Studies at the Center for Strategic and International Studies, a think tank in Washington, D.C. Relations between China and India have also periodically been tense, due to the legacy of a 1962 war over their shared border.

Yet the Sino-Indian relationship may be nearing a turning point. The election of Indian Prime Minister Narendra Modi in May presented a new opportunity for refiguring the India-China relationship in terms of mutual gains. Modi has promised to adopt a pragmatic attitude toward foreign investment and partnerships in an effort to reinvigorate India's economy. In Modi's first few months in office, he met with China's president Xi Jinping, on the sidelines of a summit in Brazil. Chinese officials including Li Keqiang, the premier and No. 2 leader, and Wang Yi, the

> "
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> Christopher Johnson
> Freeman Chair in China Studies
> CSIS

Chinese foreign minister, also traveled to India to meet Modi. After his trip, Wang commented: "China-India cooperation is like a massive buried treasure waiting to be discovered."

Many companies are likely to unearth the rewards of this relationship in the years to come. By 2020 or 2025, China and India may be two of the world's three largest economies. India could benefit from absorbing some of China's manufacturing capacity and infrastructure expertise, while Chinese companies could discover a new supply of low-cost labor and a vast consumer market in India. A handful of innovative Chinese and Indian companies are leading the way, carving out a new Silk Road for others to follow.

## India's Deng Xiaoping?

The results of the Indian election, which concluded in May, were a strong sign of the Indian people's desire to break with the past. The Indian National Congress, the party that has run India for most of its post-independence history, was firmly thwarted, while Modi's opposition party stormed into power with a landslide victory. The results demonstrated just how dissatisfied Indians were with the sluggish economic growth, persistent inflation, and rampant corruption of the past five years.

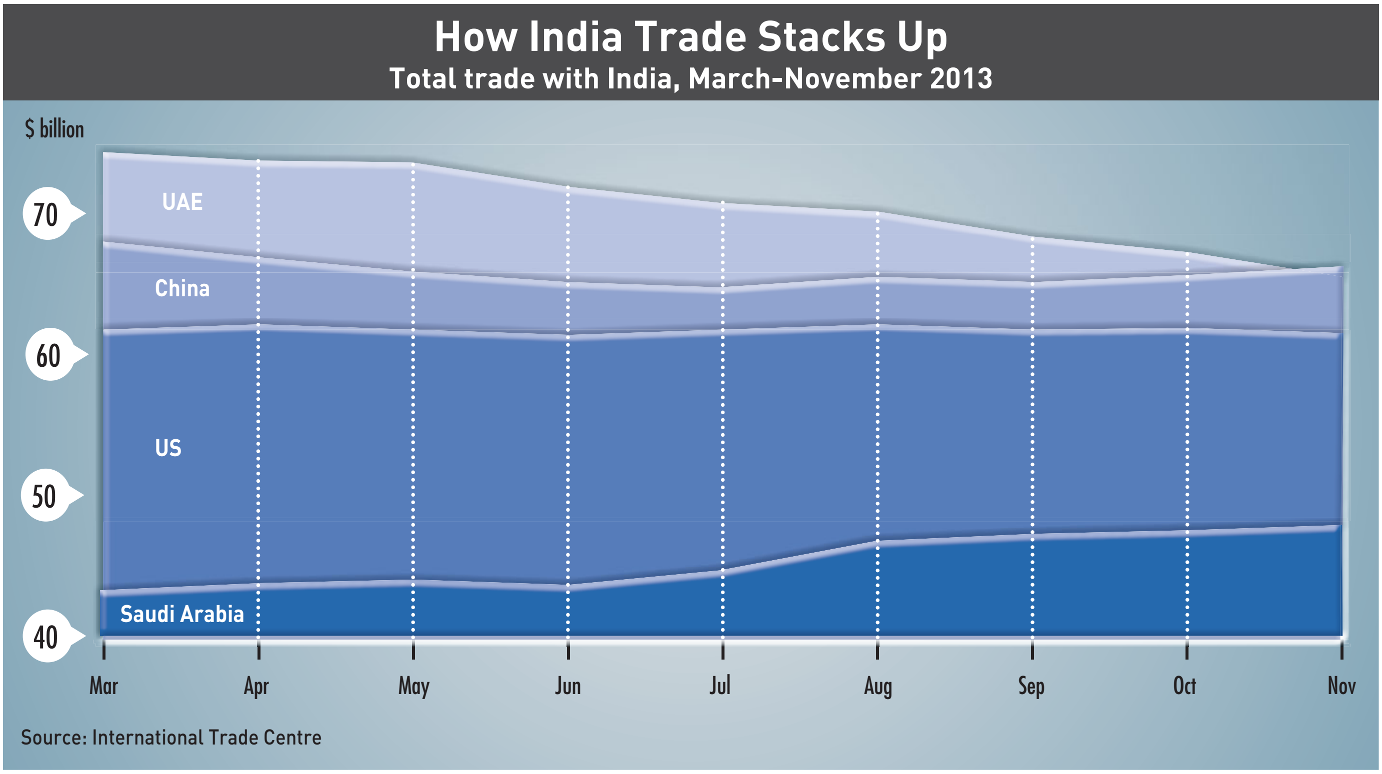
Modi's government has variously promised to create jobs, balance public finances, build out infrastructure, rein in inflation, and boost Indian economic growth to 7-8%. Clearly, achieving these ambitious targets will be no easy task, and critics question whether he can really eliminate India's long-standing inefficiencies.

One of Modi's main goals is to boost India's weak manufacturing sector, which contributes only 15% of GDP and about 11% of jobs. (By comparison, manufacturing accounts for 32% of China's GDP.) Due to its lack of manufacturing capacity, India imports a huge variety of goods and sustains a large trade deficit.

The main reason for weakness in the Indian manufacturing sector stems from the country's strict labor, land, and tax laws, which respectively make it difficult for companies to terminate workers, acquire new land, and transport goods across state borders. Poor infrastructure also makes it hard to get Indian products to market. While China ranks 60th in the World Bank's 'Ease of Doing Business Index,' India comes in at a lowly 120.

"India sometimes runs an obstacle course for investors," says Girija Pande, the executive chairman of Apex Avalon Consulting Singapore and the former Asia-Pacific chairman and CEO of Tata Consulting Services, where he was responsible for crafting China strategy.

Shanghai Urban Construction Group Corporation (SUCGC) is one company that got stuck in this obstacle course. In 2012, the Chinese company won a contract to build part of a new 9.37-kilometer subway tunnel in downtown New Delhi in partnership with Larsen & Toubro, India's largest engineering and construction company. SUCGC had plenty of experience to




finish the job: it was one of the primary builders of Shanghai's 439-kilometer and 12-line subway network, as well as a builder of subway lines in Singapore.

Unlike in Shanghai and Singapore, however, the Indian subway construction project was bogged down with red tape and delays. Because the New Delhi line runs below a railway line, the project needed approval from the Indian railways bureau, a requirement that kept the company's machines immobile for months in 2013. According to company managers, obtaining work visas for SUCGC's Chinese employees was another problem. The process could take up to two years, and many applications were rejected, sometimes forcing it to refigure its operations.

Modi has promised to dismantle some elements of this obstacle course in order to stimulate labor-intensive manufacturing. Yet, perhaps because of political challenges, the government's first budget, presented in July, failed to address the binding constraints to manufacturing in India, namely the regulation of key factors of production such as land and labor, as well as specifics on tax reform, says Milan Vaishnav, political analyst in the South Asia program at the Carnegie Endowment for International Peace.

There is much at stake in these reforms. A streamlined India could absorb some of the manufacturing that is exiting China—especially given India's huge, young labor force. Chinese growth has resulted in steadily increasing wages over the past few decades, gradually making low-end manufacturing less competitive in China. At the same time the Chinese population is aging and its workforce shrinking. Aware of this economic shift, the Chinese government is trying to promote the growth of the domestic service sector—which generally requires fewer workers and pays higher wages—as well as more high tech manufacturing.

"I do think there is an opportunity here where some of Chinese manufacturing is going to relocate, and some of it could relocate to India," says Derek Scissors, a resident scholar at the American Enterprise Institute who studies Asian economic issues and trends. "India certainly has the scale to absorb a good deal of it, unlike say Bangladesh or Vietnam. But you need a better Indian market, and [tax laws are] a big part of that, and so are labor laws."

### Infrastructure King

One of Modi's biggest proposals is to spur economic growth by building out India's notoriously poor infrastructure, including roads, airports, railways, and internet connections. China's expertise in building and financing infrastructure projects could play a valuable role in these initiatives—as it did in Modi's home state of Gujarat, an industrialized state in India's west that is seen as a development success story.

Attracted by Gujarat's investor-friendly reputation, as well as Modi's interest in developing the region as an industrial hub, several Chinese companies invested big in Gujarat during Modi's term as chief minister there. For example, Tebian Electrical Apparatus Stock Company, a manufacturer of energy equipment based in Xinjiang, signed an agreement in 2011 to invest about $500 million in a green energy park and a wholly-owned manufacturing facility for energy equipment in Gujarat, according to local media.

"Part of the big boom in Gujarat over

the past few years has been the infusion of Chinese investment, and I would guess that Modi sees this as a key to the growth that happened in Gujarat and why he was able to have such positive impacts there," says Anish Goel, Senior South Asia Fellow at the New America Foundation, a think tank. "And if he is smart he wants to replicate that on the national level."

Cross-border investment between India and China is rising, but it is still at a very early stage, says Haiyan Wang, Managing Partner of the China-India Institute. China's total foreign direct investment (FDI) in India is only $800 million, representing 0.2% of China's total FDI stock. Meanwhile, India's FDI stock in China is $500 million, or 0.4% of its total FDI stock. "That's hardly anything," she says.

But Chinese investment in India could increase significantly, for several reasons, says Wang. Flush with cash from its export sector and large trade surplus, China is willing to provide low-cost financing to its business partners. In addition, because many of the banks and companies that provide financing are state-owned, Chinese companies tend to have a much-longer time frame for making projects profitable.

Indians are likely to reject some Chinese investment in infrastructure due to security concerns. But even so, there is ample opportunity. While China may be barred from owning a train network, a Chinese company could easily set up a coach manufacturing plant, or help lay railway tracks, says Anil Gupta, a professor at the Robert H. Smith School of Business at University of Maryland.

Chinese companies can also ease mistrust by entering the market through joint ventures. Shanghai Electric operates a manufacturing plant in India through a 50:50 joint venture with France's Alstom, while SUGCG won its bid for Indian subway projects through a joint venture with domestic builder Larsen & Toubro.

The extent to which Chinese companies take advantage of these opportunities will depend on whether India can create an investor-friendly environment. Says Gupta, "If Indian companies themselves are not investing in India, why would anyone else?"

## A New Silk Road

There are two main ways Indian and Chinese companies can operate in each other's markets, says Gupta: a company can either directly enter the foreign market, either as a wholly-owned foreign enterprise, or it can acquire a multinational with pre-existing operations there. This latter strategy has proven to be an effective way for India and China to overcome their relatively weak consumer brands.

One case in point is the auto market, which has boomed in China over the past decade and is set to do the same in India. Tata Motors, India's first domestic automaker, purchased Jaguar Land Rover from Ford in 2008. Chinese auto maker Geely followed in its footsteps by buying Volvo from Ford in 2010. Both acquisitions greatly increased the potential sales that each company could expect in the other's country.

"What is the possibility that Indians would welcome a car from China branded Geely? The probability thinking as a business strategy person is zero, end of discussion, let's talk about something else," Gupta says. "But if Geely buys Volvo, is there a chance that a Volvo car could do very well in India? The answer is yes." The situation is the same for Tata Motors selling a brand like Jaguar Land Rover in China, he says.

MNC acquisition offers a useful model for how many Chinese and Indian companies may ultimately enter the other market in the years to come. But increasingly, Indian and Chinese companies are also developing the skills to go-it-alone in each others' markets.

This approach typically requires the company to localize its products and services, hire local talent, and find reliable joint-venture partners. Beyond that, India and China present unique challenges. "India has complained for over a decade of market access issues in China, where it sells mainly commodities and raw materials," says Reshma Patil, the author of *Strangers Across the Border: Indian Encounters in Boomtown China*. "The Chinese tend to complain about Indian visa procedures and security concerns raised in India about Chinese telecom companies."

Indian firms looking to enter China find that many sectors of the economy remain completely or partially closed to foreign investment. However, China has rolled out the red carpet for a narrow range of industries that are seen as strategic in developing the domestic economy—particularly services and information technology (IT), sectors in which India excels.

Tata Consultancy Services (TCS), the IT consulting arm of India's Tata Group, found its way into China in 2002, through a Chinese government initiative aimed at encouraging the development of a global off shoring base. Then in 2008, the company formed a joint venture with the Chinese government to provide IT training services. TCS now has about 3,000 employees in China, 97% of whom are locals.

Sujit Chatterjee, the President of TCS China, says that one reason for the company's success is that it has paid attention to the deep underlying interplay between its clients and the government in China. "For any organization to succeed in China, you need to understand that interplay. You need to be playing across the local government setup, the customer organization, as well as from a social stakeholder perspective," he says.

NIIT, an Indian IT training and software services company that came to China in 1997, credits its success to a similar approach. It saw a need in China for better IT training in universities, and worked with the government to expand its business, both by setting up independent training centers and embedding its training in university curriculum.

Prakash Menon, the China President of NIIT, cautions that foreign companies need to remain flexible in the China market. Even companies with successful business models will find that their models only last five years in China, says Menon. Either their success will attract a flood of local competition, or a government policy will suddenly change, forcing them to adapt. "The whole trick in China is how to be very nimble-footed. You should be able to run, and if something comes your way, you should be able to make a turn, work out something quickly, and move on."

China also tends to be very non-transparent, says Menon. Many top-shelf Indian companies, which successfully work with major Western clients, have so far failed to win the business of Chinese state-owned enterprises. "You may have a better product or service, but you may never sell. There is an invisible kind of a reason why you don't sell. It's not just Indian companies, many foreign companies are completely baffled about how this works," Menon says.

In contrast to China, Menon describes the Indian market is much more transparent, but even more complex. India also has significant barriers to many types of FDI, though Modi's government has eased some restrictions in a bid to boost the economy and create jobs. But the real challenge for foreign companies in India is that the Indian consumer market is complicated and fragmented, with many different cultures, religions, and languages—so much so that developing a single strategy for the country often proves impossible.

Telecoms equipment maker Huawei was an early Chinese entrant into India in 2000. Its journey was not an easy one: it found the Indian telecom market to be crowded, with a deep suspicion of Chinese political intentions and product quality.

Huawei worked to overcome these suspicions by building large R&D and service centers in India—including a 5,000-seat R&D center in Bangalore and a manufacturing facility for network optical equipment in Chennai—that operated with almost solely Indian employees. The company tried to source as many components from India as much as possible, both to cut costs and avoid criticism. Huawei also sought to address the Indian government's security concerns by being one of the first multinational telecom vendors to offer the source codes for its network and products to Indian officials, says Suresh Vaidyanathan, spokesperson for Huawei India.

Despite these efforts, tensions remain high. In February 2014, the Indian government launched a probe into allegations that Huawei had hacked the telecom networks of state-run phone company Bharat Sanchar Nigam. But because Huawei has been operating in India for 14 years and is now a significant employer—95% of its 6,000 employees are locals—the Indian government seems unlikely to ban it altogether.

Following Huawei's lead, other Chinese technology companies are feeling out the Indian market. For example, UCWeb, a Chinese company that develops internet browsers for smartphones and was fully acquired by Alibaba in June 2014, has captured about a third of the local browser market since entering India in 2011, according to tracking by StatCounter. In August 2013, the company surpassed Opera to take the number one spot in India's mobile browser market.

Companies like UCWeb and Huawei that have built strong mobile businesses in China are likely to look to India for growth in coming years. According to tracking by International Data Corporation, India was the fastest growing smartphone market in Asia in the first quarter of 2014, recording year-on-year sales growth of more than 186%. The market still has much room to grow, with only 10% of Indians owning a smartphone.

However, that 10% is enough to cause a stir of activity around Chinese phonemaker Xiaomi's Mi 3 model phones, which in its second flash sale in mid-August through Bangalore-headquartered e-commerce company Flipkart, sold 15,000 units in two seconds, as Xiaomi reports it. What's key about the clamor for Xiaomi phones is that it really marks the first time a Chinese smartphone is taken for something of intrinsic value, as opposed to simply cheap and available.

On the software front Tencent is also scoring one for the home team. According to the Best of 2013 list on Apple's App Store, WeChat is the top non-gaming app in India and the second most downloaded app overall.

If Xiaomi and Tencent can ride the wave of positive attention, it could signal an initial breakdown of the stigma associated with Chinese products in India.

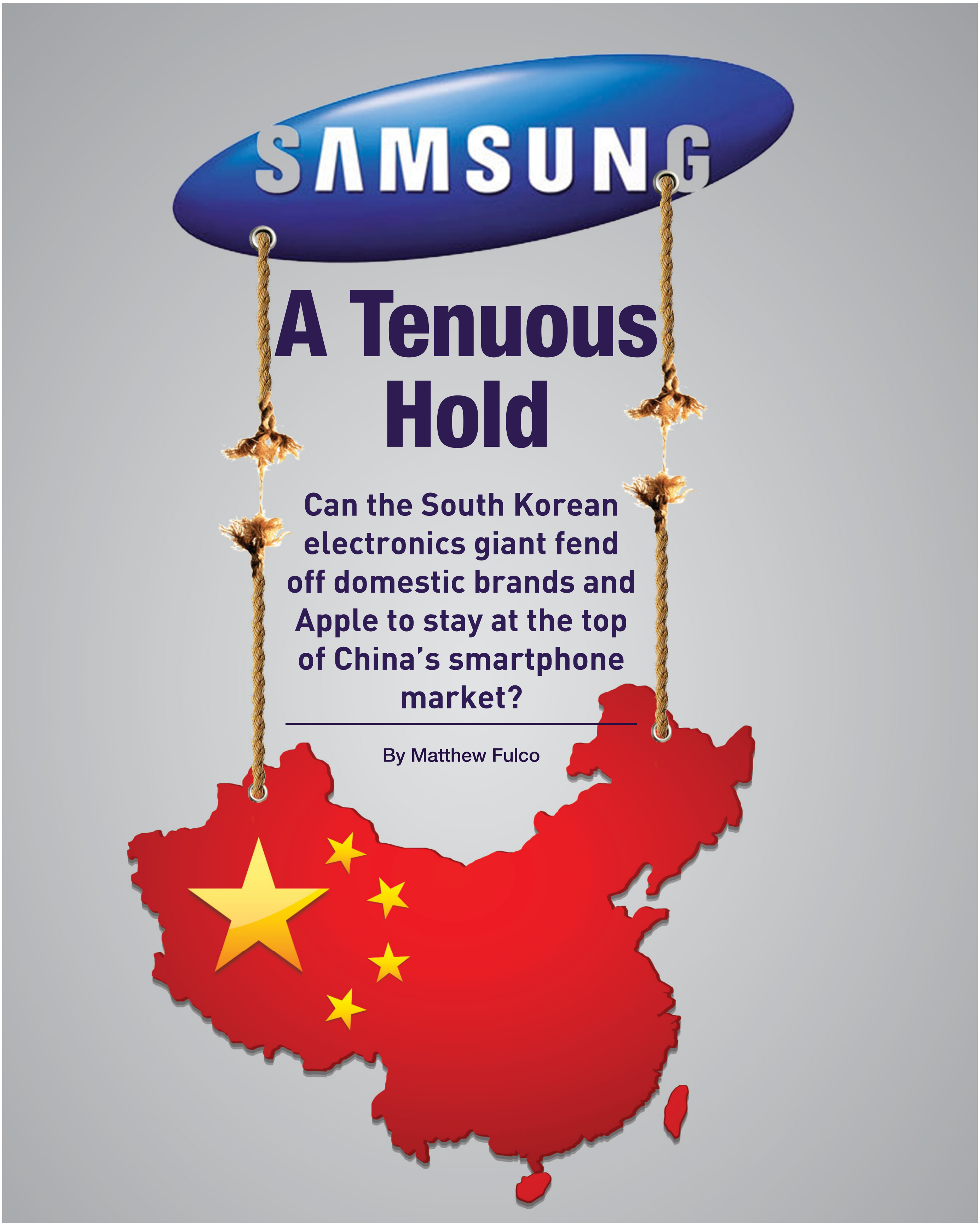
## The Long Road to Partnership

While the Sino-Indian relationship looks ripe with opportunity over the next decade, many challenges remain. Case studies such as TCS, NIIT, Geely, UCWeb, Huawei and Shanghai Urban Construction Group Corp provide a useful roadmap to new opportunities in foreign markets. But forging a closer Sino-Indian business partnership will entail revamping and improving the Indian economy and infrastructure, and removing restrictions to foreign investment on both sides.

It will also require overcoming lingering mistrust between the two Asian giants, which has especially bloomed in India as China's economic, political, and military power has grown. A recent Pew poll found that only 35% of the Indian public had a favorable view of China; 41% and 22% said their opinion was unfavorable and very unfavorable, respectively. Patil, the author of *Strangers Across the Border*, argues that Sino-Indian economic engagement cannot substantially improve until both sides improve their political relationship, ease strategic distrust, and enhance the mutual cultural understanding.

Yet if there was ever a moment to look for closer Sino-Indian relations, it is now. Modi's unprecedented rise to India's highest office has demonstrated the Indian public's eagerness for pragmatic policies that will reinvigorate the economy. According to Menon of NIIT, the climate for investment in India "suddenly and spectacularly changed" after Modi's election. "The hope in India is that there will be, probably in the next six to eight months, changes in legislation which would open [India to industry] a little more."

The road to China looks similarly bright for Indian companies. The TCS China President and CEO says that, given the Chinese market's size, potential and growth rate, "there is not much choice about being in the Chinese market or not". Indian companies that want to be considered major global businesses should enter China sooner rather than later, he says. "On the aspect of timing, in my opinion, it should be done today."




# A Tenuous Hold

**Can the South Korean electronics giant fend off domestic brands and Apple to stay at the top of China's smartphone market?**

By Matthew Fulco

Until recently, South Korean tech giant Samsung Electronics has enjoyed the title of undisputed champion in China's smartphone market, a position it has held since 2012, jamming retail channels to the point of near omnipresence with handsets that seemingly combine up-market sensibilities with the pervasiveness of the Android operating system. But recent drops in operating income—the most recent nearing 25% in the second quarter of the year—has mobile market watchers wondering if the company's slip is beginning to show in China.

As competition intensifies at the bottom of the market and sales growth at the top slows, Samsung's reported profit margins—roughly flat at 19.8% at the end of the first quarter of 2014 compared to a year ago—are coming under intense pressure. Apple—recovering nicely from its run-in with state media last year and lackluster rollout of the iPhone 5C, thanks largely to its deal with China Mobile—is luring away Samsung's high-end users. At the same time, Chinese vendors are co-opting the Android operating system (OS) into inexpensive handsets tailored to the local market, rendering consumers hard pressed to delineate what makes Samsung midmarket phones worth the price. "Outside of the premium segment, Chinese handset makers have pulled even with Samsung on hardware," says James Yan, a technology analyst with IDC Research in Beijing.

With less and less distinguishing Samsung handsets from that of its Chinese competitors, the *chaebol* is at a crossroads in China, which accounted for 18% of Samsung's revenue in 2013, according to a Sino Market Research report released in May of this year. Further emphasizing Samsung's tenuous China positioning is its reliance on handsets, which make up 76% of the company's total income, according to company reports

"Samsung is in a precarious situation," says Jeff Pu, an analyst with Yuanta Securities in Taipei and former head of market intelligence in Taiwan for Samsung SDI, an affiliate of the electronics giant. "China is very important to them—there is no way they can ignore a market that size—but sales are not good and Samsung has not done anything to give investors reason to believe they will improve."

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>
> Jeff Pu
> Analyst
> Yuanta Securities

Among Samsung's underwhelming countermeasures is the development of a mobile OS of its own called Tizen, of which analysts are rightfully skeptical. Enhancing doubts of Samsung's homegrown OS was the July news that the company would be postponing its launch to "further enhance the Tizen ecosystem", according to a company statement. On the premium hardware side, Samsung will release its high-end flagship Galaxy Note 4 in October with a curved screen, a new feature it hopes will win over Chinese consumers with a penchant for novelty.

Unfortunately, none of these moves heralds a paradigm shift for Samsung. With the commoditization of smartphones in China, Samsung will be unable to rely on its hardware and brand strengths alone to justify premium pricing. Nor can it accept razor-thin margins like some of its Chinese competitors who hedge their smartphone revenues by expanding into different product lines. Without a reboot of Samsung's China strategy, the South Korean conglomerate's share of the world's largest mobile market looks set to fast erode.

## Still Number One?

For now, Samsung remains at the top of the China handset market with 18% market share through the first quarter of 2014, down from 20% a year earlier, according to the research firm Canalys.

But in late June, CFO Lee Sang-hoon told reporters in Seoul that the company's Q2 earnings report wouldn't "look too good". He was right. Operating income fell nearly 25% to 7.2 trillion won ($7.1 billion) in the second quarter, the third straight quarterly drop, driven down by cheap Chinese handsets and a strong won.

Samsung does not disclose smartphone shipments, but analysts say it sold about 78 million units in the three months leading up to June—short of the 90 million units expected. "The company witnessed a slowdown in the overall smartphone market growth and saw increased competition in the Chinese and some European markets," Samsung said in an explanatory note to investors. What makes the downturn more perilous is China's tendency to chew up mobile leaders and spit them out as shells of their former selves

## Here Today, Gone Tomorrow

If its China smartphone sales fail to pick up, Samsung may go the way of Motorola and Nokia. Both firms once led the China mobile market within the last decade, but couldn't adapt to changing market conditions—intensifying competition in particular—and saw their market shares plummet. Motorola withdrew last year while Nokia holds on to less than 1% of the market.

According to Vanessa Zeng, a senior analyst with Forrester Research in Beijing, has-beens are common in a market where Chinese consumers, accustomed to a deluge of new handset models, change their phones regularly. Their lack of brand loyalty naturally favors newcomers. "You could say Samsung was one of the main benefactors of Nokia and Motorola's collapse in China," she says. "Samsung picked up many of their high-end users."

Despite competition from Apple, Samsung's high-end user base remains solid. But domestic brands with low overheads, eager to gain a foothold in the market, are undercutting Samsung in its vast middle and lower tiers.

One of the fiercest such competitors is Xiaomi, China's number three-handset maker behind Samsung and Lenovo. In 2013, Xiaomi sold 18.7 million smartphones almost exclusively from its website, generating \$5 billion in revenue. "They can accept very low margins, almost zero," says Nicole Peng, Director of Research at Canalys in Shanghai. "Samsung can't compete with that."

Horace Dediu, an independent analyst who previously worked for Nokia in the 2000s, predicted two years ago that cheap Chinese handsets would be Samsung's undoing. As Chinese brands narrowed the hardware gap with Samsung, the company's lack of software and services—drivers of future growth in the handset sector in his view—would hamstring it, he wrote on his online tech analysis portal, Asymco.com.

## Made for China

Dediu's forecast was spot on. Between the first quarters of 2013 and 2014, Xiaomi nearly quadrupled its share of the China smartphone market from 3% to 11%, Canalys found. In the three months leading up to April this year, Xiaomi's RedMi, which retails for RMB 980, was the top-selling handset in China, with nearly one-

**'Others' overtake Samsung in China**

% of smartphone shipments in China in Q1 2014


Source: Counterpoint Technology Market Research

fourth of its buyers switching over from Samsung, said the consultancy ComTech in a June research note.

Xiaomi has cut into Samsung's market share with an aggressive localized strategy. It eschews retail outlets, instead selling its inexpensive, high-performance handsets online, where Chinese consumers increasingly prefer to shop. It does little conventional advertising, earmarking just 1% of its revenue to marketing, compared to Samsung's 5.4%. Xiaomi also channels the tremendous reach of China's social networks, Weibo and Wechat, to bring users into an integrated platform that includes software and internet services tailored to the Chinese market.

Xiaomi's strategy has gone one step further by applying consumer feedback in rapid fire fashion in the subsequent editions of the handset and its software, a tack that has bestowed upon the phone maker considerable gains. Not only is it now China's number three smartphone vendor, but its users are fiercely loyal, a rarity in China.

Xiaomi interacts closely with its tech-geek fans on social media, and invites them to its promotional events, says James Yan of IDC Research. Combined with its software and services, that leads to stronger brand loyalty than is seen with other domestic handset makers, he adds.

Number two Lenovo, whose market share rose from 9% to 11% between the first quarters of 2013 and 2014, also threatens Samsung. Chen Xudong, Lenovo's China President, said last year that his company aims to surpass Samsung's China smartphone sales within two years.

Lenovo already challenges Samsung in the lower end of the market, but it will not stop there. Last year, Lenovo released its first premium handset, the K900, to compete with the Samsung Galaxy.

Meanwhile, arch-rival Apple began selling iPhones last December through China Mobile, the world's largest carrier with 772 million subscribers. Thanks to that agreement, Apple's Q2 sales in China rose by around 13% year-on-year.

The deal has thus far ensured the iPhone 6, due out in September, will be available to Chinese consumers at heavily subsidized prices. "The iPhone 6 is going to sell in huge volumes in China because of that deal," says Jeff Hu of Yuanta Securities. "Samsung has no way to beat Apple in China this year."

The best Samsung can do is leverage its core hardware strengths as it launches the Galaxy Note 4, Hu says, adding that it be the first mobile phone with a 4k (ultra high-definition) screen.

## Prescriptions for Recovery

For Samsung, it's all about core strengths according to analysts. Peng of Canalys believes Samsung should launch a new smartphone line just for the China market and sell it exclusively online to generate buzz. The smartphones should be priced to compete with domestic Chinese rivals, but should not comprise too large a part of the product line. "You want a balanced portfolio," she says. "Having too many low-end phones could impact the performance of the high-end models."

Given the strength of the Samsung supply chain, the company is in a position where it can easily launch new products faster than its competitors, Peng says. "They have the scale. We're talking about a company that ships almost 90 million smartphones per quarter."

Samsung's vertical integration is one of its largest competitive advantages. Because the company began as a hardware manufacturer—it produces application processors, DRAM, NAND flash and displays, four of the most valuable components in handsets—and later expanded into end products, components have always generated profits for Samsung. Its competitors, on the other hand, acquire components at a cost from external suppliers. In Apple's case, that supplier is Samsung.

In contrast to its strong supply chain and hardware, Samsung is weak in software, where it relies on the same and widely used OS as its Android-based competitors.

That lack of software differentiation has prompted the company to develop its own Tizen OS to reduce its dependence on Google. Analysts expect Samsung to launch a Tizen-based handset in China at the end of this year or early in 2015, but the new OS faces a major uphill battle in China.

First, Tizen will have to contend with Chinese regulators. Beijing has openly expressed its dissatisfaction with Google and Apple's dominance of China's handset software market for national security reasons.

There is little reason to believe Chinese authorities would be supportive of yet another foreign operating system, especially since they have been busy creating their own, the China Operating System (COS), developed jointly by the Chinese Academy of Sciences and private-sector partner Liantong Network Communications Technology. China Telecom and China Mobile are currently undertaking tests of the COS platform.

At the same time, Android is entrenched in the China market. Chinese consumers accustomed to the localized Android ecosystem will not easily switch over to something unfamiliar, even if it comes attached to a reputable brand like Samsung.

Smartphones typically require app stores with tremendous variety to gain traction with users, and Tizen has almost no apps. "It's too risky for Samsung to abandon Android in China," says Hu of Yuanta Securities. "The Tizen ecosystem is too immature," he says.

And therein lies the crux of Samsung's software issues. It's stuck with Android if it succumbs to short-term pressures, which will ultimately hurt its chances of maintaining a sustainable advantage over the competition.

According to Zeng of Forrester Research, Samsung needs to stay focused on the premium segment of the China handset market, where margins are much higher. In Zeng's view, with its Galaxy Note models, Samsung remains superior to Chinese brands, competing only with Apple. "Apple will not launch a low-end smartphone in China, and so Samsung shouldn't either," she says.

To Zeng's point, premium handsets are increasingly showing themselves to be Samsung's bread and butter. An unnamed Samsung executive told Korean media earlier this year that it expected the Galaxy S5 model to sell 35 million units in the second quarter of 2014.

For perspective, Samsung's total global smartphone sales for the first quarter of 2014 reached 89 million, meaning just the one premium model is generating nearly 40% of sales.

But locking horns with Apple will become decidedly more treacherous if the rumored release of a large-screen iPhone 6 goes well.

"Apple is not engaging in a simple hardware competition," says Zeng. "It invests more time than Samsung in developing genuinely innovative new products. If the big-screen iPhone 6 lives up to the hype, it will have a major impact on Samsung's China sales."

Other emerging markets offer Samsung opportunity to rebalance, says James Yan of IDC Research, but he does not expect the South Korean electronics giant to dial down its presence in China given just how important a market it remains. "Samsung will step up its smartphone shipments in Russia and India, which are two of the largest emerging markets," he says. "But China will remain a crucial market for Samsung because of its size and the huge investments Samsung has made here."

That's a position Samsung may want to rethink as Chinese device makers are casting ever bigger shadows over the current market forerunners.

# The New Number One

## China's rise to economic superpower status comes at a cost to its international maneuvers

By Zhou Chunsheng

China's economy has emerged rapidly in the past two or three decades. It surpassed Germany's in 2009 and Japan's in 2010 and is slated to become the world's largest economy this year, according to a World Bank report. China has therefore attracted the world's attention on a variety of fronts—political, economic and strategic. The world watched nervously in May as a collision between Chinese and Vietnamese vessels in the South China Sea threatened a serious escalation of tensions in the Asia-Pacific region. As Xi Jinping's anti-corruption drive intensified, international media pondered the implications for foreign corporations whose Chinese partners were on the receiving end of the crackdown, from Canada's National Petroleum Corp to the British cereal maker Weetabix. The rise of Alibaba from a Chinese start-up to the world's largest e-commerce company is about to make history, according to some, on the New York Stock Exchange with a record-breaking IPO value.

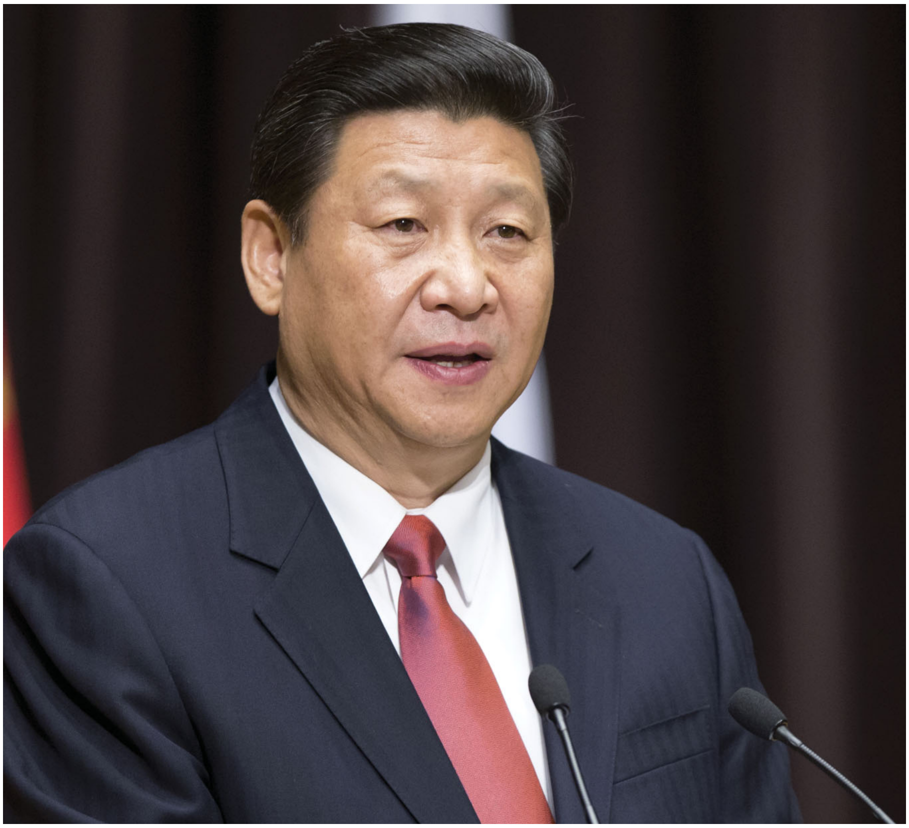
With greater power, however, comes greater scrutiny. As China becomes stronger it will use its soft power to play an increasingly important role in global politics. Small nations in particular will be attracted by the many benefits inherent in cooperation with the world's largest economy, but so will developed nations. But scrutiny from developed nations will also increase, a prominent example of this being the United States' foreign policy pivot to Asia and efforts to develop the Trans-Pacific Partnership.

Economic power will necessarily lead to increased military power and strategic influence as well—so-called superpower status. Yet China is very different from the US, which has been the world's only superpower since the dissolution of the Soviet Union. The rest of the world has grown accustomed to its superpower status. China, on the other hand, is a new superpower both economically and politically. It is this element of the unknown that has created a certain amount of international anxiety. Other nations don't know what to expect as China steps into its position as a new world leader.

This should come as no surprise to students of history. Whenever a new superpower steps onto the world stage, it naturally tends to cause discomfort on the part of the old superpower, which is typically reluctant to renounce its influence. Due to such fears, for example, the United States plans to strengthen cooperation with Japan to counterbalance the rise of China in the Asia-Pacific region.

A major benefit of China's emerging superpower status is the ability to reduce its economic dependence on other nations. The world is dangerously reliant on the World Bank and other financial institutions, where the United States wields an inordinate amount of influence. A major issue currently is the inequitable distribution of shares. In the International Monetary Fund (IMF), the United States controls nearly 18% of Special Drawing Rights while China, rapidly becoming the world's largest economy, controls a mere 4%.

To counter this, China recently signed a deal with Russia, India and the other BRICS nations to create a New Development Bank and is currently in talks with Korea to set up an Asian Infrastructure Investment Bank. Such institutions would counterbalance the financial domination of the World Bank and the IMF. That China is able to credibly



**China's President Xi Jinping is increasing China's presence on the world stage**

propose such plans is directly related to its growing economic clout. Therefore China's emerging economic power represents an encouraging development for emerging market nations.

As another example, the international financial system is dominated by the US dollar. This international demand for the dollar has resulted in a situation where quantitative easing (QE) and other domestic policies of the US Federal Reserve often exert a dangerous destabilizing influence on markets worldwide. When the Fed announced plans to begin tapering QE in late 2012, emerging market nations experienced sizeable stock market drops as well as increases in sovereign spread, a measure of the risk involved in lending to a given country. An important solution to this dependency is the internationalization of the renminbi. Reducing dependence on the dollar, the euro and other foreign currencies is China's ultimate goal, and its new title as the world's number one economy could help China reach this goal by giving it added leverage in negotiations.

> China will also have to work hard to win the respect of its neighbors as well as Europe and North America

Of course, even if China becomes the world's largest economy, this does not mean domestic affairs will be easy. In fact, China's new status will escalate citizens' expectations for material wealth and continuous economic growth, making domestic politics increasingly complicated. China will be forced to work harder to improve social welfare and reduce debt, while its newfound superpower status also gives it the added burden of projecting its soft power worldwide.

What's more, Chinese society is in a state of transformation. It is, in a sense, unprepared to fill the role of an economic and political leader. China will need to work to emerge as an economic leader independent of the aegis of the US. It can begin to realize this goal by taking actions that illustrate economic leadership, such as providing foreign aid to developing countries and helping to determine the course of the global financial system, to cite a few examples.

China will also have to work hard to win the respect of its neighbors as well as Europe and North America. It must develop its economy while increasing transparency, projecting its image as a responsible and reliable world citizen. This will help China's case in the South China Sea dispute and in other issues of international relations. It is also important to present an image of non-aggression even as it consolidates its economic power.

There is space within China's current political system for China to become a responsible global leader, but it will not be easy. Even as the Communist Party retains its hold on power, China is changing and democratizing. This has been underscored most recently by Xi Jinping's fight against corruption.

Though China is a Communist country, nations of all ideological stripes are able to engage in peaceful and constructive diplomatic and economic relations with China today. This will surely be a boon as China steps into its new role as a world economic power.

*The author is Professor of Finance at Cheung Kong Graduate School of Business*

# Conversations

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"I think the first thing you should never do is assume your technology is so advanced that you're going to trump everybody and you can live off that "

**Allen Wu**

*Greater China President, ARM*

# Rise of the Newcomer

## Luxury car maker Infiniti is a relatively new entrant in China's luxury automobile sector but it's already ready to swing into high gear

By Neelima Mahajan and Major Tian

Infiniti, the luxury car division of Nissan Motor Co., is on a roll in China. Originally a brand created for the US market, Infiniti entered China only in 2007, years after its German counterparts which currently dominate the Chinese luxury car market. Yet in a space of just about seven years, the China market has grown to become Infiniti's second-biggest market globally and continues to grow at a scorching pace. To put this in perspective, just take a look at its most recent sales figures: in the first six months of 2014, Infiniti sold 14,000 vehicles in China, more than double the number for the previous year.

Even though Infiniti has been doing phenomenally well in China, it still trails the big three German carmakers—Audi, BMW and Mercedes-Benz—as well as others like Cadillac, Jaguar Land Rover and Porsche.

The global parent has huge ambitions for the China subsidiary. The company's President Johan de Nysschen has gone on record saying that he wants Infiniti to increase its sales to half a million a year over the next four-five years and the China market will contribute roughly one-fifth.

Daniel Kirchert, Managing Director of Infiniti China (a German and an old BMW hand at that), explains how the company plans to achieve that goal.

*Q. Infiniti entered China only in 2007, which is not so long ago, but it has managed to do very well for the global parent. How have you managed this in such a short time frame?*

A. As a new entrant [in China], the first thing we need to do is to let people know about our brand. We have been focusing a lot in the last [few] years to build awareness and let people know the core value of the brand, what makes us different from other established premium brands as the German three. We've already seen quite a rapid phase of growth in the last two years. This year we are already coming close to 2% of the market share in the premium sector. Nevertheless, I still believe that we have quite some potential ahead of us. Our market share in the US is around 8%. We will continue to put a lot of efforts in the market and we see much more potential in the future. To build a brand in the Chinese market from a global perspective is the most important priority for Infiniti.

Originally a US-centric brand, going global our vision is to establish Infiniti as a truly global premium brand, No.4 in the exclusive club, the first three being the three strong German players. To realize this, China is the most important place. We will focus all our efforts on localization in China.

*Q. How is your approach in China different from that of the big three German automakers?*

A. The three German brands are very successful in China. They entered China in the 1990s and most of them had more than 10 years of global production. So they have a natural advantage of entering the market early, building the business, and localizing the model. They did a good job in setting up the joint ventures, building the market and they are dominating the market currently. In the premium segment in China, close to 80% is covered by the three German brands. In the US, it's only 50%. So it's a very strong position.

The Germans are very good in highlighting their strength in their products in a rational way. We also want to do this but besides that, we want to really position ourselves as a very emotional brand and be much stronger in building a bond with the consumers, not only representing great products, but also representing something to build real relationships with consumers and generating experiences for them. We want to use more emotional marketing.

From the market point of view, a lot of consumers also want to try something new. We are targeting the young-minded premium consumers in China. Saying "young-minded" doesn't mean the consumers have to be young. These consumers are different. They are changing from the traditional premium luxury consumers in China. They place much more emphasis on individuality. They want to choose a brand which will reflect something for themselves. This is our target group and I think we'll have a differentiated brand positioning from the Germans with [this] unique group of people.

*Q. So this consumer is different from the kind of consumer that BMW and Audi will go after?*

A. This is a very big and fast growing group. It is so big so everyone will go after them. How we position the brand, how we talk to them, will create a brand that can really build great consensus with this target group.

Saying 'young-minded' doesn't mean the consumers have to be young. These consumers are different. They are changing from the traditional premium luxury consumers

*Q. Is the localization you do in the Chinese market very different from what you do in other markets?*

A. China is special because it's the biggest market globally and in the premium market this year China will most likely become the biggest market. It will probably overtake the US in 2014. So if a brand wants to be a truly global player, the road goes to China. Localization in China is of strategic significance.

Consumers in China are quite different from consumers in Europe and the US. Localizing needs to be part of a company's culture. It means respecting the market and consumers. Because China has the size and big potential, it also means [we have to do local production]. At the end of this year we'll have localized two of our new models for China.

We are [also] localizing our branding approach. We've created a very unique way of expressing our values in Chinese to address our local consumers. We've localized the majority of our management team. These are all top people from the industry. They understand the market and the consumers. We also try to have a good corporate culture, get engaged in the society, and get engaged in corporate social responsibility. If you are in the market, you also need to give back something.

*Q. To what extent are you present in the hinterland in China?*

A. This is fairly important, of course, because China is so big. Our network is around 68 dealers and if you compare this to the three Germans, we are still quite behind them in terms of coverage. We are focusing a lot this year, next year in expanding our network. We planned by the end of this year to have more than 80 dealers and basically every year from the next year we will cover at least 30 more places. In China you need to have geographic coverage. To have people considering buying your product, you need to be close and be able to provide the service to them. So network development is very important. We need to do this not only with the quantitative focus but also a high focus on quality [in terms of] top customer service experience.

*Q. How important is your plant in Hubei to the brand in terms of capacity building and leveling up manufacturing quality?*

A. We'll localize two models, Q50L and QX50L by the end of this year. These two segments are very big and fast-growing segments in China: combined, they account for around 40% of the premium segment. They will be the main contributors to bring the volume up for our plant in the next five years. I believe more than 50% of the volume in China in future will come from local production.

*Q. Is this factory also shared with Nissan?*

A. It's a Renault Nissan factory which also produces Nissan. This factory for the last [few] years constantly ranked among the global Top 3 in terms of quality. But of course for the localization of Infiniti, we have set up a separate line. We will fully enforce the global Infiniti quality standard.

*Q. There are concerns that Infiniti should not be manufactured with Nissan. To what extent do you think they will be insulated?*

A. You need to look at the structure of the plant. In the existing Nissan plant, we will set up dedicated facilities for the Infiniti production. On the production side, [we will] enforce our global quality standard and have people trained to do this.

*Q. Will China also be a very significant production base for you globally?*

A. The local production is planned for the Chinese market only.

*Q. The Chinese market, especially in the premium segment, is growing. From Infiniti's perspective, how are your China operations seen?*

A. In terms of volume, the US is still the No.1 market, and China is No.2. The brand was built for the US market originally. If you look at the future growth, China is clearly the market with the most potential. It's also reflected in the decision to move Infiniti's global headquarters to Hong Kong. To build the image of the premium brand first necessarily needs [the brand] to have independence because a premium brand requires different kinds of methods.

The move to Hong Kong [also] signifies the attention to the Chinese market: [it is very close to] the mainland China headquarters in Beijing. We are the only global premium auto brand which moved the global headquarters to Greater China.

> Maybe there is a traditional way to look at cars from their country of origin. But I think in future this will change. Brands need to represent something more, in terms of value, in terms of what they stand for

So the headquarters can truly understand and fully support China. This is very different from companies that need to go halfway across the globe. Globally, they have a very clear vision to build Infiniti into a real member of the club of first-tier premium brands. Our goal for the next 5-10 years is not to attack these German three in terms of volume, but on brand recognition of being a truly global player, an important presence in all major markets. Of course there is a volume ambition too. On the global scale, we want to go beyond half-a-million cars before 2020. China plays a major role. Our goal is to break through another thousand units in the next five years.

To make this come true, we are not focusing purely on volume growth, but also on building the brand. This is a very young brand which appeals to young-minded premium consumers. Our differentiation is being an emotional brand and building consensus with consumers. At the same time, we need to do a lot of basic work in China—for example expanding our dealer network and providing the best customer service for our dealers, preparing for local production and launching more products.

At the global scale, Infiniti will expand [its] portfolio by over 60% in the next five years. Our job, of course, is to make all of those products fit the Chinese market. As we have a long-term vision, it's not so much what you can achieve in the next four-five years. We believe the volume will [come], but we have to really work on the basics to make this happen and make sure [we achieve] more than the target.

*Q. Is this shift to Hong Kong also a conscious move to distant the Infiniti brand from the parent Nissan to some extent?*

A. Yes, definitely. I think it's not so much about the country of origin. Nissan is a very successful brand globally and especially in China, but the premium brand needs to be different. It has a different identity, different character. All Infiniti products are developed on its own platform. We use some synergies in R&D and production but the platforms for the product… are very different. Because Infiniti is much smaller than Nissan, to make it successful, it was a very conscious decision to set up separate headquarters, separate management teams to go on this mission.

*Q. A recent Reuters piece said that in order to attract Chinese car buyers and better compete with established global premium brands like Mercedes-Benz and Audi, Infiniti is "quietly scaling back its Japanese roots and, in the words of brand president Johan de Nysschen, 'going global'." What* *is the thinking here?*

A. Infiniti was born for the US market. The heritage for us is more of a US brand. Our products from the past were focused on the US market. Since we started the expansion, we took a very global approach. I think the brands need to be international.

Consumers now are changing: from purely looking into the product [they are looking at] the brand and the message behind. For that reason, in future it's much more important to build your brand in a globalized way. The country of origin will become much less important. Also in consumers' minds, it's about having a feeling of what this brand stands for and whether this brand appeals to them

*Q. Is it also spurred by the fact that Japan is not really known for luxury, especially in cars? When we talk of luxury cars, we are more likely to look at German cars or European brands.*

A. Maybe there is a traditional way to look at cars from their country of origin. But I think in future this will change. Brands need to represent something more, in terms of value, in terms of what they stand for. For the young generation, they will not distinguish this so much anymore in the future.

*Q. To what extent is brand awareness a challenge for you? Honestly when we talk about luxury cars, Infiniti is not a name that comes to mind.*

A. That's true. In the US it's the opposite. When talking about luxury brands everyone will say, "Infiniti" as it has a good history of over 20 years. But in China it's not there yet. It's more important to let people know what the brand stands for and also to let them know what makes you different. Currently this is [our] most important job in China.

We have a few good activities running in terms of increasing awareness. For example, we sponsored a very successful TV show *Baba Qu Na'Er* (*Where are you going, Dad?*) last year. To raise awareness it's important to become a social topic. This show became the hottest TV show in China last year and Infiniti had a chance to display our great 7-seat luxury SUV.

The goal is to No.1, build the brand and make it a top brand here. We have brought forward a very clear strategy... It's really helping to raise the awareness, but we need sustainable long-term investment

At the same time the show is a perfect match for the brand's direction. It's a very emotional show: it shows true emotions between fathers and their kids and how to go for challenges together. That's exactly what we want our brand to stand for, a reflection of building genuine emotions. A lot of people bought Infiniti immediately after they watched *Baba Qu Na'Er*.

We are also trying to do this in a not very traditional way. The traditional way may be advertisements. We want to become a "topic". We want to create experiences for people. There is a very popular documentary in China called *She Jian Shang De Zhong Guo (A Bite of China)*, which is about Chinese food and the stories behind that. It's very emotional because of the unique personalities and stories behind that. We also sponsored this show. This sponsorship provided a platform for our dealers to organize similar trips and experiences with customers and prospects to go out and have a unique journey to experience these fantastic places and find out about some of these foods.

This had a huge influence and it became a social topic. I think it's more important than putting your brand logo everywhere. If people talk about it, if they have a great experience, they will talk to their friends. This is a more effective and faster way to raise awareness.

*Q. Going forward, it seems like there is huge expectations riding on you. Your global CEO said that he "wants to boost Infiniti sales to half a million a year in the next four-five years with a fifth of those sold in China". The base right now in China is small. So is that a realistic goal?*

A. The goal is to No. 1, build the brand and make it a top brand here. We have brought forward a very clear strategy. So far it is working and very appealing to the consumers. It's really helping to raise the awareness, but we need sustainable long-term investment to build the brand. This is the most important precondition. We are bringing the product to the market. We are expanding our network. We are doing localization in more and more areas. That's what we need to do to achieve these other thousand units in China. It's very challenging, but very feasible. It's not so important to achieve these things in the next four-five years. It's more important to do these things right.

*(To watch the video, please log on to knowledge.ckgsb.edu.cn)*

# Choice Liberates. Or Does It?

## Sheena Iyengar, author of *The Art of Choosing*, on the limitations of choice—and how to choose wisely

By Neelima Mahajan

We all think that more choice is good. But a trip down the supermarket aisle reveals otherwise. It isn't as simple as picking things off the shelf and dropping them into your shopping cart. When you see an item like 'toothpaste' on your shopping list, you have to not only choose from an endless list of brands like Colgate, Close-Up and Crest, but also navigate through a dozen or so variants within each brand: gel, whitening, anti-cavity, toothpaste with additives like baking soda, etc. You do it first for toothpaste, then for soap, shampoo, ketchup, till you reach the end of your shopping list—and quite literally, the end of your tether.

Navigating through a maze of brands and variants has become an exhausting mental exercise. Intrigued by instances such as this one, Sheena Iyengar, the S.T. Lee Professor of Business at the Columbia Business School, started to explore the idea of choice, and whether choice is always good. Her research led to a bestselling book called *The Art of Choosing* which received critical acclaim from the likes of Malcolm Gladwell and Dan Gilbert. In this interview, Iyengar, who was voted as one of the top 50 most influential business thinkers of 2011 by the Thinkers50, walks us through how we choose, why choice has its limitations, how different cultures see choice and the implications of her research.

*Q. People often view choice as something that empowers them. To what extent is that true?*

A. Obviously putting a number on it would be very complicated, but here is how I would answer that question. Is your life affected by fate? Sure. If I ask you how you became the person that you are or [got to] the position that you are in, you will absolutely point to the circumstances of your birth or your fate that helped you get there. Are you affected by luck or random events? Absolutely, you can also answer that question. If I also ask you: "Did you make some choices to get to where you are today?" The answer, again, would be yes. So you can answer all three questions, and your answers to all three questions will be different.

But I think that there is something different and more powerful about choice compared to fate and chance, because choice is the only one of these three forces that puts control in your hands. Ultimately this is the only tool that any of us have that enables us to go from where we are today to where we want to be tomorrow. It's the only thing you've got. Now it's really up to you to figure out how to get the most from this tool.

*Q. You say, "We get a lot more out of choice in our lives if we understand that we don't always know how to choose, and that choice has its limitations". Can you explain what you mean by the limitations of choice?*

A. There are two things about that. As Asians, we are much more likely to say, "Oh, I have no choice. It's a matter of fate and it's not under my control." While the Americans are much more likely to say, "I can do anything. If I want it, I can have it." Clearly the truth is in the middle. The key to the power of choice is recognizing what the aspects on which you have choice are and what the aspects on which you don't have are.

Let me make this more concrete. One of the things that I have people do is that I have them thinking about one thing that they are struggling about right now in their life. And then I ask them to generate choice. What are some things you could do about it? If you give that task to Americans, they feel very positive and happy because they've come up with a whole bunch of ideas. If you give this task to Asians, they feel depressed because they feel none of these are possible. What I then get them to do, because both ethnic [groups] have not done the exercise correctly, is that you have them generate the choices, and then each day you have them generate, again, more choices. Because what is going to happen over time is that they will start to generate the choices that are actually doable. We can't do that right away. We are not capable. It takes us time to think it through. But over time, if you keep doing the exercise of generating options in a way that takes attention to the constraint, you won't come up with your own ideals, which is something you have to recognize, you never get fully what you want, but you can absolutely improve upon your status quo. Little by little, with each improvement on your status quo, you get closer to your ideal. I think that is the power of choice.

*Q. It's interesting you mention the Asian and American attitude towards choice. What roles do social norms play in how we look at choice?*

A. I think it means a lot. It's how you see the world. It's whether you see yourself as an empowered person or merely a cog in the wheel. Social norms play a very big role. [For example], as an Asian, we are very good at coming into a room full of people and trying to figure out what the norms are here. My job is to follow the norms and fit in. As an American, you walk into the room, you look around and you think, "Hmm, what would I like here? What would be cool for me?" It's a different attitude.

*Q. What role does our desire for self-identity play here?*

A. We have different notions of how to develop a self-identity for sure, but I think in general, no matter where you go in the world, everybody wants to be well regarded. They want to be valued persons. It's just how do you achieve being valued persons and give people different messages about that, right? In Asian cultures, people are told that if you want to be a valued person, you need to follow the norms really well. You make that dish perfectly as a woman. You dress the way that everybody would say is the right way. You are the perfect wife, or you are the beautiful boss. While in American culture, you are supposed to figure out a way to stand out, but in a way that's cool rather than bizarre. We are all trying to be valued people.

*Q. From what you say, it seems like we all like to have choice, but we don't necessarily know how it works. The ability* *to choose gives us a sense of control and probably makes us happy or satisfied. Would you agree with that?*

A. I think that one of the biggest [issues] no matter where you go is that people don't know how to choose. We would all be better off if we spend more time teaching our children how to choose. No matter where you go in the world, parents focus a lot of energy on telling children what to choose. We all know that 20 years from now, the world is going to look very different. There is actually no point in teaching your children what to choose because those choices are probably not going to be relevant. Let us just teach them how to choose. How to choose means of thinking through consequences and trade-offs. People have a very hard time with that. They are not wired to think that way.

*Q. One very profound thing you once said is that "choice is never a solitary activity. Though we think of choice as a means to individuate ourselves, we never choose alone". Why?*

A. Because choice is a 'body language'. Every time you make a choice, you are communicating something to other people, whether consciously or sub-consciously. One time you are trying to communicate: "I'm okay", and other times you would try to communicate: "Hey, I'm a little different." All the time, we are trying to communicate something.

For example, what you wear. Even when you make choices that are 'consumed' in secrecy, such as what you eat or how much you sleep, these are a bunch of choices that you could hide. Even then, those choices are not made independently from other people. The rest of the world has told you how to interpret it and what to think about it.

*Q. Would you say that most of us exercise our choices within a given band or a range? Not so much similar to the majority so that we still stand out and maintain our individualism, but not too extreme?*

A. Yes, I would agree with that and I also would say that most of what we do is habitual. We don't actually make a lot of choices. I think for the most part, the only time when we really choose is when we are trying to bestow something, right? We are not very thoughtful about most things we do in life. Probably it's for good reasons because we would go crazy if we actually think about every single thing we do in every single moment.

The key always is to understand what is the most important to you. Because if you understand what is the most important to you, then you are more likely to stop when you get to a decision that is related to that thing that is important to you. At that point, you would exercise the power and think, "Wait a minute, what do I really think here?"

That's what I really meant when I say "veto power". If you can at that time say, "No, I will not go with the norm. Yes, I know my parents would like me, the society would like me to pursue this career, but you know what, for these sets of reasons I don't want to do this." That is the only moment of choice we really exercise [choice]. For the most part, we just follow the norm. That's actually fairly functional. We don't want to make every single choice.

*Q. I'm curious about how our brain reacts to and processes our choice. If I'm sitting in a restaurant and I have the menu in front of me, if there are a lot of things on it, it obviously takes me a long time to decide what I want. Why does too much choice overwhelm us? What happens in our brain when we are confronted with too much choice?*

A. First of all, it's hard to compare and contrast. What do you do when you are confronted with a bunch of choices? You compare and contrast upon their different attributes. Actually you are trying to figure out what this fish would taste like. Is it heavy or light? Chicken versus beef? Or vegetarian? You are trying to figure out how would each one feel to me. You are going to evaluate a bunch of different things.

It gets complicated if you get more choices, cognitively. Now you need to track a little. How are you going to keep track of your preference ordering? That's one thing that happens.

The second thing is that your expectations change when you have more choices. The more choices you have, you feel like you ought to get a better meal. If you just have two choices, the chicken or the vegetable, your expectations are appropriately aligned. If you have more choices, your expectation would be: "I want a delicious meal." And then the fear of regret goes up. It's a harder task. It's a harder choosing exercise. On top of that, your expectation of what you are going to get out of it goes up, so your fear of regret goes up.

*Q. What does your research suggest regarding limiting choice?*

A. People are generally happier when they choose something of 'smaller limits', because they are more confident about what they have chosen. We don't like to limit ourselves though—we are very nervous about that. But it's okay if someone else limits our choice. We don't like doing it for ourselves.

*Q. What is your advice to companies and marketers? Is there an optimal number of choices that they should offer?*

A. I think companies should do it themselves. In the short run they are better off by creating these minor variations of choice. In the long run they are better off shrinking their choices and offering the things that are truly different and offer a value.

Apple doesn't overwhelm you with choices. If you look at their phone options, their laptop options, their iPod options, their iPad, they are all of limited choice. Even when they offer you so-called color choices, there are so few.

*Q. What is your advice to individuals? When we are confronted with increasing choices every day, how can we process them better?*

A. I think most of the choices don't matter. Most of the time, just go with the norm and focus your energy on the choices that matter to you. And I feel like to make a good choice actually takes a lot of effort. You do need to leave the energy for that.

# Pursuit of Marital Property

## Author and researcher Leta Hong Fincher on the confounding phenomenon of women forfeiting their property wealth in China

By Suzanne Edwards

Leta Hong Fincher has been intimately connected with the Far East for nearly three decades, starting with her Harvard BA in East Asian Studies where she graduated Magna Cum Laude, then soon after launching her graduate work in the same field at Stanford University. Fincher took her academic knowledge of the region and wasted no time in launching a long and decorated career as an Asia correspondent. From producing for Radio Free Asia to becoming the Shanghai Correspondent and Beijing Correspondent for CNBC Asia and Voice of America respectively, Fincher has investigated some of China's most pressing social issues, including the construction and impact of the Three Gorges Damn on its nearby population and the prospects for China's one-child policy. Most recently, as part of Fincher's doctoral work in Sociology at Tsinghua University, she analyzed state-sponsored media messaging around the concept of *shengnu*, or leftover women, and its correlation with the practice of women forfeiting their property wealth to husbands and male family members in China. The result was her now well-reviewed book *Leftover Women: The Resurgence of Gender Inequality in China*. Since the publishing of her book, Fincher has completed her PhD in Sociology at Tsinghua University, becoming the first American to do so.

*Q. How do you feel your background as a journalist shaped the way you approached your research?*

A. It was absolutely critical to the way I conducted my research. I had all these years of experience of doing reporting all by myself, alone. So I was extremely accustomed to just ferreting out information and investigating. My research was very qualitative, it wasn't a random sample, and I relied very heavily on individual interviews with ordinary people. I did an ethnographic study, that's the strand of sociology where you really immerse yourself in a particular area and site and just observe what's happening. This research is very empirical and field-based research, and it definitely overlaps with journalism, it's just much more in-depth. But then I was able to draw on theory that I learned [in] sociology to inform my observations.

*Q. What new point do you feel your research is adding to the discussion of women's roles in Chinese society?*

A. I'm looking at China's real estate boom, and the tremendous accumulation of wealth through the purchase of residential property... from the woman's perspective, which is one of tremendous inequality. The arguments that have been made that buying a home is a tremendous burden for the man, and the poor men have to come up with all this money, otherwise they won't be able to find a bride. It's true that there is this very strong norm out there that everybody believes in, that a man is supposed to own a home in order to attract a bride. But there are many, many ways in which that is a total myth and I just deconstruct it. Because parents in China believe that a man has to own a home in order to attract a bride, they end up just buying homes for their sons and they don't buy them for their daughters, because they expect the man—when their daughter marries—to provide her with a home. A lot of parents feel this way. But then there is another aspect I discovered that is entirely new, which is this whole campaign [concerning] *shengnu*, the leftover women, [which] feeds into this new economic inequality caused by the real estate boom. Because of the intense anxiety about getting married, there are quite a few parents with daughters who contribute money to purchasing a home. But, they don't insist on their daughter's name being added to the deed.

> They're afraid they won't be able to find a husband if they rebel against this

It's really important to look at the real estate boom and the subsequent accumulation of wealth because it's unprecedented in history. Ever since the mid-2000s home prices have escalated exponentially, so now according to HSCC, residential property in China is worth over $30 trillion. That's a staggering accumulation of wealth in a very short period of time. But who is getting all that wealth?

Basically, the data, the large-scale quantitative data that exists, indicates that this wealth in the form of property is largely earned by men. And my own smaller-scale, non-random survey looking at why this happens, all the different mechanisms of why women leave their name off the property deed [and] how the women contribute to the purchases of property. A 2012 survey by Horizon Research found that over 70% of marital homes purchased in the top four cities—Beijing, Shanghai, Guangzhou and Shenzhen—were financed by the woman or the woman's family. Yet only 30% of those home deeds included the woman's name. And that's also consistent with a government survey, the third social survey on the status of women in 2010, [which found] that most properties are in men's names. I found many young women contribute their entire life's savings, and they take it and finance this marital home, even before they're married. In many cases they're simply giving the money to their boyfriend to buy a home which is only registered in the man's name. And it's really—I argue—intimately connected with marriage anxiety. Because why would so many very educated, extremely intelligent women who know a lot, why are they not looking out for their own economic interests? And one of the big reasons is they're afraid that they won't be able to find a husband if they rebel against this unequal financial arrangement.

*Q. After launching your research, to what extent were you really surprised by what you found and to what extent were your expectations met?*

A. The catalyst for my research direction was that China issued a new judicial interpretation of the marriage law in 2011. And this new judicial interpretation said that whoever's name is not on the property deed doesn't get the marital property in the event of a divorce. I wanted to find out more about the effects of that new interpretation. I was extremely surprised when I found out how widespread this practice was of women transferring their assets over to their boyfriends to buy a home and then not registering their name on the deed. And not only that, parents are also putting pressure on their daughters to help their male relatives. If they have a brother, they want the daughter to help the brother buy the home. I found examples where only-daughters [were] helping the male cousins buy a home, instead of investing in homes themselves. These patterns are very shocking to me, but a lot of people consider this to be just unremarkable. There is a growing minority of women who do own property in their own right, and I hope that in the future more and more women are going to recognize the importance of owning their own property.

*Q. How does the media messaging targeted at women in China contribute to the mindset that is responsible for women forfeiting their property rights and ownership?*

A. As for the *shengnu* media campaign, [it's] a backlash against tremendous education going to Chinese women over the past decade or two. Women now are much better educated than ever before in history, and they're outperforming men at the university level. But there are a series of measures that are being introduced by the government that hold back [the] success of women and promote men instead. For example there are gender-based quotas that favor the admission of men to certain university programs because the Ministry of Education said that it was in the national interest to have more men in certain fields than women. And as for marriage pressure, there's this sex ratio imbalance, but the surplus men in the population tend to be rural and uneducated, and it's the educated urban women who are fitted by the government [to be] the high-quality people. Those are the women that the government wants to have children for the future of the country. The State Council explicitly said this in 2007 in its population decision: "China has to upgrade population quality" The government in China now is much more concerned about marrying these women off than [they are about] having them succeed in the workforce. And the reason why they want the women to marry is so that they can have a child, or two, for the good of the nation, because these children are considered to be higher quality. The notion of quality, *suzhi*—part of it is genetic makeup, but part of it is education and upbringing. In fact, there used to be a draft law called the Eugenics Law [but] they renamed it the Maternal and Infant Health Law.

*Q. Logically how does that figure? How on one hand can the government acknowledge that education is a primary factor in the determination of population quality while on the other hand simultaneously deterring them from pursuing said education?*

A. I think that it's just a very mixed bag of policies. I look at the policies they're developing, and the leaders are not concerned about removing talented women from the workforce. They are very concerned about the future, the population in China and its ability to make China a strong, powerful, country. It's part of their policy that China needs to produce higher quality people, and obviously that means through children. So they're not concerned about losing educated, talented women from the workforce now, they're more concerned about getting those educated, high-quality women to marry and have high-quality children who will help build the Chinese economy in the future. But there is a complete oxymoron there. It's not going to make sense in the long term if labor force participation among women continues to decline, then that obviously is not going to help China compete globally either.

*Q. Speaking to economic goals, certain global companies have recognized the importance of women owning more of the top decision-making process, and correspondingly the need to be proactive in creating more of a gender balance in the boardroom. To what extent do you see that kind of proactive mentality taking shape in Chinese firms of comparable size?*

A. I've looked a little bit [at] women in companies—there's not a lot of reliable data on that, and some of the data is flat-out wrong. So just to give you an idea, Grant Thornton did a survey and they claimed that 51% of senior managers in China are women, and that survey is severely flawed. They're not looking primarily at Chinese companies, and it's kind of a small sample. If we're looking at Chinese state-owned enterprises (SOEs), which are really the peak of the economy, women are dismally represented at the senior level. And the last study done several years ago showed that only one out of 120 centrally administered SOEs is led by a woman. But then in multinational companies that are led by foreigners, they tend to value the contribution of women more. This is not the focus of my research, [but] I spoke to an analyst from McKinsey, and he tells me that they had so many extremely qualified women applying for the jobs at their company. Why were there so many more qualified women than men? He said the Chinese companies didn't want to hire the women. There are other studies showing that there's very rampant gender discrimination in hiring among Chinese companies. According to the UN Women, there are many, many more male college graduates who have a job lined up before they graduate, many more than women who are graduating from college. But women are outperforming men at the university level, so it doesn't make sense that more men have jobs than women when they graduate, unless there is rampant gender discrimination.

*Q. So in that case, would you say that the relationship between foreign enterprises and educated Chinese women will become increasingly important?*

A. Just from my own peripheral observation, if I were to give career advice to young women graduating from college, or from a Masters degree program, or a PhD, I would strongly urge them to look at foreign companies. My hope certainly is that Chinese companies are going to value women, and there is just a really broad and deep epidemic of former gender discrimination. There are so many anecdotes I've heard from women trying to get jobs, and then also from employers hiring at Chinese companies who are screening out women because they're afraid that the woman is going to get married and have a child. They're routinely asking questions in job interviews—"Well, when are you getting married? What are your plans for having a child?" The assumption is that if a woman is getting married, then she's going to want a child, and if she has a child she's going to miss work. There's another issue which is China's law mandating maternity leave for women. [Maternity] leave only applies to mothers, it doesn't apply to fathers. So employers look at that law, and the specifics of the law prevent a lot of employers from hiring women of childbearing age because they don't want to have to pay for the maternity leave.

# Becoming Indispensable

## Allen Wu, chip designer ARM's Greater China President, explains how the company is navigating China's increasingly treacherous environment for foreign companies

By Suzanne Edwards

Since May, the Chinese government has been urging many state agencies and state-owned enterprises (SOEs) to reduce or cut entirely their use of foreign tech providers. The orders have impacted firms from Microsoft and IBM to internet security provider Symantec. Yet in this tense climate, UK-headquartered semiconductor manufacturer and designer and Intel rival ARM is actually seeing more opportunities open up. With key foreign customers Apple and Samsung playing hardball in China, and newer customers in the domestic mobile device market like Huawei, ARM is engraining itself in the very fabric of China's mobile market, according to Allen Wu, Greater China President for ARM, which derived 26% of global revenue from the region last year. ARM lays claim to the architecture in 95% of the world's mobile handsets, and according to IDC, the company will hold 13% of the PC chip market by 2015. Wu explains how his company achieves this and gives his thoughts on what mistakes foreign tech firms are making in China.

*Q. The global semiconductor industry appears to be staging a rebound after really suffering from the financial crisis. Do you agree with that assessment? How do you see the Greater China region fitting into that global semiconductor ecosystem?*

A. From an overall industry perspective, clearly we have seen some drivers that are actually driving some growth going forward, and actually have already driven a lot of growth in the last four or five years since the crisis. The driver primarily comes from the consumer perspective. China represents the emerging market, along with its ecosystem and so on, whereas the internet is sort of like the prevailing force that kind of levels the playing field a bit, in terms of information and everything. These are probably the leading drivers. But specifically to the semiconductor industry, I would say that number one, if you look at the China or emerging market angle, you've got a huge growth of [a] new class of consumers. Certainly these consumers today may have a spendable income relatively speaking lower than their counterparts in the West, but how the greater China electronic system or IT system is set up, is that they find ways to hock down the system, and make it so efficient that actually it's quite affordable to these people. For example, if you look at the majority of the smartphones sold in China, the biggest smartphone is actually in the RMB 700 [price range] or below.

*Q. So Xiaomi phones, for example?*

A. Yes. You've got a consumer aspect. And the second aspect, how that reflects to the semiconductor industry, is [the] interesting bit, is that because it is really consumer driven, so its lifecycle is actually fairly fast. You throw your phone away every year. And even the pad, the tablet, you buy it and a year and a half later [the next generation] is so much better and essentially it's pretty much the same price, I'm just going to upgrade, right? You see a lot of that happening. That means two things. One is that the market itself is expanding, because of the cycle. Two [is the] consumer experience or taste or whatever, they are pay-scale driven, so IT is very diversified. Probably for the first time in the history of IT or electronics, this is like selling a handbag. It could be the RMB 30 one off the subway station, or it could be $30,000. Consumer demand is just very long tail, it's very fragmented. So in turn, that actually drives the growth of semiconductor industry.

*Q. How do you, as a semiconductor manufacturer, stay flexible between the bread and butter of serving high-margin, high-end products such as the iPhone and iPad and the large swathe of cheaper smartphones hitting the market?*

A. That really cycles back to fundamentally how long-[game] the business model has been. ARM's business model is about taking [a] percentage. We take percentage of whatever your component is going to cost. The iPhone is probably four or five times more expensive than the regular phones in China. But from our perspective, our model is that we take a percentage of the final chip [used in a phone]. We take a cut of the value we produce. Frankly, we can either get it at the higher-end margin, lower volume, [or actually which we prefer] is whatever your price, bigger volume the better, because we take [a] very, very small portion… we are taking probably a couple of percent [of the final cost]. So from that perspective, we look at the volume. We didn't really intend or target the [smartphone] area. What we do is we say, "Okay, let's provide a fundamental piece of technology platform and let's have a model—you know what, they're [a phone maker is] going to make it big if they're successful, and we're going to take a small cut of that". It's a model that's so consistent, they go, "Okay, even if I become really successful going forward, I know I only still have to pay a small percentage to ARM." So basically there's really no need for me to look for another alternative. Because whatever alternative there's going to be, [there] isn't going to be that much cost difference but it's actually going to take away a lot of value.

The first thing you should never do is assume your technology is so advanced that you're going to trump everybody… tech barriers are reducing everywhere

*Q. Given the ongoing problems of protecting intellectual property (IP) rights in China, what measures does ARM take to protect itself when taking on a new client?*

A. Before we deliver the product as part of a contract we do conduct an IT audit. I mean, obviously it's not a very extensive audit, but we do have some IT requirements that they have to put in place in order for us to deliver the intellectual property. Most customers are very accepting of that because again, they want to protect theirs [IP], so normally they already have something like this in place. The second aspect of it is, in our business model, [it is that] in order for you to start a project you need to invest a lot of money, and whatever you pay ARM is [only] a small piece of it. When you are successful, you need to ship millions, or tens of millions or even hundreds of millions [of units] to make a lot of money. So in that scenario, if you are so successful shipping tens of millions… paying ARM a bit is probably the last thing they worry about. We are fortunate in that sense, that we're so small, essentially it doesn't really pay to really have an IP problem with ARM. The risk and return just doesn't come out at all.

*Q. In that sense, is it kind of an equal consideration between Chinese companies and foreign companies?*

A. Yeah, we have equal consideration, and it's really interesting, our partners, our customers want it that way too. They figure, we have a property license in ARM, so [they think], "I'm not going to tolerate anybody even thinking about having a kind of backdoor whatever." I mean business is business, there's no difference really.

*Q. Do you see mainland China catching up in terms of the design talent?*

A. I think they are catching up, but they still have a gap. There's a 15-year gap that's not easy to overcome. Now, the interesting bit on that is that in China the talented engineers will go on the management track, because of the lack of deep experienced people. Whereas Taiwan, it's long enough that there are a lot of senior engineers that are technical track. ARM's business is not doing entry-level stuff, it's doing fairly advanced, I would say probably the most challenging part of the device. What we want is really a lot of experienced, talented technical-track people. It's much easier to find in Taiwan because of that situation.

*Q. Recently there has been official pressure on Chinese state-owned enterprises to curtail the business they do with foreign tech companies. Do you feel any blowback from this?*

A. We are actually not impacted by that very much, for two reasons. One is our business model is about enabling and leveling the playing field, and we've been talking about this message for the last six, seven years, probably even longer than that, how we as a technology company enable new developments, especially people focusing on Taiwan, China. So that model lends itself to that. We've had a fairly close engagement with relevant ministries on that aspect. From our point of view we are not viewed as being a problem, so to speak, at this point.

*Q. Your model is to be a key part of the value system and level the playing field, but a level playing field does not seem to be a priority for the government as they apply pressure on foreign firms, but rather to boost Chinese businesses. So how do the two fit together?*

A. In the end-part services [sector], you see some of that. So what we do is provide the technology platform and the framework. They need us to get to that end product. Relatively speaking, in the chip design business, the Chinese industry is still behind North America and Taiwan, from capability and market share and everything else. So without us it would be like shooting themselves in the foot.

*Q. Well, as we saw in May with the ban on ties between US consultancies and SOEs, it is not outside of the government's capability to make a decision that is seemingly not self-constructive. So again, wouldn't ARM need a contingency plan in such an event?*

A. There has been a consistent effort to try to build something in parallel, indigenous. And honestly I think this probably will still go on, and I understand that. There is a sense of need for a big country like China to say, "I have to have the same thing everybody else has." But we don't worry about that. So what we do is we actually go engage with our partners in industry and make them successful. If they're successful and your entire industry [finds it] easy to work with you to run their business, you're going to be there. In fact, [we've] seen recently since this year a loosening up [in] policy, allowing ARM into more spaces, into electronics and into industry sectors. So from our perspective, we actually see improvement over the last few years. But it's not easy. They had a policy which restricts us in certain spaces, in some government funding [procurement], but they realize that actually having us in there is much more beneficial than keeping us out, it just takes some time.

*Q. That seems like a fairly big accomplishment, getting to the point where you are seen as indispensable in the value chain. What's a tangible example of how you really make yourself indispensable?*

A. I use the example of a server business. China always wanted, for good reason, to have the ability to design advanced server chips so they can have their own servers, and given quality and everything, the server is such an important piece [of equipment] and given the [information they store] it's probably even more sensitive. So what we do is we—and there is concern on relying on ARM if one day ARM pulls out—actually [grant] licensed local companies the right to design their own microprocessors, [so] even if ARM does not supply, they can design their own. We give them a license such that whatever they design, it's fully compatible with the current ecosystem. So they do have a sense, yes, [of] "I do have control of my own destiny." Working with partners in China, it is important to make sure they understand they do have control of their own destiny. Economically, [doing it on] their own might not make sense, but they do want a sense of the ability to move on if we were no longer there.

*Q. What goals would you say ARM is helping the government to achieve?*

A. We help them achieve a couple of goals. Number one, you probably hear this all the time, in terms of dollars they spend more money on the chips they import than they spend on oil. So they want to enable a local IT industry. I would say China wanted to have a CPU [central processing unit] business forever, and the government funded a gazillion projects [yet] the only time they finally have an attraction worldwide on a significant percentage of CPUs is on the tablets and on smartphones.

*Q. In the semiconductor sphere, what kind of mistakes do you see other multinationals making?*

A. I think the first thing you should never do is assume your technology is so advanced that you're going to trump everybody and you can live off that. The technology barriers everywhere are reducing rather than increasing. Never underestimate the ability of local companies to get there. Not only because of how the society is [today], but for example, today Huawei is able to recruit global talent. So I don't think there will be any barrier from technology perspective on that issue because today the increase in technology really resides with people and talent, rather than a specific infrastructure. And the other thing is engage with the government, understand what they want to achieve. The policy is just a reflection of certain goals they want to achieve. You just need to figure out, okay, that's the goal they want to achieve, and the policy may not work out for you, [so] what can you do to help them achieve their goals while maintaining or growing your business? That's a challenging balance.

*Q. Of all the mainland companies, if there is a contender that could enter ARM's competitive sphere, would it be Huawei?*

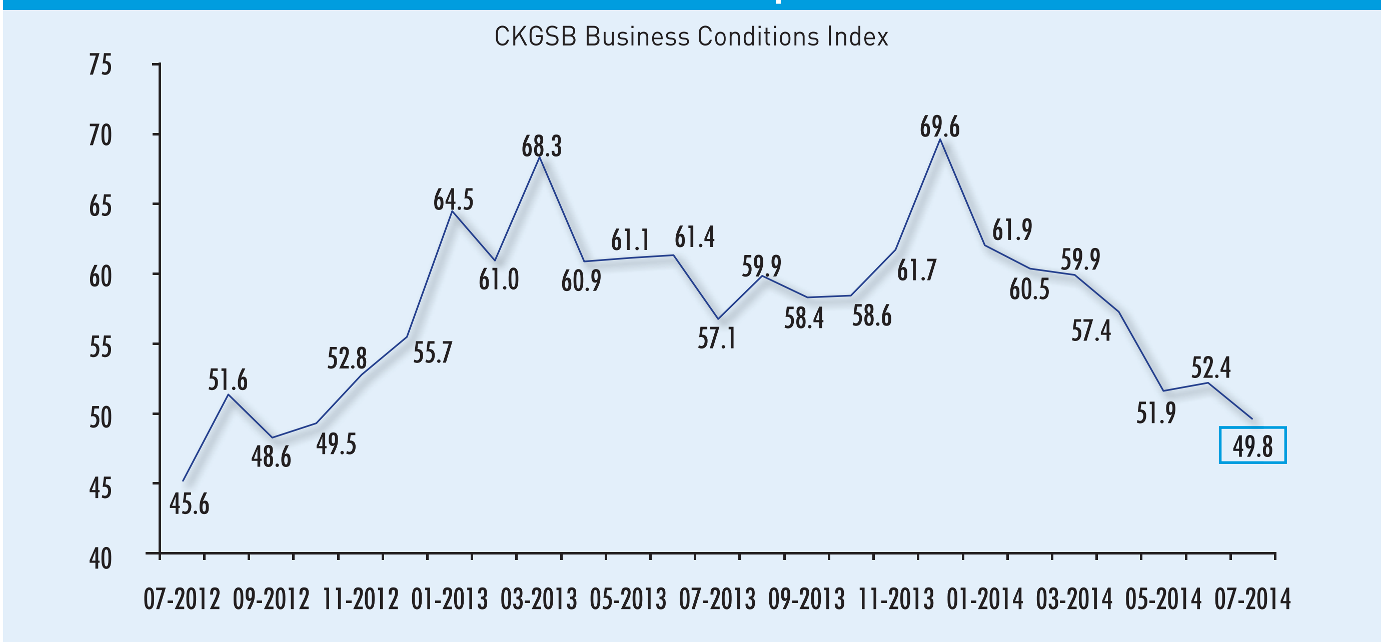
A. No. Huawei is one of our biggest customers in China, and actually [we] are supposed to be strategic partners, and we are in every single of their product lines. So frankly, I don't see anybody at this point. Because this CPU business is such a difficult business, in terms of not just technology, I think that piece is relatively overcomeable, it's that you need a global ecosystem support. It takes probably 20 years to achieve that. We are fortunate to get there. If you look at it 20 years or even 10 years ago there were so many CPU companies, and they all fell by the wayside. Essentially now it's just Intel and ARM.

# Buckle Up

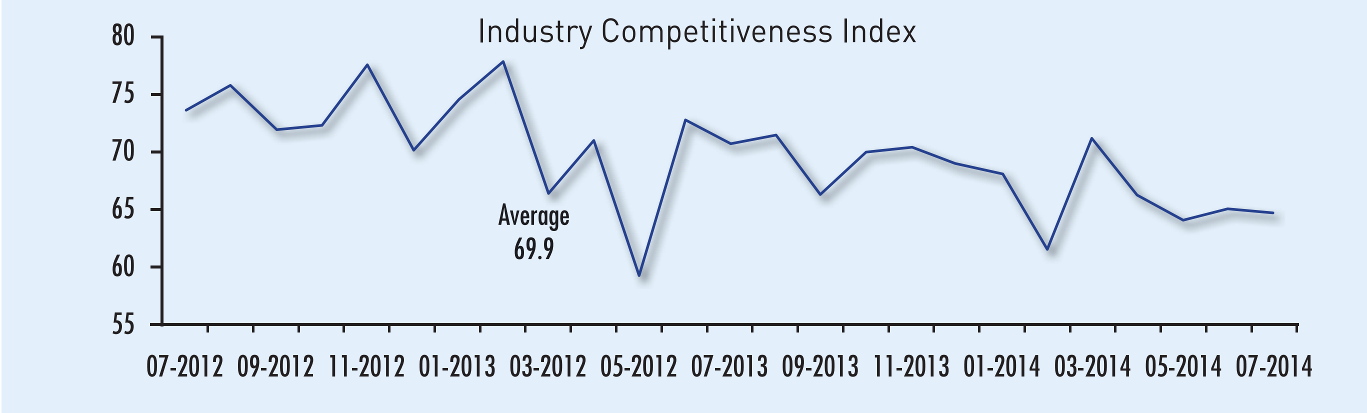
## China's entrepreneurs are settling into their negative outlook on the country's business conditions

Business sentiments in July continue to weaken, breaching the threshold between confidence and a lack thereof. Each month CKGSB's Case Center and Center for Sustainable and Inclusive Growth conducts a survey of leading entrepreneurs in China to gauge and track changes in their business sentiment. The result is the CKGSB Business Conditions Index (CKGSB BCI), directed by Li Wei, Professor of Economics and Emerging Markets Finance, and provides a barometer on the state of the economy as viewed by China's entrepreneurs. For the first time since November 2012, the CKGSB Business Conditions Index, or BCI, has dropped below 50. At 49.8, July's BCI falls just on the downside of the threshold, indicating falling confidence in China's business conditions over the next six months. In the past few months, the BCI has shown a clear downward trend, consistent with China's economic slowdown. The government's "mini-stimulus" policies, including further investment in railroads, will have impact, but to what degree? Will the government's efforts have a positive effect on financing for private industry? In the questionnaire respondents indicate whether their firm is more, the same, or less, competitive than the industry average (50), and from this a sample competitiveness index is derived (see Industry Competitiveness Index). Consequently, as sample firms are in a relatively strong competitive position in their respective industries, so CKGSB BCI indices are higher than government and industry PMI indices. Users of the CKGSB BCI index may thus focus on data changes over time to forecast trends in China's economy.

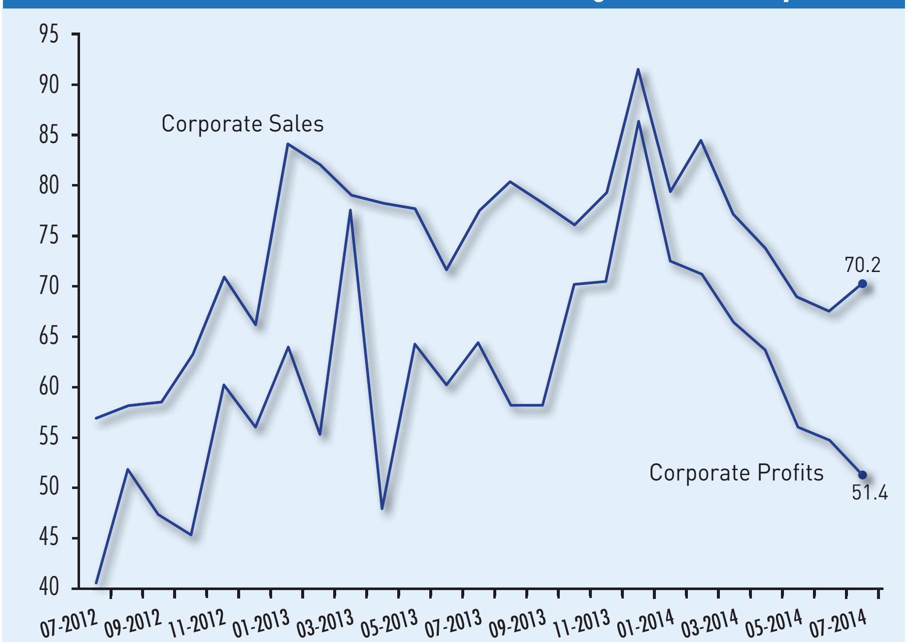
**Time to brace for impact...**



## ...no matter how much the situation looks like it is improving



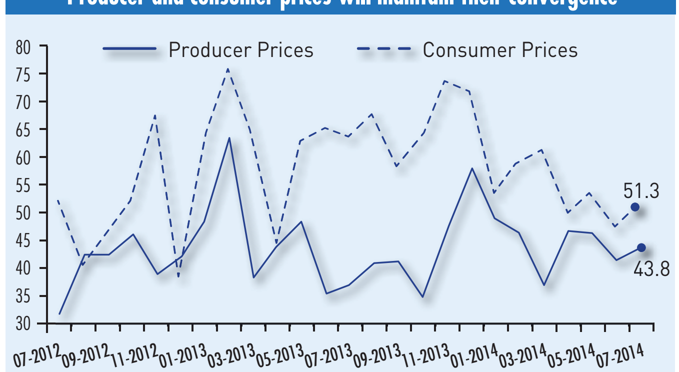

## Profits will continue to fall even as sales begin their recovery...




Of the BCI's four sub-indices, only the sales index has risen since last month, from 67.6 to 70.2, showing that firms believe sales growth will recover in the next six months. July has seen the profit index fall from 55 to 51.4 (see Corporate Sales and Corporate Profits), illustrating this quarter's downward trend. The labor costs index rose from 87.9 to 89.0 and the overall costs index fell from 85.3 to 83.5. The costs indices have been consistently over 80 for a long time, painting a picture of soaring costs (see Labor Costs and Overall Costs). The consumer price index has risen somewhat, from 47.4 to 51.3, showing firms expect consumer prices to rise, perhaps slightly, in the next six months. Producer prices have also risen, from 41.6 to 43.8, but have remained below the confidence threshold for some time, indicating that China's overcapacity issue has yet to be resolved.

## ...while overall costs will ease slightly


## Producer and consumer prices will maintain their convergence

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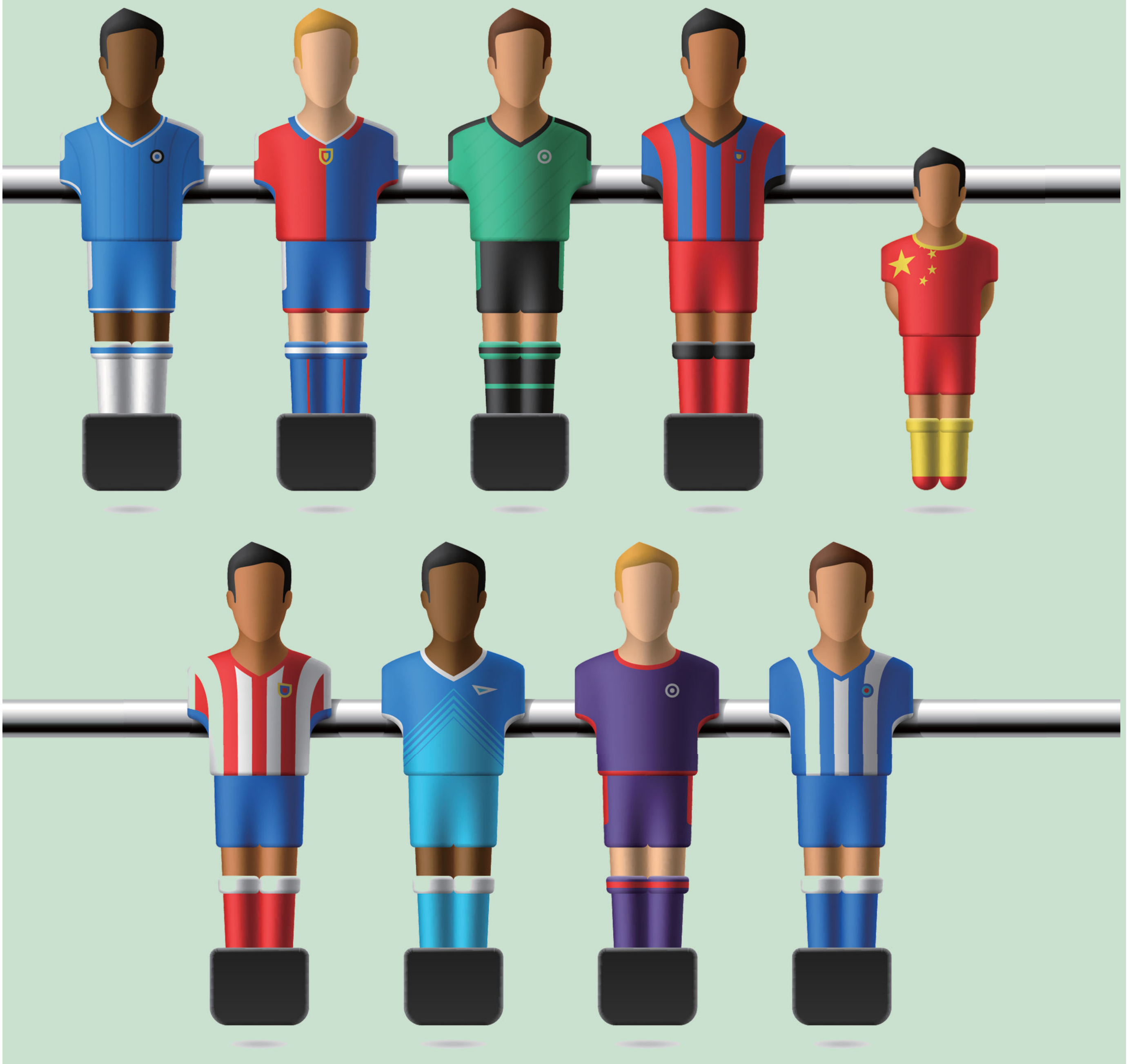
# A World Apart

## Can China turn around its soccer fortunes, and will fans be on board?

By Colleen Howe



It's 4.30am on a July weekday morning at Foreigner Street, a bar district in the upscale Hongqiao suburb of Shanghai, and more than 100 Chinese football fans have stayed up to watch a FIFA World Cup soccer match. Sitting in a tent that slowly gives in to the baking effects of the morning sun, the fans cheer loudly as the goals fly in. But swathes of red with sprinklings of yellow stars, indeed the colors of China, were nowhere to be found—instead the venue was enveloped in the red, black and yellow of the German national team and a handful of Brazil's yellow jerseys. The crowd resounded chants of "*Deguo!*", the Chinese word for Germany. By the end of the night the Germany fans were posing for pictures in front of the giant screen, timing the snaps to ensure they captured the faces of their soccer idols displayed behind.

It would be an unthinkable scene by the standards of any country with a half-decent soccer team, but in China it has somehow become the norm. This was underscored by the mortifying defeat of the Chinese national team at the hands of Thailand's under-23 squad a year ago. But in fact this earlier defeat was only a symptom of problems that had been festering for much longer. Since China failed to score a single goal at its erstwhile World Cup appearance in 2002, the national squad has become something of a national joke.

Germany are the most popular foreign national team in China

## Fickle Fans

Jack Hu, cheering on his local team at a recent Shanghai Shenhua vs. Beijing Guo'an match, says he would never support the national team—even if they made it to the World Cup. "I hate China's soccer system," says Hu, who favors Spain. "I only support Shanghai Shenhua." His friend, who preferred not to be named, explains that the national team was too politicized, detracting from the purity of the game.

Some fans, who would otherwise support the team, cite more banal issues, such as a lack of funding. "It's a systemic problem. Many [local sports] clubs don't have money," says Kevin, 30, a manager at US-based fashion retailer Forever 21 in Shanghai. It is difficult to sustain local soccer programs in cities where land is at a premium and the average consumer is hesitant to shell out several hundred renminbi a pop for tickets.

Others blame social expectations. Daniel Xu, 26, who works in insurance operations, says that because parents expect kids to spend all their time studying, "they don't have any time to enjoy soccer and that kind of thing. So academic pressure is a big problem."

It's not a secret, either, that Chinese soccer has acquired a reputation for corruption. In 2012 the marketing director of Nike China allegedly bribed Chinese Football Association head Xie Yalong in order to secure a sponsorship deal. Even worse, accusations of match-fixing have shaken fans' faith in the integrity of the games themselves.

Still, it's unclear whether cleaning up the game would make a difference to fans who, unlike many European soccer buffs, aren't bound by home country loyalty. Instead, they choose teams with a proven track record—teams that will make them look good by association. "Their point of engagement is not socio-cultural identity necessarily. Their point of engagement is success, it's conspicuous consumption. It's choosing a team that is doing well, which confers a particular status upon them," says Simon Chadwick, Chair in


Sport Business Strategy and Marketing at Coventry University Business School and long time researcher of soccer in China.

### Training Up

Slowly but surely, things are starting to change. Like many Chinese citizens, the Chinese government also sees the soccer program as something of an embarrassment—an economic superpower that can't even best a bunch of Thai teenagers.

Chinese leagues have spent millions of dollars putting band-aids on the problem. They have brought in star international coaches like the legendary Serbian Bora Milutinovic and Jose Antonio Comacho of Real Madrid, and regularly recruit foreign players, thought at times unsuccessfully as was the case with Shanghai Shenhua's failed recruitment of star Ivory Coast striker Didier Drogba, who left the team after half a season.

> Their point of engagement is not social-cultural identity, necessarily. Their point of engagement is success.
>
> Simon Chadwick
> Chair in Sports Business Strategy
> Coventry University

But a major barrier to World Cup glory is the lack of a domestic soccer culture to get kids on the field early. What most people don't understand is that star soccer players need to begin technical training before the age of six, says Tom Byer, Head Technical Director for the Chinese School Football Program. "Believe it or not, even a lot of governments and educators don't really understand how you actually develop players," he says. "They think it's about the professional league—put more money into that, bring foreign coaches to coach the players." But the country isn't going to get ahead internationally "unless you really put a major investment into the younger kids," he warns.

The Chinese School Football Program, a government-sponsored grassroots soccer education program launched in 2009, is targeting that pipeline. So are a number of private programs like the Evergrande Academy in Guangzhou. At Evergrande, aspiring soccer players train in both sports and academics, assuaging parents' fears that the game will prove distracting.

The academy is the brainchild of Xu Jiayin, a property tycoon who bought Guangzhou Evergrande in 2010—and some say this strange marriage of real estate and sport could represent a new model for Chinese soccer. Evergrande was just another struggling local football club when Xu Jiayin took the reins in 2010; by 2013 it had rocketed to the top of the Asian Champions League. Most recently Jack Ma, CEO of e-commerce giant Alibaba, announced he was jumping on the bandwagon with plans to buy a 50% stake in the Guangzhou team.

In a country where soccer clubs have struggled to find a viable ownership structure, some see these property and tech moguls as providing just the right mix of capital and entrepreneurial spark. "Obviously China has a history of politicized soccer, whereas now potentially the country is on the cusp of commercialized soccer. So in one sense this really is a difficult situation for them, but in another sense… it's an amazing opportunity," says Chadwick.

Still, strong club teams don't necessarily equate with a winning national team, and it will take one or two generations to create a system capable of sustainably producing domestic talent. That means many soccer fans won't be stocking up on national team jerseys just yet. But as China sets out on the long road to the top, there are at least a few loyal followers who will be there every step of the way. When asked if he would support China if the nation managed to field a World Cup team, Kevin adds, without hesitation, "Of course. I'm Chinese!"

# Playboy and TMZ, the Stuff of Experts

**Shaun Rein skewers conventional China authors and tells us how to vet China books**

I was still a teenager when I arrived in China in the mid-90s to study the language at Nankai University in Tianjin. I was drawn in by the electric optimism in the country, but even more so by the fact that what I found here was completely different from the way China was portrayed in the American media. Being a teenager I had no idea what I wanted to do in the future but I figured it would always be important to learn about China. I later studied economics in college, but for me economics was just a way to try to understand how ordinary Chinese people live.

Unfortunately, media coverage of China hasn't improved. Many journalists still don't speak, read or write Chinese. It's pathetic that top-tier publications need news assistants to translate. Another problem is that there are people in the US who lived in China for one year 10 or 15 years ago and are considered China experts. Recently MSNBC had someone from *Foreign Policy* who graduated from Harvard a year ago talking about China. He had no idea what was going on. I called him out on Twitter, and the response was that he was an Israeli specialist who somehow was brought onto *Ronan Farrow Daily* to talk about China. These people are part of the problem—not because they're stupid, but because they're uneducated and unexposed to China.

In terms of vetting China books, my first rule is never read a China book by anyone who hasn't spent at least five years here. Take James Fallows, author of *Postcards from Tomorrow Square*. He came in admitting that he didn't know China and I like that, as sometimes someone with fresh eyes can see something new. But from years two to five he somehow positioned himself as a China expert. I don't think you can become an expert in just five years, especially if you don't speak the language. Then after five years he left and wrote his book using mostly English language sources.

The second rule is don't write like you're an expert in something if you're not. Another one of my least favorite people here is James McGregor, who wrote *No Ancient Wisdom, No Followers: The Challenges of Chinese Authoritarian Capitalism*. He has said that the GaxoSmithKline episode was an act of protectionism and a way to show foreigners who's boss, but that's really not the case. The crackdown on corruption, similarly, is not a factional fight. It's about learning lessons from the Soviet Union and targeting the issues facing Chinese people today—healthcare, food and day-to-day corruption.

The best book I've read on modern China is *Operation Yao Ming* by former *Newsweek* journalist Brook Larner. It describes the difficulties Houston faced in getting Yao Ming to join the NBA against opposition from the Chinese Basketball Association. More importantly, it explains how that opposition stemmed from Yao Ming's parents' denouncing the head of the Shanghai Sports Bureau during the Cultural Revolution. It reveals the ongoing impact of that period. Many people put too much emphasis on viewing China through the lens of Confucianism or power politics.

I also like *Wild Swans: Three Daughters of China* by Jung Chang. I'm a big believer in studying history to understand business and consumer behavior.

For leisure reading I gravitate towards historical biographies—they make up about 90% of my reading. I find them more objective than current affairs, because people aren't trying to make a point to make money.

My guilty pleasure read is *TMZ* because they're brilliant at distilling stories and making them simple and accessible, something I strive for in my own writing. It all comes down to the headline. It needs to be appealing and eye-catching but high-brow enough that you're not overly embarrassed to read it—and rooted in facts. *Playboy* interviews are also great, and surprisingly they're not blocked in China.

Books on China often have the same problem. Unfortunately to get famous you need to have great sound bites, so pundits tend to take an exaggerated view. I suppose that's why I'm not as famous as some of these other guys.

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**Business Bestsellers in the US**

1. The Organized Mind — **Daniel Levitin**
2. Strengths Finder 2.0 — **Tom Rath**
3. Flash Boys — **Michael Lewis**
4. The 7 Habits of Highly Effective People — **Stephen Covey**
5. How to Win Friends and Influence People — **Dale Carnegie**

Source: Amazon.com

**Business Bestsellers in China**

1. Internet Thinking — **Dawei Zhao**
2. You Have a Team, Now How do You Lead? — **Wei Zhao**
3. Marketing is All About People — **Jianwei Ni**
4. The Startup Owner's Manual — **S. Blank Bob Dorf**
5. QBQ! The Question Behind The Question — **John Miller**

Source: DangDang.com