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The Trade Race is On

For both the US and China, trade deals are increasingly becoming an important way to influence the Asian and global order

- Has the government's reform agenda matched progress to promise?
- Will the two-child policy deliver a significant economic boost for China?
- Chinese firms' appetite for foreign assets keeps on growing

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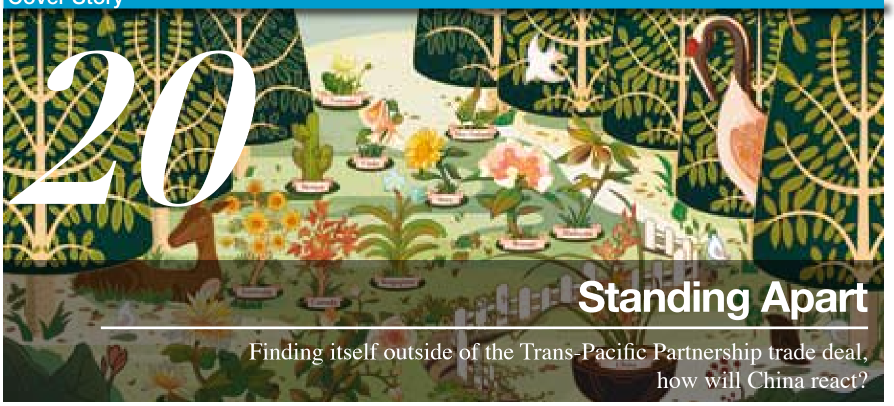

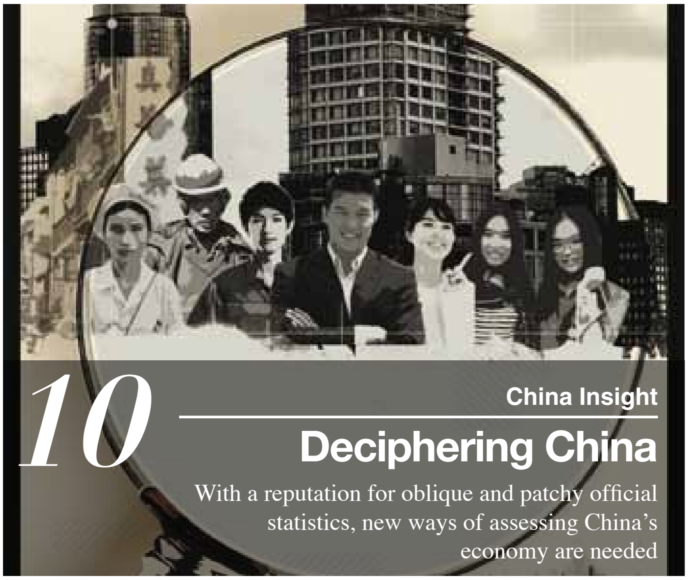

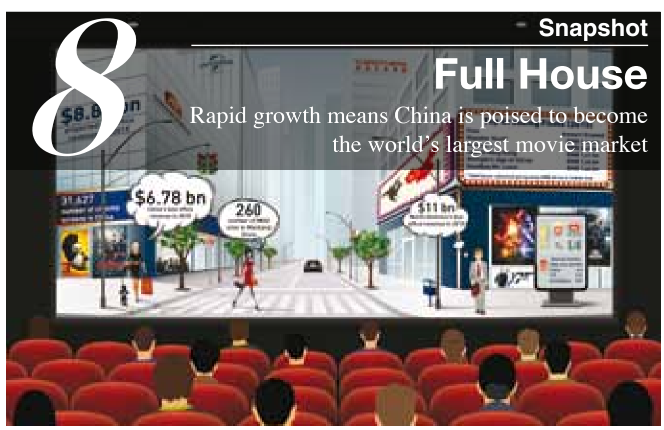

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Will the TPP Succeed Without China?

The recently signed Trans-Pacific Partnership (TPP), in my opinion, may not serve the purpose its key members, such as the US and Japan, aim for if China, the largest trading nation and the second-largest economy in the world, is not a part of it. Ironically, the country that is promoting the TPP the most (the US) might end up being the one that blocks it if the US Congress votes against it. Whether China decides to join the TPP in the future is something no one can quite predict. So what is the prognosis for the short term? Can China's involvement in other regional trade agreements and bilateral treaties be an effective counter to its absence from the TPP? We analyze this and also paint a scenario for a hypothetical situation in which China does decide to join the TPP. For details, turn to our cover story on page 20.

In China, the leaders of the Chinese Communist Party and all the members of the Central Committee convene at least once a year for a meeting called the 'plenum'. Typically, the most important policy and personnel changes are introduced at the 3rd Plenum, or the third such meeting over a five-year period. Under the leadership of Xi Jinping, the Party had its 3rd Plenum in November 2013. It unveiled 60 reform proposals covering everything from markets, social welfare and land reforms. Two years have gone by. Our story titled 'Striking Out' on page 15 takes stock of the progress the reforms have made so far.

Last month, ChemChina, a state-owned enterprise, made what is being called the largest ever attempted overseas acquisition by a Chinese company when Swiss pesticides and seeds manufacturer Syngenta announced that it was going to be acquired for $43 billion. Faced with a slowing domestic economy, the need to diversify their investments and gain better valuations in overseas markets, Chinese companies are buying up assets in Europe, the US, Japan and other Asian countries. How have the Chinese companies' overseas M&As evolved over the years? How have Chinese companies themselves matured in their approach to acquisitions? Are these acquisitions boosting their competitiveness? And what are the key challenges that crop up? We explore all that and more in the context of Western acquisitions in our article 'Making a Meal of It' (page 31).

People like us lead busy lives and are part of the proverbial corporate rat race. We think we can 'postpone' our happiness, but we may end up not being happy at all. In our interviews section we bring you, among others, a very interesting conversation with Emma Seppälä, a Stanford professor and the author of *The Happiness Track*. Seppälä, who has researched this problem deeply, tells us what's wrong with the way we work and how to prioritize things in such a way that we bring happiness back into our lives. I am sure that for a lot of busy executives this theme will strike a chord. To find out what she says, turn to page 61.

I hope you enjoy reading this issue. I look forward to your comments and suggestions (*lzhou@ckgsb.edu.cn* or *ckgsb.knowledge@ckgsb.edu.cn*).

Yours Sincerely,

Zhou Li
Assistant Dean, CKGSB

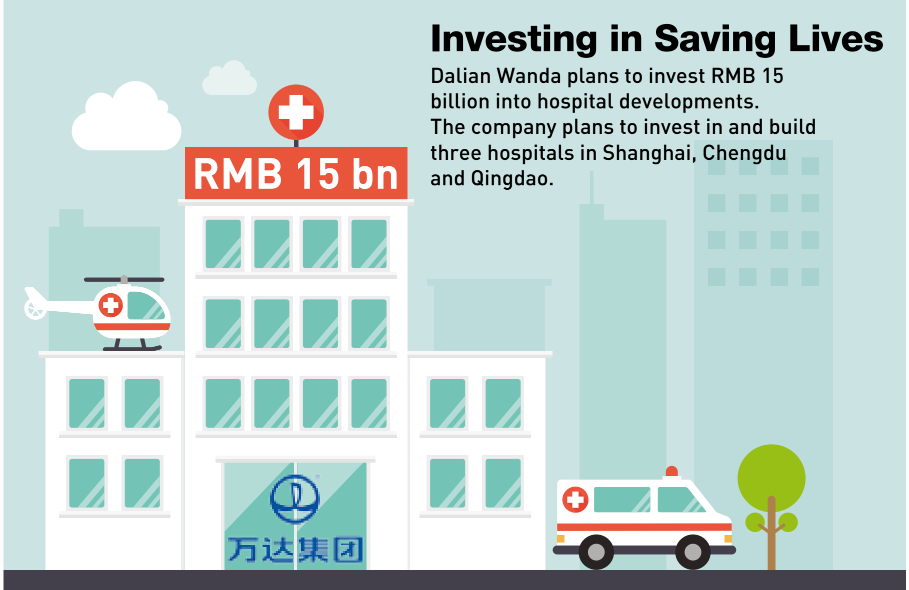
For more insights on the Chinese economy and business, please visit the CKGSB Knowledge site: http://knowledge.ckgsb.edu.cn/

China Data

The stats you need to know

Investing in Saving Lives

Dalian Wanda plans to invest RMB 15 billion into hospital developments. The company plans to invest in and build three hospitals in Shanghai, Chengdu and Qingdao.



Source: *Wall Street Journal*

We Are the 1%

Peking University's Institute of Social Science Survey found the wealthiest 1% of families in China own 1/3rd of the wealth,10% less than the US, where the wealthiest 1% own 40% of the total wealth. The study also found that the poorest 25% of Chinese families only own 1% of the country's wealth.

Source: *The Financial Times*

Homeward Bound

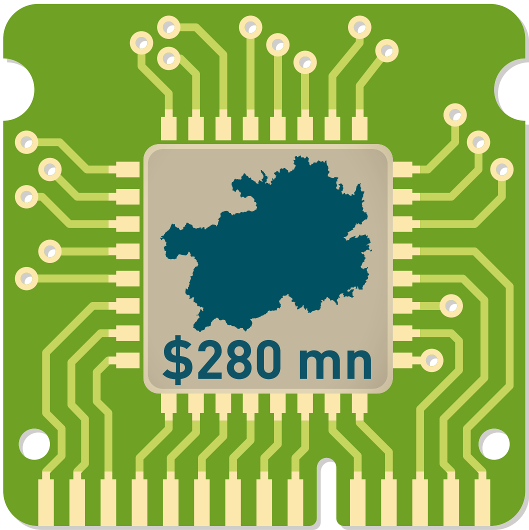
The travel period around Chinese New Year is routinely described as the largest human migration on earth, and this year the Ministry of Transport predicted 2.9 billion passenger trips over the period of Jan 21 to March 3. Inevitably, great strain is put on transport infrastructure and nearly 100,000 people were left stranded at Guangzhou Railway Station after trains were delayed due to cold weather.

Source: *Washington Post, BBC*

Amazing Grains

The US Department of Agriculture estimates that by the end of the 2015/16 crop year, China will hold almost 250 million tons of combined corn, wheat and rice stocks—almost half the world total.

Source: US Department of Agriculture



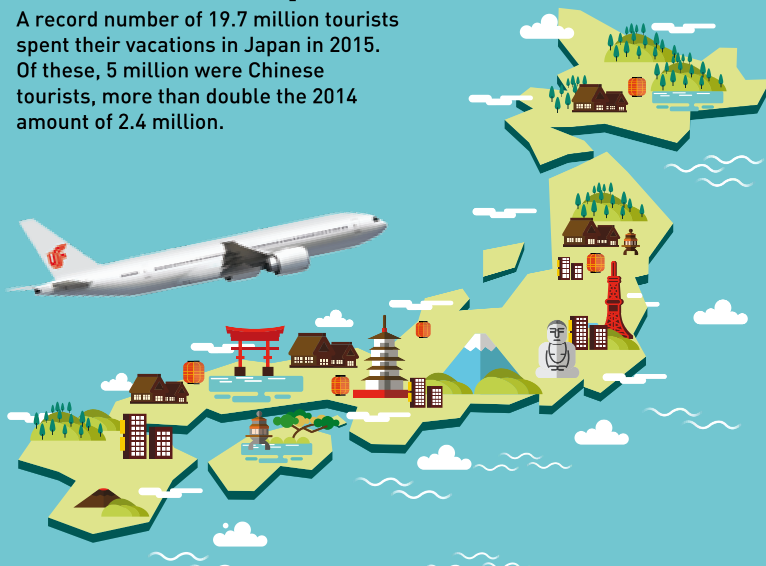
Chipping In

Qualcomm and Guizhou province have formed a $280 million joint venture. Guizhou Huaxintong Semi-Conductor Technology Co. Ltd, as the new venture is called, will be 55% owned by Guizhou provincial government and 45% owned by Qualcomm.

Source: Qualcomm

Welcome to Japan

A record number of 19.7 million tourists spent their vacations in Japan in 2015. Of these, 5 million were Chinese tourists, more than double the 2014 amount of 2.4 million.



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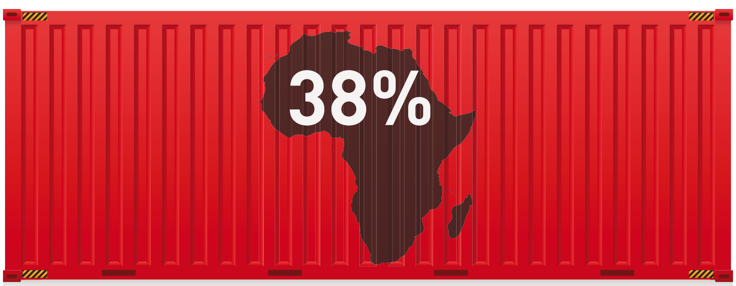
Source: Japan National Tourism Organization



Lighter Containers

In 2015 Africa exported $67 billion worth of goods to China, down 38% from 2014. Conversely, China's exports to Africa have increased by 3.6%.

Source: ***BBC***

Raised Offer

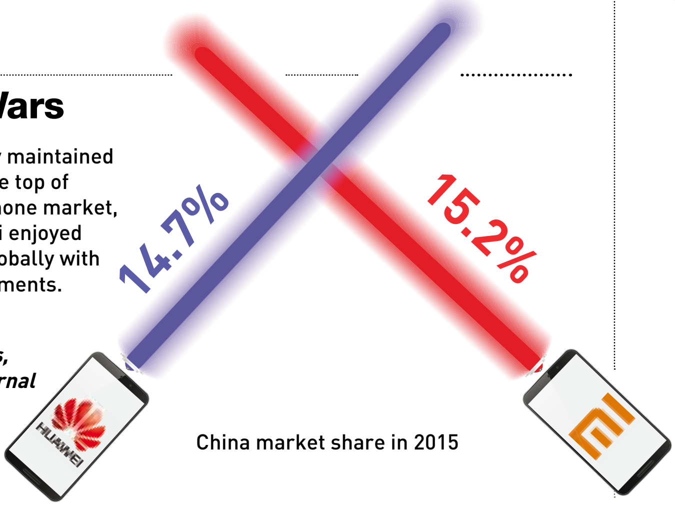
On January 15, 2016, China's Haier Group announced the purchase of General Electric Co's appliances branch for $5.4 billion, $2.1 billion more than the arrangement GE walked away from in early December. The US company announced on December 7, 2015 that it would not follow through with previous plans to sell its appliances branch to Sweden's Electrolux for $3.3 billion.

Source: ***Forbes***

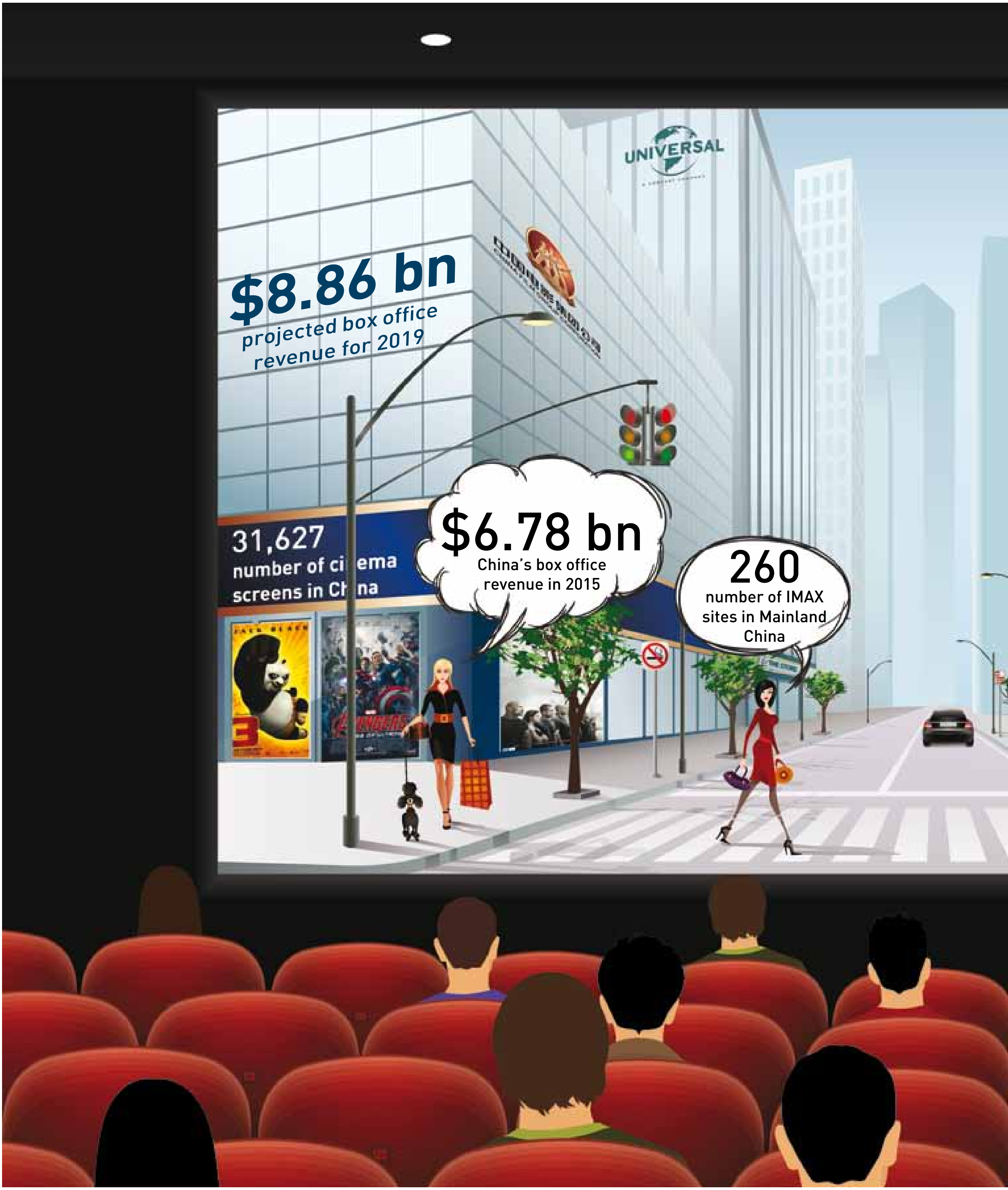
Phone Wars

Xiaomi narrowly maintained its position at the top of China's smartphone market, however Huawei enjoyed greater sales globally with 108 million shipments.

Source: ***Reuters, Wall Street Journal***



China market share in 2015



$8.86 bn
projected box office revenue for 2019
31,627
number of cinema screens in China
$6.78 bn
China's box office revenue in 2015
260
number of IMAX sites in Mainland China
UNIVERSAL


H.BROTHERS
華誼兄弟傳媒
Top Grossing Films (2015)
Film
Amount Grossed
Monster Hunt* RMB 2,44 bn
Furious 7 RMB 2,42 bn
Lost in Hong Kong RMB 1,61 bn
Avengers: Age of Ultron RMB 1,46 bn
Goodbye Mr. Loser RMB 1,44 bn
* Distributor admitted giving away RMB 40 mn in tickets free
$11 bn
North America's box office revenue in 2015
Annual cinema visits per person
China 0.8
US 3.22
South Korea 3.87
STAR WARS

Deciphering China

With a reputation for oblique and patchy official statistics, new ways of assessing China's economy are needed

By Chris Russell

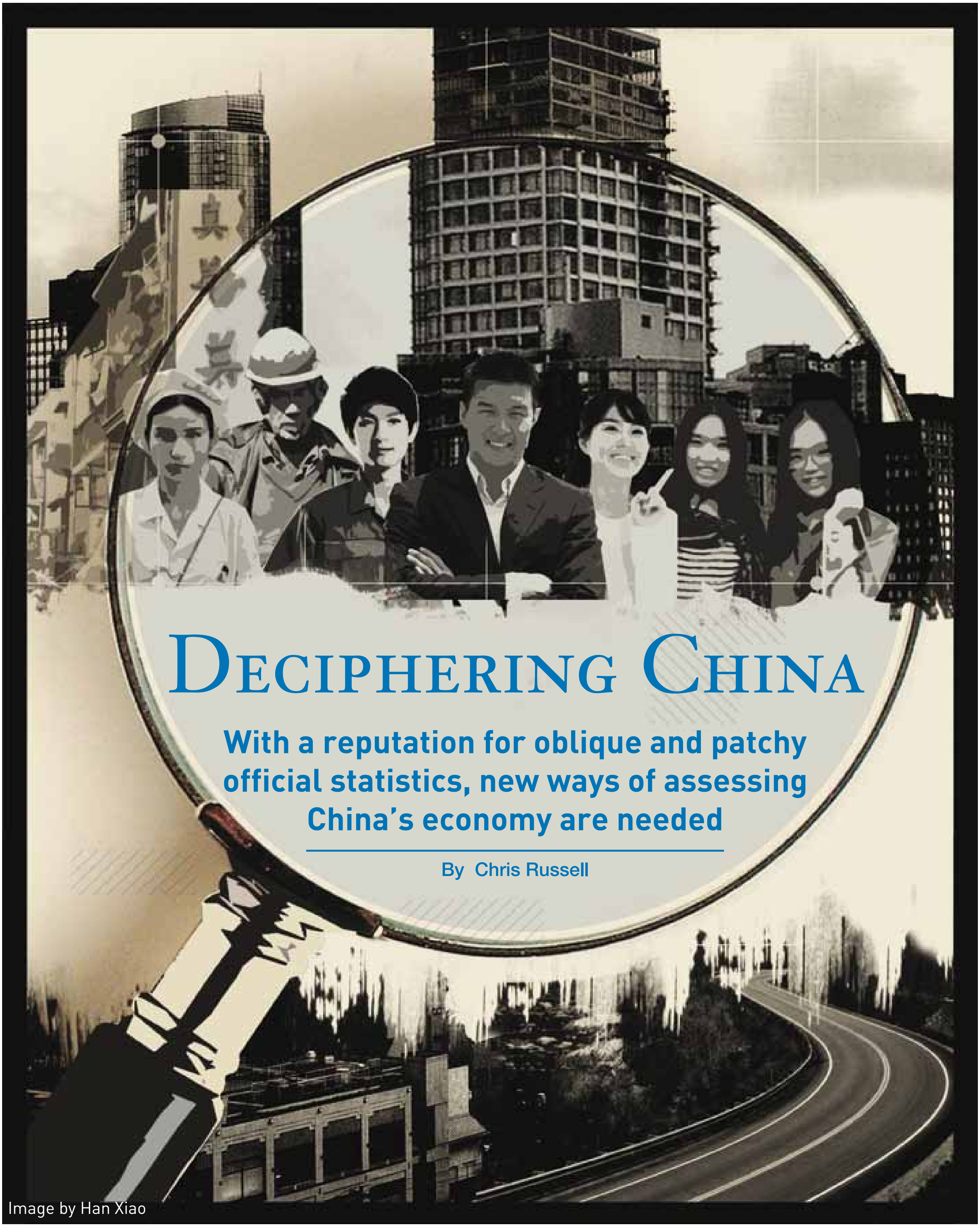


Image by Han Xiao

In previous years as provincial-level GDP data rolled in, China's top leaders and the provinces' respective officials could no doubt take a certain satisfaction from the bountiful increases in wealth displayed therein. But were they to spend a bit more time with the data, such pleasure would likely lead to a state of confusion, if not consternation—the sums, quite literally, don't add up.

Taken together, the total of provincial-level GDP has outstripped the national figure year after year, a problem that has only gotten worse over time. What was once a discrepancy of a mere RMB 1.97 trillion in 2009 had increased to RMB 4.8 trillion by 2014, as shown by National Bureau of Statistics (NBS) figures.

Far from an isolated incident, official Chinese statistics are home to a range of quirks, which, in combination with various gaps in data provided by the NBS, has led economists, analysts and businesses to cast around for other measures of the world's second-largest economy. Never was that truer than last year, when the skepticism surrounding Chinese statistics seemingly reached its peak.

Consequently there has been a rise in the number of indicators that purport to give a true reflection of the situation, and which encompass everything from boutique services, such as the China-focused data analytics firm China Beige Book, through to sales of KFC and movie tickets. Moreover, signs often taken to show a weakening economy, such as falls in the stock market and a weakening exchange rate, are less useful in China—the former bears little relation to economic fundamentals, while the latter is subject to heavy intervention from China's central bank.

But for an economy as complicated as China's, not to mention one growing as fast, obtaining clear and accurate information may be easier said than done. "Because of the size of China, the ability to be absolutely accurate becomes harder, particularly because it's a developing, fast-growing economy," says Matthew Crabbe, author of *Myth-Busting China's Numbers* and Research Director, Asia-Pacific for Mintel. "Any deviation from reality is going to be a magnified by an order of scale."

> "Because of the size of China, the ability to be absolutely accurate becomes harder
>
> Matthew Crabbe
> Director of Research, Asia/Pacific
> Mintel

Casting Doubt

Naturally one of the most contentious statistics is one of the most prominent: China's GDP. And scrutiny has only intensified as growth rates have fallen amidst the country's economic transition, with many wondering whether the official figures convey the full extent of the slowdown—a fact that has led some organizations to issue their own growth rates, some of which are several percentage points below the official figure.

More specific doubts stem from the speed at which the GDP figure is produced, with the initial figure for 2015 being revealed less than a month after the start of the New Year. Hong Kong, by comparison, releases its figure in late February despite having an economy a fraction of the size.

Adding to these concerns is the oft-repeated anecdote that in 2007 China's current premier and then-Party Secretary of Liaoning province, Li Keqiang, dismissed GDP figures as "manmade", according to a US diplomatic cable revealed by WikiLeaks. Such revelations have done nothing to temper beliefs that the headline figure is unreliable, or perhaps even fabricated.

Moreover, in a period where even shortfalls in growth amounting to a tenth of a percentage point are enough to alarm investors and, perhaps more importantly, determine whether government targets are achieved, highly technical debates about the NBS's methodology for calculating GDP have assumed greater importance.

Recent focus has been on the GDP deflator used by the NBS, which adjusts the growth rate for changes in prices, after Capital Economics suggested that this was exaggerating nominal GDP value by claiming China was in deflationary territory.

Calculations published by *Bloomberg Briefs* in September showed that using an adjusted deflator would lead historically to more volatile GDP growth with higher highs and lower lows and, at times, differences of up to two percentage points in either direction from the official figure.

While that debate is by no means settled, there is a more substantive, and perhaps more prosaic, reason for concerns over the accuracy of the NBS's GDP data—an alarming lack of resources. "They have a very, very teeny national accounts division in the NBS—the number of real professionals on national income accounting is extremely limited," says Nicholas Lardy, the Anthony M. Solomon Senior Fellow at the Peterson Institute for International Economics.

Having a national accounts division a fraction of the size of equivalents in other countries would be a big enough problem in its own right, but it is exacerbated by the inherent scope of the bureau's duties.

That lack of sophistication naturally means that the specificity of data can be misleading. "You're getting general trends rather than genuinely fine-tuned data," says Fraser Howie, co-author of *Red Capitalism*.

As is often the case, failures in China's GDP figure may well then constitute more cock-up than conspiracy. "I think [the GDP figure] is the best they can make it," says Lardy. "No one's really been able to demonstrate that they're falsifying the data or cooking the data in my opinion."

Indeed, Crabbe notes that the way China's statistics are assessed don't always fully take into account its developing world status: "Many of the assumptions they make about China's statistics are based on assumptions made from a developed-world point of view." Moreover, Crabbe adds, no national statistics from any country should be taken simply at face value. "There's an inaccuracy in any national statistics… it's always a best estimate," he says.

All the same, Howie notes that while there is a lack of evidence for outright falsification, in general, numbers in China are often political due to government targets, which in turn creates incentives for officials to try to be seen matching or, better still, outperforming.

"I don't think China actually falsifies its data—I think there's certainly an incentive to over report it or take the benefit of the doubt and I certainly think lower down at the provincial or county level there could certainly be a lot of falsification," he says. Indeed, in December *Xinhua* reported that economic data was being inflated by some local governments in the northeast, the area arguably worst hit by China's slowdown, in some instances by as much as 127%. Howie adds, "They are trying their best, but when a process is politically driven you're going to get bad answers."

Certain numbers, such as highway freight traffic, have been known to be prone to statistical oddities, and the fact that these numbers are harder to verify may make it tempting to massage them for political purposes. Even if that is hard to prove, it and other major numbers can raise more questions than they answer.

One example is China's unemployment statistic, which has remained remarkably flat in the face of events such as the Asian Financial Crisis, China's accession to the WTO and the Great Recession. Looking more closely at the data, however, and there is the strange phenomenon of frequent shifts of one-hundredth of a percent that do in fact roughly track growth in the economy.

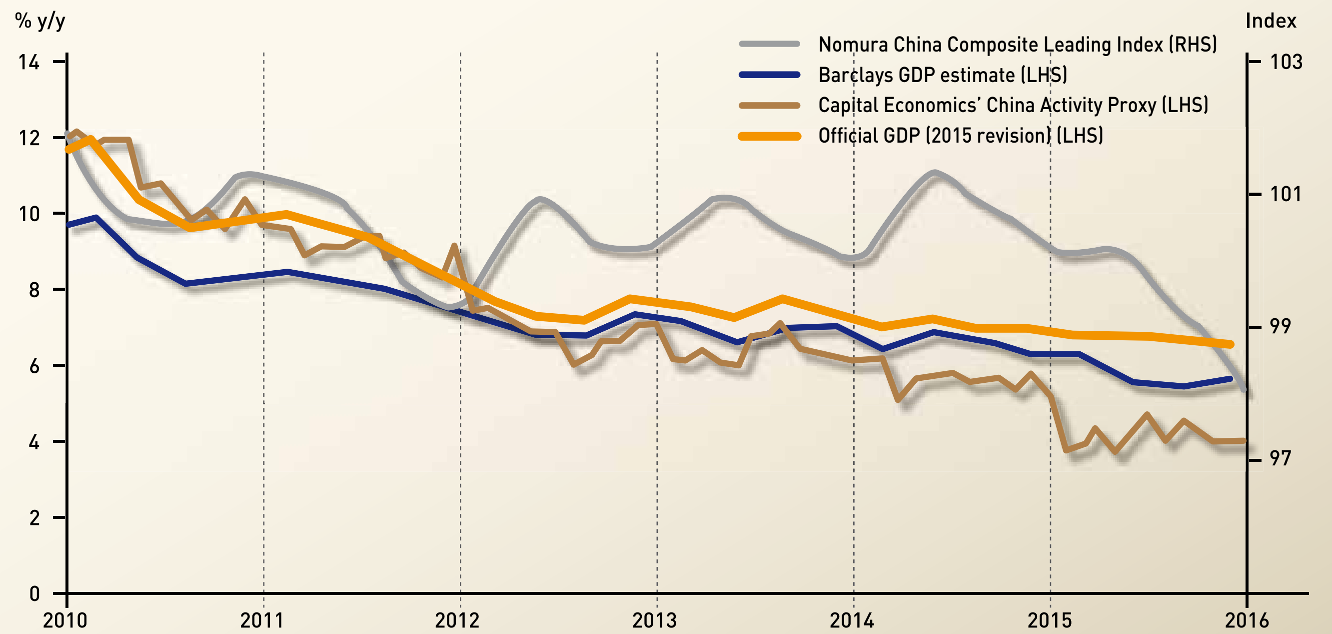
The idea that the government hasn't being completely transparent with regard to unemployment data was given credence in January 2015 after Ma Jiantang, then head of the NBS, said in response to a question from the *Financial Times* that internal non-published unemployment data put the figure at 5.1% for 2014, compared to 4.09% for the official figure for urban unemployment.

But the clearer charge against the quality of the number is what it doesn't tell observers: the unemployment rate for the huge migrant workforce, the very people who have powered China's economic boom. And even amongst urban workers it only counts those who bother to apply for the country's paltry unemployment benefits.

That information may be unavailable simply because the NBS feel they don't have reliable data. That scenario would

The Great Divergence

Official GDP growth versus unofficial estimates and indices



Source: Barclays, Nomura, Capital Economics fit with a pattern Lardy identifies of the bureau doing just that: "When they don't think the data are so good they don't release them… it takes them a long, long time to have confidence that the numbers that they have are worthy of being put out."

But whatever the reasons behind official headline figures' vagaries, the question remains: if they can't give a full picture of the economy, what can?

Manufacturing Data

Li Keqiang's comments in 2007 not only fueled skepticism around the GDP, they also bequeathed the world a new makeshift index for tracking China's economy. Having supposedly dismissed the GDP figure, Li noted that he instead looked at electricity output, freight volumes and loan growth to get a true gauge of the economy. Subsequently these have been bundled together to create what is known, unsurprisingly, as the 'Li Keqiang index'—and the story it appears to tell about the Chinese economy in recent years has not been a good one, with the index frequently cited in support of the argument that growth is being overstated.

But if the Li Keqiang index might once have been a reasonable measure of the economy, it is increasingly less so as China transitions towards growth driven more by consumption and services. Neither of these relies on electricity and freight for growth, and services had already become the main driver of growth in the economy as of 2013. That transition has also had a knock-on effect on the relevance of other closely watched indicators such as growth of exports.

Moreover, reliance on heavy industry isn't evenly spread around the country, with regions such as the north-east more seriously affected by the current downturn than more developed metropolises such as Shanghai. While a declining Li Keqiang index might suggest something of note about the former, it has a lot less to say about the latter. Nor should it, given one key detail that is often ignored when economists apply the index to the country as a whole.

> The real problem is we don't have any real good, high-frequency data on the service sector
>
> Nicholas Lardy
> Senior Fellow
> Peterson Institute for International Economics

"[Li] was actually talking in a relatively narrow framework, he was talking just about Liaoning province," says Howie.

Taking a similar approach to the Li Keqiang index are proxies for the national economy from Bloomberg, Capital Economics, Nomura, Lombard Street Research and Oxford Economics. While offering a more rounded view of the economy than the Li Keqiang index, they too are typically hamstrung by a reliance on data concerning the so-called 'old' economy such as construction, electricity output and seaport cargo.

Similar concerns apply to China's much-watched manufacturing purchasing managers indices (PMI)—both the official gauge and alternatives from companies such as Markit—which spent most of 2015 in contractionary territory.

"I don't think the PMI data is worth very much at all," says Lardy, noting that official output data has also recorded persistent declines, albeit not as severely as the PMI data would suggest it has. "It's trying to be forward looking, but how successful it is I think is an open question."

In addition to the manufacturing PMI, the NBS and Markit both produce another gauge for services (or "non-manufacturing" as it is called by the NBS), both of which produce an altogether more positive picture when taken together with their respective counterparts. But not everyone is convinced of their value generally.

"A lot of economists tend to downplay PMI because they're a pretty blunt measure of things," says Howie. "I think in China as well it's not clear that with the PMIs you've actually got a long enough historical data set that you can actually really tell that much about the underlying economy."

Questions of Service

If consumption and services are increasingly important to the economy, then information on these areas is, too. However official data for both leaves much to be desired. Breakdowns for the composition of value-added in the tertiary sector, which covers services, are dominated by a blanket category simply labeled 'others'—which in 2013 accounted for as much as 38.5% of the sector's total.

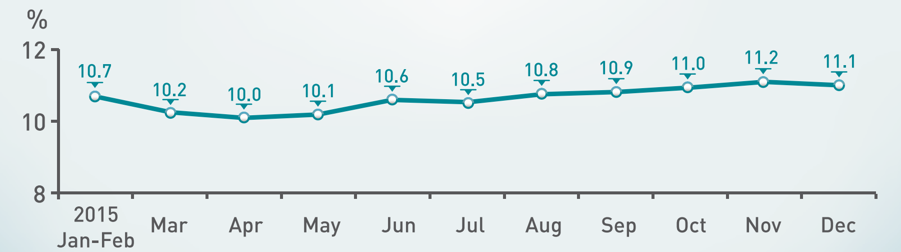
"The real problem is we don't have any real good, high-frequency data on the service sector," says Lardy. "It's half of GDP now and we only get value-added data on a quarterly basis and there's very little disaggregation when we do get the value-added… there's no underlying data to back it up or granular data like there is in the manufacturing sector."

Meanwhile official figures on retail sales are becoming increasingly useless as indicators of total consumption, which is itself more and more dominated by services. And to add still further uncertainty, official retail sales data also covers purchases by the government and public agencies.

With NBS data so wanting, economic sleuths must look elsewhere. "[The data] is coming out of industry associations

In With the New

The monthly growth rate of retail sales of consumer goods has maintained double-digit growth while other indicators have fallen



Source: National Bureau of Statistics

and other government agencies, so you have to look at things like transportation, movie ticket sales, passenger traffic on the trains, civil aviation," says Lardy. Crabbe also adds tourist numbers, consumer confidence indices, online retail sales and growth in consumer incomes as pertinent data points.

"I've just done some research on this which basically indicates consumer services is probably as big as the retail market, if not bigger," says Crabbe, noting that the work included looking at everything from hairdressing to funeral services to elderly care. "A better understanding of the size of the consumer services market will give us a better overall idea of the true size of the consumer economy, and actually I think we would find that the economy is very robust because of that."

But Howie sounds a note of caution regarding some of this data and notes the very real risk of over reporting. Last year the domestic film *Monster Hunt* was reported to have become China's highest grossing film ever after it took in RMB 2.43 billion at the box office—RMB 160,000 more than the previous record-holder, *Furious 7*. However, after internet users highlighted unusual screening times for the film during its final 15 days in theaters, the distributor later acknowledged giving away RMB 40 million worth of tickets to bolster its box office total.

"You just know that's happening in a lot of cases because that's how China works, that's the incentive structure," says Howie.

That being so, Howie advocates not simply relying on statistics but instead matching this with how things seem on the ground. To this end he cites surveys of the kind conducted by J Capital Research's Anne Stevenson-Yang as providing helpful information. "I still feel the anecdotal is very important, and this especially if you're talking about the consumption or service sectors," he says.

Howie points to the key example of overstaffing: there is no index measuring this phenomenon, but is easily observable in everyday life and all the same tells you something about the economy and productivity. "It's taking some of these numbers with a pinch of salt—does that reconcile with what I understand it to be?" he says. Conversely, the fact that Chinese cities are now awash with couriers delivering packages supports reports of prodigious growth in numbers relating to e-commerce.

Drilling Down

While information on the health of China's national economy remains vital, there is nonetheless the possibility that for certain observers it is beside the point.

"Many of the indicators people rely on, such as GDP, aren't actually that useful when you're looking at an economy like China," says Crabbe. "The key thing here is that really what companies need to know about is the sector that they're really involved in, not the overall national economy size and so on."

An important part of that, says Crabbe, is to realize that China isn't just one homogenous market. "As a company looking to invest in or actively take part in the China market, you have to look at it regionally and you have to understand regional markets, different consumer trends within those regions and the more detailed micro-demographic or regional trends within the market specifically that you're looking at."

GDP remains a convenient and appealing concept for any country, and China is no exception—and indeed, the longstanding obsession isn't much helped by a strong, target-based political culture. Still, the best analysis will continue to come from those who take a broad and even-handed view of the economy, although there is also an onus on the NBS to improve its methodology and transparency as, rightly or wrongly, so many decisions and perceptions are based on their numbers.

"When I met with Liu He [Vice-Director of National Development and Reform Commission] last year, I said one of the most important things you should do to improve policy making is to have better GDP data," says Lardy. "You need better data in order to judge exactly where the economy is so policy making can be improved—the NBS doesn't have enough resources."

In its place, observers will need to give consideration to the full gamut of information coming out of China—everything from e-commerce data to tourist numbers to manufacturing output—together with their own street-level observations to get a reasonable picture of China's economy, however imperfect it may nonetheless remain. Meanwhile, businesses will be best served by moving to a more nuanced picture of China's composition and, consequently, focusing on their specific market while also keeping abreast of the national situation.

"China is one of those markets where you really have to do your homework to get it right, and I think relying too much on easily accessed data is erroneous," says Crabbe. "It's time for people to stop fixating on the national macro-economic data and move into more granular, regional, micro-market data to base their business decisions upon."

Striking Out

Entering the fourth year of Xi Jinping's rule, just how much progress has there been with China's reforms?

By Douglas Bulloch

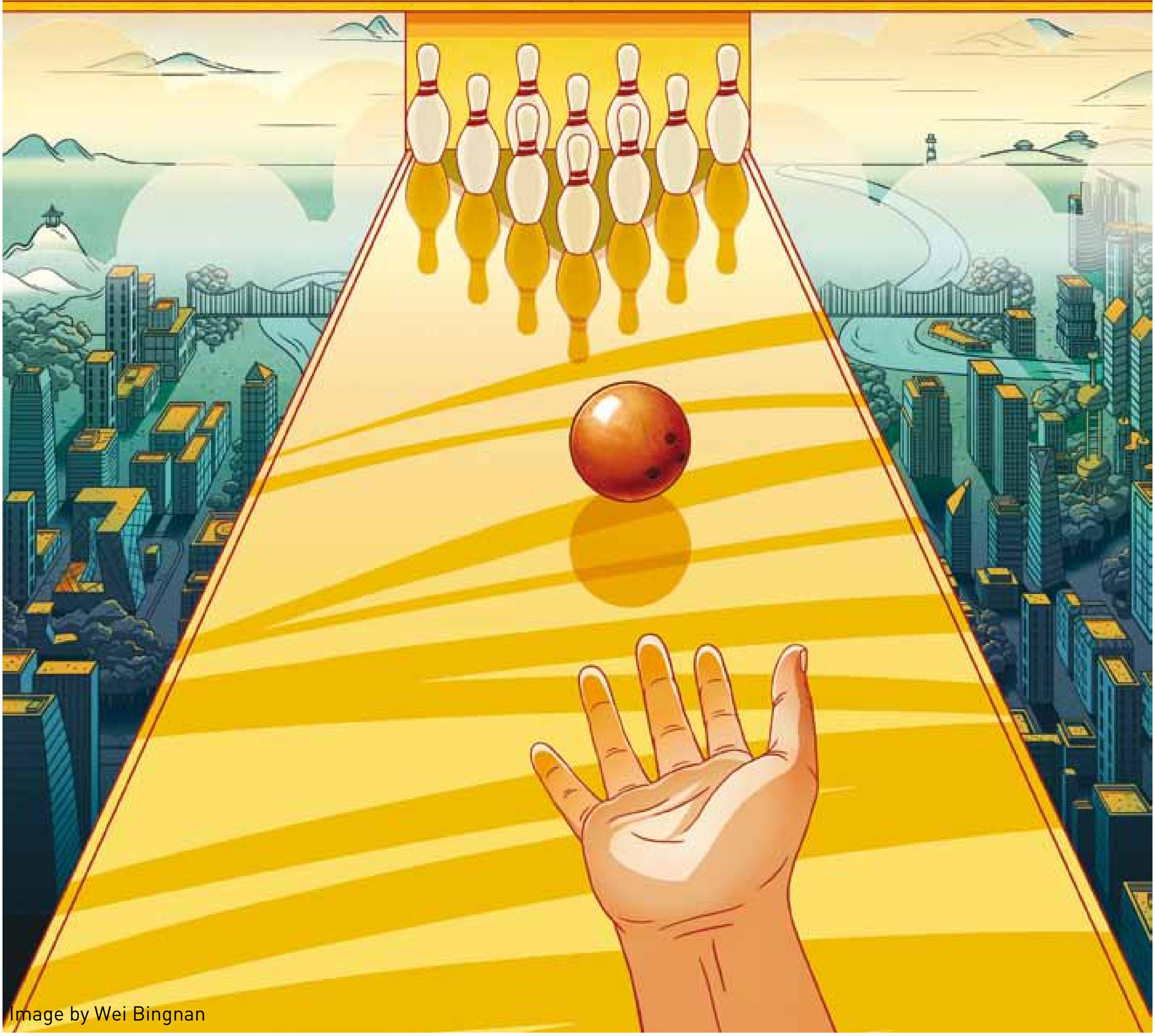


Image by Wei Bingnan

Traffic jams in China have become something of a YouTube staple. From the sudden appearance of paralyzing city gridlock when no one is prepared to give way, to the 100 km holiday-weekend nightmare caused by just too many cars. Both are, of course, a consequence of China's rocketing, decades-long development trajectory, a failure to adequately adjust the rules, along with the simple fact of China's vast population.

China's longstanding reform program has arrived at much the same point. The enormous impact on growth of joining the World Trade Organization (WTO) has now largely played out, and the path towards developed economy status—while avoiding the so-called middle income trap—depends upon careful management of an extensive program of economic reform. In November 2013 at the 3rd Plenum of the 18th Central Committee, a grand total of 60 reform proposals were outlined, affecting almost every aspect of the economy.

"It's kind of extraordinary that they were so ambitious," says Kerry Brown, Professor of Chinese Studies and Director of the Lau China Institute, King's College London. "But you've got to move beyond promises… when you make so many promises, you get people's attention, and they wonder when the delivery is going to happen."

> "State enterprise reforms haven't gone that far… [Xi Jinping] has just got higher priorities
>
> Leslie Young
> Professor of Economics
> CKGSB

Bold Intentions

The 3rd Plenum, however, is not the whole story. Brown contextualizes it as a "broad political commitment" which can only be assessed in relation to an associated "explanatory statement" issued by Xi Jinping himself, indicating 11 core priorities within the 60 proposals, which Brown summarizes as "absolutely orthodox Deng Xiaoping standard reforms… to deliver a sustainable economic model, to continue to have SOEs (state-owned enterprises) as the backbone of the economy, but to introduce, through the market, new ideas and new ownership models."

Without the explanatory document, Brown views the 3rd Plenum communiqué as "a difficult document to interpret or make sense of beyond demonstrating elite political will" essentially leading up to the 13th Five Year Planning cycle; that is, ultimately, "the implementation document".

That said, the key elements of the 3rd Plenum document will be familiar to most China watchers: the need to ensure the market plays a decisive role in resource allocation while conceding an important influence for the government on the management of the economy. The need to "work on the problems of an underdeveloped market system, excessive government intervention and weak supervision." The desire to "promote reform by opening up." It introduces the broad issue of land reform although this receives less prominence in Xi Jinping's explanatory statement. Then there is the question of anti-corruption, which appears alongside general comments about strengthening the rule of law.

The communiqué is a long document, but the word that appears more often than any other is 'reform' itself, leaving observers with unanswered questions about the eventual detail. "From a macro perspective… [the] reform agenda… is very broad and principles-based and doesn't contain details against each specific area," says a senior, Beijing-based business consultancy source who wished to remain nameless.

Indeed, the same source suggests the frequency of the word 'reform' may disguise the absence of actual reform in the detail: "Without making reference to specific policies it can leave people wondering what area of reform we need to carry out. [Leaving] interpretation in the hands of whoever is in charge."

The importance of the document therefore must reside in the principles it outlines, rather than the absent detail, which await clarification in the small print of the 13th Five-Year Plan. Nevertheless, the 3rd Plenum has always been viewed as a key moment in China's periodic cycle of administration, and this last occasion was the first chance the current leadership had to set out its stall.

But in doing so, the leadership inevitably raised the stakes of reform and ensured they will be judged on its outcome. "The government is always chasing people's expectations," says Brown, and the people expect "the things that have been promised."

There is no question that the ideas, if not yet the detail, outlined at the 3rd Plenum point to some very radical changes for the Chinese economy. Transforming a formerly communist—and still strongly state-lead—economy into one in which the market plays a key role in the allocation of resources is not simply a question of flicking a few switches. Headline macroeconomic plans towards internationalizing the RMB and opening up the capital account catch the attention of international markets, but most economists think the more urgent, and inevitably more difficult, tasks center on making the domestic economy more productive and more competitive, ultimately able to withstand direct international competition without the protective intervention of the state. And it is the area of SOE reform that attracts the most immediate skepticism.

Andrew Collier, Independent Macroeconomist and Managing Director of Orient Capital Research in Hong Kong, says of much heralded SOE reforms: "Recently there's been a lot of noise about significant reforms, but I haven't seen much progress. We've seen some mergers of some large state firms, but… most of those are in peripheral sectors or are… ways to avoid debt problems."

Leslie Young, Professor of Economics at the Cheung Kong Graduate School of Business, broadly concurs. "State enterprise reforms haven't gone that far," he says, although he puts this down to a question of priorities, suggesting that without immediate reform "nothing terrible is going to happen. [Xi Jinping] has just got higher priorities, like cleaning up the military."

Young adds that there is much misunderstanding in the West of just how government works in China. "The implementation of the plan has been not so much prioritized in the technocratic sense or in terms of an economic analysis of priorities, but in terms of personalities," he says, adding, "It is just the way things work in China." He goes on to say of SOEs that "there is a vast, loose power structure… that is capable of hedging and fighting back", neatly describing the hazards of confronting vested interests within a government characterized by complex personal entanglements.

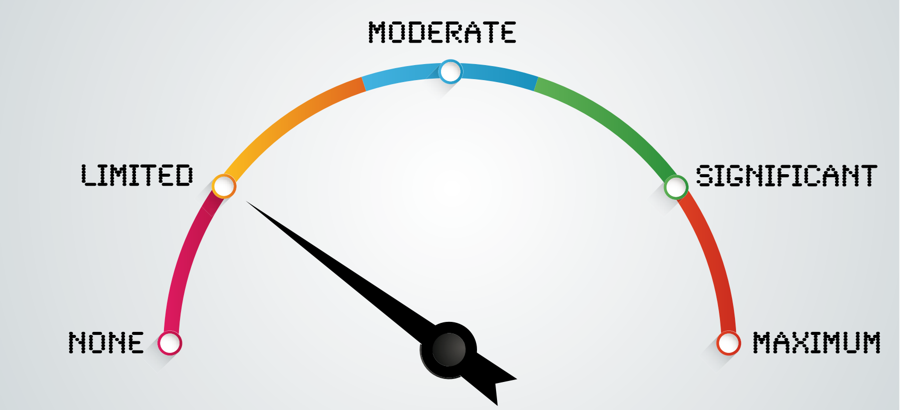
Steady Progress

Nevertheless, despite the macro-level skepticism and the absence of detail so far, some do see progress, particularly in the area of innovation, but also on those SOEs not perceived as central to China's notion of state-lead capitalism. Song Gao, Managing Partner at PRC Macro Advisers in Beijing, takes the view that "they have done a lot to encourage… innovation and… entrepreneurship." Equally important, they have been active in "streamlining the government approval process", all of which is significant from a supply side perspective. Song believes that "the 3rd Plenum reforms are more about the supply side", reinforcing what he describes as the emergence of a "New Supply School or Theory" attributed to Xi Jinping.

Collier also stresses developments in the technology sector, with the emergence of companies such as Alibaba as key examples, but suggests this is largely a consequence of longer-term shifts in investment patterns, rather than directly related to the reform program. "There has been an inexorable rise in private investment over the last 20 years… you could argue that there has been a de-facto privatization going on regardless of the power of the large state giants."

Not Making the Grade

Impact of economic reforms on foreign businesses, August 2015, according to the US-China Business Council



No change since June 2015 report

Source: US-China Business Council

Moreover, Song suggests that so far, because the 3rd Plenum reforms are focused on the supply side, "the first two years" have prioritized laying "out the overall structure and direction, putting the legal framework in place." Eventually SOEs will be divided into two types: "One will be for public services or SOEs in natural monopolies" and the others "classified as commercial SOEs or operating at a local level, will eventually be let go. Not privatization, but more like 'public-ization'. They will be allowed… to diversify their shareholding… between private investors, SOEs and even local governments."

Roadblocks

There are, however, important reasons why progress has been slow in this area. Like the holiday traffic, the sheer numbers of SOEs are staggering. There are estimated to be over 150,000 in China, regionally distributed, and attached to all different parts of government. "Even the State Council's research department has about 10 SOEs. They are the mastermind of all the reform proposals, and they are supposed to be neutral… but they still have a conflict of interest," says Song. "This will be a very slow process."

Then, when considered abstractly, the question of valuation is no small matter, given the staggering stock market fluctuations seen last summer and in the New Year. This, CKGSB's Young believes, is a regrettable distraction. "A collapsing stock market in Germany, in South Korea and the US means big trouble and… big wealth effects. But the proportion of Chinese holding stocks is relatively low, so the wealth effects are not anything like as significant."

Moreover, he argues that "China doesn't have law in any meaningful sense. Absent law, if you were to push the SOEs into market reform and the shareholders have no legal rights and you don't have an independent judicial system, what you'll have is Russia."

Then there is the inevitable conflict

of interests within the government itself, which like the sudden city gridlock, results from legislative gridlock as different centers of authority refuse to give way. Song suggests this is because "there has been a lack of consensus at the very top of the political spectrum about which direction these reforms should take", a tension which can only be exacerbated by slowing growth and market headwinds. Song further argues that the main tension exists between the Ministry of Finance, which "controls … the central SOEs", and the SASAC (State-owned Assets Supervision and Administration Commission of the State Council), which directly oversees the SOEs.

Further Afield

Another important area of reform concerns rural land rights, announced in an effort to improve land use and rural productivity in a time of rocketing food imports. Currently rural land in China is collectively owned and farmers are unable to exchange their rights for any financial benefits. This produces many constraints on economic development by tying workers seasonally to the land in order that they secure the meager returns available, while dis-incentivizing investment to improve the land over time. It also has the effect of preventing more rapid urbanization as farmers lose their small farming rights if the land use changes, prompting them to resist development due to a lack of adequate compensation.

In early 2016 this aspect of the 3rd Plenum reforms was announced again by Finance Minister Lou Jiwei, but there are still many question marks over how it will proceed, with pilot schemes in the more advanced provinces seen as most likely. Unfortunately, the structural resistance to these reforms is likely to be even greater than that over SOEs as the point at which the legislative gridlock will occur is already one of the key political intersections in China; that between local and central authority.

According to Collier, "local government derives anywhere from 40% to 80% of their revenue from land sales." Song adds that the "central government is reluctant to allocate more tax incomes to local governments", which places the issue into the wider context of very difficult fiscal reforms, with Song describing "this stalemate between the central and local fiscal reforms" as "a big hurdle."

> It has become commonplace to see the assertive centralization of authority under Xi Jinping as a prelude to deeper reforms

On these reforms, Young reverts to his point about the absence of meaningful law. "There's no question that privatization and transferability [of rural land] is a definite plus because it permits aggregation and scale economies…. But you can't predict that the legal, political, democratic structure will be powerful enough to provide an alternative safety net."

Lastly, Song believes that on the question of land reform, "assigning property rights to farmers touches the bottom line of Chinese political commitments." He nevertheless thinks there are some potential advantages from assigning partial rights for land usage, although these are still shrouded with reservations concerning the precise impact this will have on the economy, hence still some way off.

On the question of macroeconomic reforms China is perceived to have made some important progress on the 3rd Plenum aspiration of 'opening up'. A signature step has been taken towards the internationalization of the RMB with its acceptance as part of the IMF's special drawing rights (SDR) basket of currencies, and the establishment of the Asian Infrastructure Investment Bank (AIIB) is widely seen as a key initiative attracting considerable international backing, which will foster greater, state-directed capital investment overseas.

Once again, however, not everyone is convinced. "There is way too much praise given to those two reforms," says Collier. "The SDR was symbolically very important for Xi Jinping, but I think from a financial and macroeconomic point of view it's not that significant."

Song regards the achievement of these two milestones more positively, noting "a prevalent view among the top leaders that the RMB's inclusion into SDR is considered at the same level of importance as China's accession to the WTO." But he suggests that the ground for these reforms was prepared long before the 3rd Plenum, hence they are not necessarily a good measure of 3rd Plenum progress.

What Xi Wants

The one area of the 3rd Plenum reforms where obvious progress has been made, at least in terms of overall activity, is in the anti-corruption drive. This is not often thought of as an economic reform exactly, but it has become commonplace to see the assertive centralization of authority under Xi Jinping as a prelude to deeper reforms.

"There's no doubt that Xi Jinping has more power than previous political leaders," says Collier. He adds, by way of an explanation for the lack of progress on economic reforms, that "[Xi's] focus is on politics, not on economics."

Kerry Brown similarly views that "the leadership have had to create the political space to cut against vested interests… and they've being doing it incrementally by the anti-corruption struggle." Furthermore, he notes that "creating a new consensus is never particularly easy."

Reform, and the successful implementation thereof, has become a key test of Xi Jinping's administration

On the other hand, Brown also cautions against too much emphasis on Xi Jinping's power, stressing that "the power of Xi Jinping… is of no use if it cannot deliver the very fundamental things that people are looking for in terms of the quality of their lives and the quality of the economic returns [from the reform program]", raising the important question of what happens if the reforms do not proceed as outlined.

"With a falling growth rate and… no real sign of political reform [the question of] what people are getting for supporting the 3rd Plenum reforms is going to start becoming more urgent."

Young, however, has an intriguingly different interpretation of the ongoing centralization of authority. Believing that "absent law" there is nevertheless a pressing need to "tighten the discipline and integrity of the process by which… officials are managed, supervised and rewarded." And this "alternative form of corporate governance… is the [Central] Commission on Discipline and Inspection", or the institutional form of the anti-corruption drive.

Young adds an important codicil with the view that the stock exchange in China is not only different from other stock exchanges around the world, but is actually a "mistake". "To have private share ownership by Mrs Wong who does it by feng shui, it just creates a political liability… you [do not create] a market for corporate control." What you have instead is "random redistributions of wealth, often [from] people who can't afford it."

All of which informs his view that the institutional mechanism of the anti-corruption struggle is itself a key economic reform, rather than a prelude to others, and it is not a temporary measure, but is here to stay. In short "where the SOEs are not subject to the market for corporate control, they are subject to an organizational discipline through the party."

The question of success or failure of China's 3rd Plenum reforms inevitably falls into the Zhou Enlai category of 'too soon to tell', but according to Kerry Brown "we have a lot of knowledge of the framework, we have a bit of knowledge of the particularities, and in a few months we will know much more detail."

Young also urges the need to take a longer view, avoiding what he terms the "knowing sarcasm" informed by misunderstanding governance in China as purely a question of power. "[The leadership] have correctly addressed the most critical issue—corruption was becoming intolerable and to privatize more SOEs, and even [carry out] land reform, that can wait for another five years."

Brown, however, is less sanguine about the timeframe, believing that "the people's expectations in China are… very high." He adds that "the government contract with them is not being met, they're just being given a lot of empty promises for tomorrow and they want something today."

All of which leaves China in the unenviable position of needing to clear the reform logjam, or see the arrival of a more prosperous future fade further and further away. As Brown says, "They now really need to be about delivery, not just about promises."

Standing Apart

Finding itself outside of the Trans-Pacific Partnership trade deal, how will China react?

By Chris Russell

Image by Wei Bingnan


New Zealand
Malaysia
Brunei
China

If Asia-Pacific Economic Cooperation (APEC) Economic Leaders' Meetings are supposed to provide a chance for members to present a united front on matters of trade and economics, there are some differences that even synchronized traditional dress cannot hide.

Indeed, there was perhaps a slight note of discord at November's meeting, with the 12 members of the then recently agreed Trans-Pacific Partnership (TPP) trade agreement meeting on the sidelines to celebrate the new deal. That over half of APEC's members were using the Leaders' Meeting as an occasion to mark an agreement that excludes some of the most important economies in Asia speaks to the growing rivalries in the region, and also the US's enduring influence.

In the post-war years it was perhaps easy to take for granted the deep and vast sway held by the US in Asia—from its significant role in the Asian Development Bank to its close relationship with regional powerhouse Japan, US influence has long been writ large. But no geopolitical situation is ever static, and China's unrelenting rise in recent decades has completely reconfigured the terms of politics, economics and trade in Asia, not to mention the world.

That has informed the US's much-discussed 'pivot', or later 'rebalancing', to Asia under the Obama administration, a key plank of which has been the TPP: a far-reaching trade deal involving the US and 11 other Asia-Pacific countries (see chart 'Barriers to Trade' on p.23) that covers 40% of the global economy. With its agreement in October after years of tough negotiations and subsequent signing in February in New Zealand, the tangled network of political and economic relationships in the region look set to be reshaped once again.

That puts China in a difficult position. On the one hand, in the long run it can try to embrace the TPP, even if it does to some extent represent a reassertion of the US's global leadership—indeed, following the agreement President Obama said, "We can't let countries like China write the rules of the global economy". On the other, it can pursue its own rival trade agreements,

"

[TPP] could potentially be part of a story where China sort of loses its vital place as the world's global factory floor and as a key segment in global production networks

Scott Kennedy
Deputy Director, Freeman Chair
CSIS

which could in turn lead to either eventual union with the TPP or a gigantic split in the global economic order.

Much is at stake, and Scott Kennedy, Deputy Director, Freeman Chair in China Studies at the Center for Strategic and International Studies, points out that the TPP is not just a regional economic agreement, but "a building block for the creation of a reformed global economic architecture".

"If China is not a part of that, then it will put them at not just a regional disadvantage, but globally," Kennedy says, "and that might lead to greater fragmentation of international economic institutions, which I think everyone would like to avoid if possible."

Making Changes

For an agreement that has pretensions to reshaping the global economic order, the TPP's origins are altogether more humble. The current agreement has its genesis in the Trans-Pacific Strategic Economic Partnership (TPSEP), which was signed in 2005 by Brunei, Chile, New Zealand and Singapore, and covered areas such as trade, intellectual property and government procurement. But from 2008 more countries became parties to discussions concerning a broader agreement that eventually became the TPP, and received support from the then newly formed Obama administration.

Covering a population of around 800 million people, the TPP involves eliminating tariffs in a wide variety of sectors including agriculture, energy and automobiles, some of which will be cut immediately. Other, more sensitive tariffs will be phased out over a longer time frame—and some, such as Japanese cars exported to the US, will take decades.

But if the TPP simply represented the removal of tariffs, its importance would not be all that great. As such, the most significant provisions of the TPP concern digital trade, environmental and labor standards, competition policy, treatment of state-owned enterprises (SOEs), investment and a move towards international regulatory coherence. All of which reflects the concerns of the advanced, developed economies who have played a significant role in pushing the TPP forward.

"A lot of what is in TPP are things that didn't make it into the Uruguay round and also weren't picked up by the Doha round in the WTO, and some things that just didn't exist then," says Kennedy. "They are highly relevant to advanced industrialized economies that have large service sectors as well, and these things are probably even more important to them than the contents of the Doha round, which was really framed to help address the concerns of developing countries."

Some countries may well see major dividends from the pact. According to a 2014 paper for the East-West Center by Peter Petri, Michael Plummer and Fan Zhai, by 2025 TPP members will collectively have seen incomes boosted by 0.9%. Broken down further, the US is expected to see a 0.4% increase in its GDP, while other countries, such as Japan, New Zealand and Malaysia will enjoy particularly strong benefits under the deal. Vietnam, meanwhile, stands to gain the most with a 10.5% increase.

But these gains won't manifest themselves overnight, with a World Bank report in January stating that benefits "are likely to materialize slowly but should accelerate towards the end of the projection period."

The Dragon in the Room

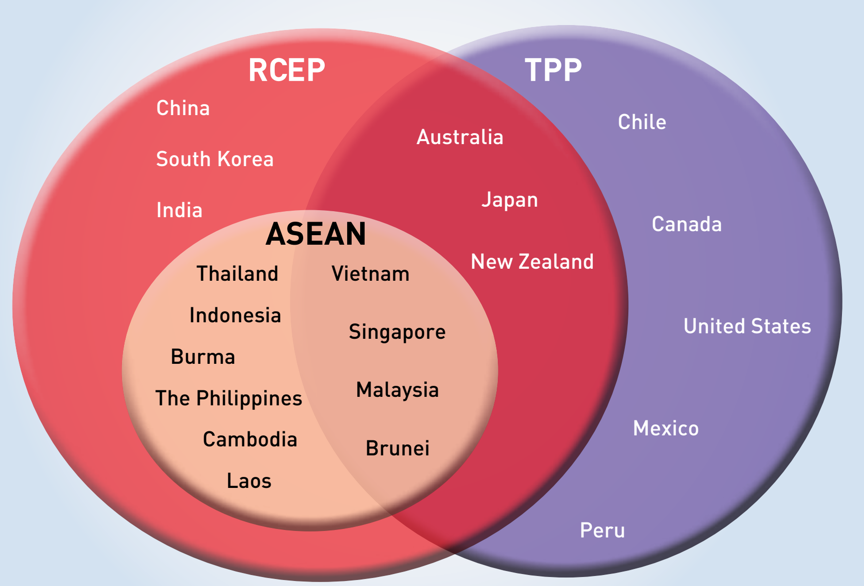
If the TPP is set to be a boon for at least some of its signatories, it seems the opposite will be the case for the most significant absentee—China. Indeed, that same East-West Center paper predicts that China will in fact see a fall in its GDP of 0.2% should it remain outside of the TPP.

But the costs to China go beyond the obvious trade impacts, and of particular note here is the regulatory convergence amongst TPP members—a point made even more important given the increasingly sophisticated nature of the Chinese economy. "I think it would be a matter of considerable concern to China that it was essentially excluded from the formulation of these agreements [on regulations]," says Leslie Young, Professor of Economics at the Cheung Kong Graduate School of Business. For Chinese businesses, these regulations will matter enormously, with Young describing them as "life and death".

It is these deeper issues that provide the most serious challenge to China. Kennedy notes that being outside of the agreement puts China at a disadvantage in sectors where it is trying to become more globally competitive and raises the costs of multinationals operating in the country as part of their production network. "It could potentially be part of a story where China sort of loses its vital place as the world's global factory floor and as a key segment in global production networks," he says.

Barriers to Trade

Which countries belong to which agreements



Source: *CKGSB Knowledge*

That could leave only those multinationals serving the Chinese market, potentially a relatively small number given the market barriers that exist, and also damage China's hopes of being a real force in advanced manufacturing per its Made in China 2025 plan.

With the possible costs of remaining outside of the TPP so high, the question arises of China seeking to join the agreement. However its relation to the US's pivot and how that is perceived has for a long while worked against that possibility.

"China is always suspicious [about the TPP]," says Ming Du, Reader at the Law School at Lancaster University specializing in international economic law. But he notes that while "at the beginning they basically condemned the TPP as a tool to contain China," now official commentary on the agreement is much more open to the possibility of Chinese involvement. In October 2015, the *Study Times*, which is published by the Central Party School, argued that China should join the TPP at an appropriate time.

Recent economic events may have had something to do with this shift in attitudes. "The recent financial turmoil has probably made China a bit more amenable to discussions," says Young. "They'll probably approach this issue now in a rather more constructive way than they would have done say one year ago."

A not unrelated issue possibly pushing it towards involvement in the TPP is that of reform (see our story 'Striking Out' on p.15). With modernizing and reforming the economy an avowed aim of China's leadership and the economy seemingly having reached an inflection point where changes need to be made sooner rather than later, the provisions of the TPP may in a sense become the outlines of an aspirational goal.

"China's economic reform goals and developmental goals are really consistent with the focus of TPP," says Kennedy. "China wants to move from being a labor-intensive, investment-intensive, capital-intensive economy to one that focuses on advanced manufacturing, innovation and services, the very types of things that TPP are meant to address and provide protections—clear, transparent, predictable rules—for."

While Du sees the TPP as providing impetus for reforms that are so hotly debated in the country, Kennedy cautions against the idea that the agreement will act as a way of dragging China along the reform pathway in the way that the carrot of WTO accession did in the 90s.

"No Chinese leader could persuasively tell anyone in China that China must do X because the TPP demands it," says Kennedy. "They will need to tell the rest of the country we must do X because it's in our best interests and it just so happens that TPP is also helpful for us."

In fact, this vexing question of reform also touches upon the issue of whether China could join even if it wanted to. To begin with, many of the provisions of the TPP are onerous, particularly for China. "IP protection, environmental and labor protection, and also the provisions on state-owned enterprises—those provisions are definitely targeting China," says Du. "They are actually written with China in mind I think to some extent."

Amongst these include requirements for countries to allow independent labor unions—here Vietnam and its one-party system may well prove to be an interesting test case from a Chinese perspective—while digital trade provisions prevent signatories from demanding that companies house their servers and data locally and reveal source code. The latter was a contentious aspect of regulations approved in late 2014 concerning the sale of computer equipment to Chinese banks.

An even bigger barrier to Chinese involvement are requirements in those areas, particularly the ones now dominated by SOEs, that are amongst the most politically sensitive in China and so would require expending a great deal of political capital in order to get approved domestically. "They may be simply unable to do it, or rather it might cost so much politically that in terms of internal political balance they think, 'It's just not worth that much to go and provoke, as it were, a putsch just to avoid a few tariffs'," says Young.

With the gap between China's current economic situation and the goals of TPP so wide, it won't be signing on to the TTP any time soon—both Du and Kennedy rule out any movement in this area within the next five years.

> "TPP kind of sticks its big foot into this intricate web… of existing business and economic relationships, and it's going to create a real mess
>
> Leslie Young
> Professor of Economics
> CKGSB

With or Without You

With China for now outside of the TPP, it has been forced to forge ahead with its own trade deals. Of these, the most eye-catching is the Regional Comprehensive Economic Partnership (RCEP) currently being negotiated between ASEAN and other Asian countries. But there are questions over just how ambitious the agreement will be compared to the TPP.

"They will probably get to something [with the RCEP], but the economic implications of the final text will probably be rather limited," says Du.

That is partly due to the fact that China is not yet ready for a TPP-like agreement. The issue is exacerbated by one of the other major players in the RCEP, India, who will also be resistant to significant reforms for SOEs, intellectual property and labor regulations. Added to this is the fact that, prior to the Modi government, India had been a relatively inward-looking economy lacking experience in negotiating major trade deals.

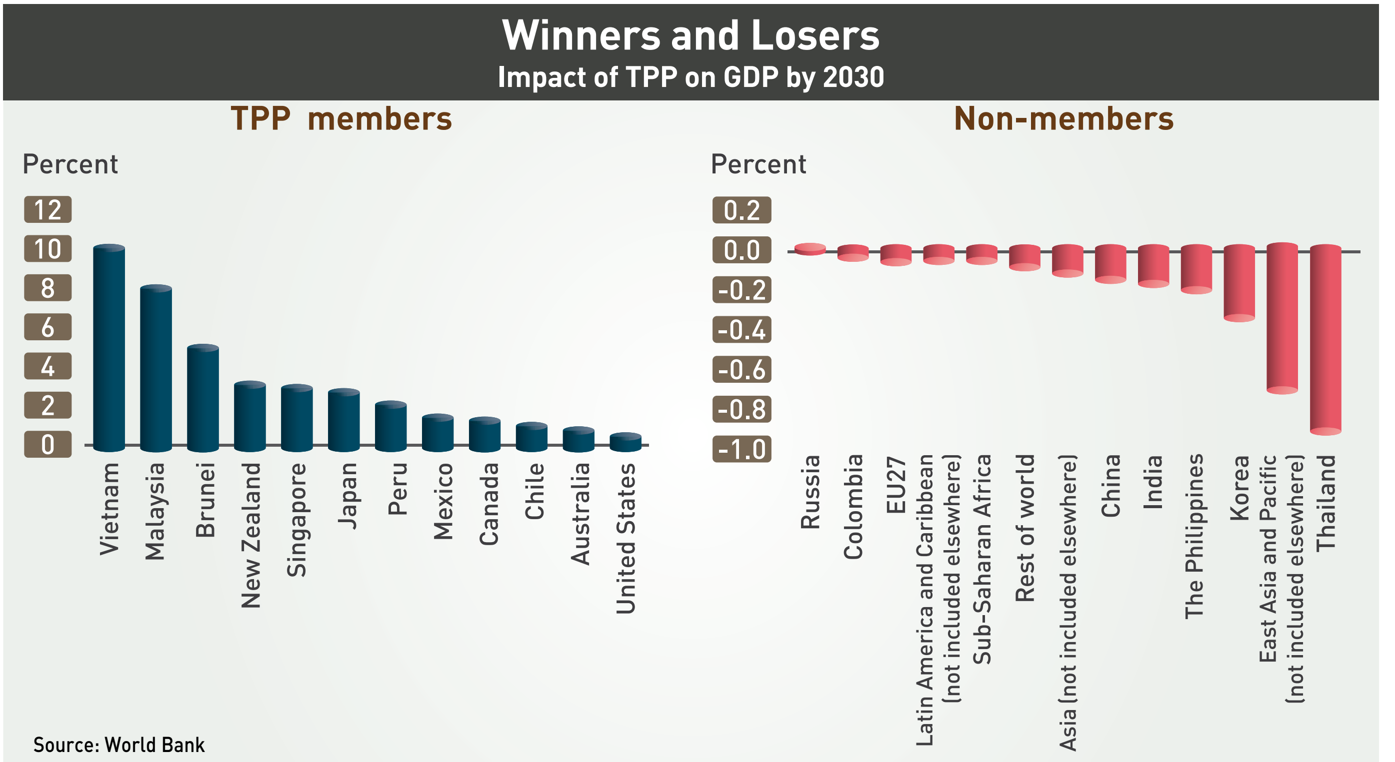
"I think the chances of RCEP achieving a very significant deal are relatively small as long as India is a part of the negotiations," says Kennedy.

Even if the best possible outcome is only a watered-down version of the TPP, a strong desire on the part of China to see the RCEP come to fruition will likely see it through. "I think the Chinese will just keep on driving it through to the end and throw in some carrots until everybody's aboard," says Young.

RCEP isn't China's only means of mitigating the effects of the TPP, even if it is the most significant option. China can continue to pursue bilateral agreements as it has done with South Korea and Australia. In this respect, the most important agreements might be those with the US and the EU.

Young feels the latter might be given added impetus on both sides by the TPP. The US is currently negotiating the Transatlantic Trade and Investment Partnership (TTIP) with the EU, and clearly the hope is that the TPP, TTIP and similar agreements can be patched together for a new US-led global framework. But Young thinks the TTIP may face greater challenges than TPP due to its onerous provisions.

Of these, the one that has arguably attracted the most attention is its investor-state dispute settlement procedure, which critics charge undermines national sovereignty—always a sensitive issue in a region where debates of EU power vis-à-vis national governments continue to dominate the discourse.



If the TTIP were to fail, then a free-trade deal between the EU and China would become altogether more appealing, and would be hugely significant—both parties are amongst the other's top two trading partners. In 2014 Xi Jinping won a pledge from the EU to explore a free-trade deal, and China also has a champion in the form of the UK. Xi and Prime Minister David Cameron jointly called for the launch of a feasibility study for a free-trade agreement last year.

But the EU remains conflicted about its relationship with China, as evinced by the fact that in January it delayed a decision on whether to grant China market economy status, and a looming referendum in the UK on EU membership means the former may not even be part of the equation at all when the time comes for the real discussions to begin.

The other element to China's counter-TPP strategy is its much-vaunted 'One Belt, One Road' strategy of building out infrastructure in Central and Southeast Asia. That could offset some of the costs associated with being outside of the TPP and would also strengthen the EU-China trade relationship.

"Having better infrastructure, including say better high-speed trains, is a way of lowering transport costs and these have broadly the same effects as lower tariffs, so in that sense they both facilitate trade," says Young. "By promoting this One Belt, One Road thing, it is in some sense offsetting any issues of being left out of the tariff agreement."

Over the Finish Line

The tone of the discussion surrounding the TPP often makes it seem like the deal is already done and dusted. But it still requires ratification by its signatories, which may be easier said than done as that process rubs up against domestic opposition and election cycles in member countries.

Indeed, this has already manifested itself after the Harper government in Canada lost power in an election shortly after the TPP was signed, with the new Liberal government saying their support for the TPP would depend upon the outcome of a Parliamentary review. Meanwhile ratification in Japan might be complicated if it coincides with elections to the upper house of the Diet in the summer.

Most importantly, the issue of the TPP has become something of a political football in the US as a result of the looming presidential election. With opposition towards the deal mounting within the Democratic Party, Hillary Clinton, one of the key driving forces behind the TPP while Secretary of State, has come out in opposition to the deal.

Envisaging such difficulties, the TPP allows for a situation where the agreement comes into force without being ratified by all signatories, provided six have ratified it and their combined GDP represents at least 85% of that of the full 12. That means failure by either the US or Japan to ratify the TPP would be enough to scupper the agreement.

But it is widely expected that the TPP will be ratified by members, not least because of all the effort that has been put in so far. "There will probably be hiccups here and there, but I expect the members will ratify the TPP," says Du.

Kennedy agrees, even if it ends up being a politically charged process. "In the US, my guess is that it will be voted on and passed during the lame duck session in between the presidential election in November and the time the new Congress and

US Secretary of State John Kerry attending a TPP meeting on the sidelines of APEC in 2013

president take their seats in January 2017," he says. "I think in many ways they'll treat this the same way that they treat arm sales to Taiwan—better that the outgoing presidential administration puts their political capital into it and clear the decks for the incoming administration."

With ratification more likely than not, questions of China's reaction will persist. It will be an issue for those in the TPP too, not least because many are parties to both the TPP and RCEP, along with long-standing institutions such as ASEAN. Young points out that by cleaving through existing trade and institutional relationships, the TPP will help create trade inefficiencies and disrupt the deep relationships created through ASEAN.

"We have to remember that ASEAN and China and Japan and Korea, they are in many senses one economy… because there's so much trade going on in intermediate goods," he says. "TPP kind of sticks its big foot into this intricate web of relationships, of existing business and economic relationships, and it's going to create a real mess…. Whether or not they want to [reconcile] they're going to have to because of these two factors."

If the US sees the TPP as a stepping stone towards an even broader geopolitical framework, China also has similar aspirations and has at successive APEC meetings pushed for the creation of a Free Trade Area of the Asia-Pacific (FTAAP). Although the US is reportedly wary, the way the TPP splits Asia's deeply rooted economic and political relationships may well expedite such a development, and the RCEP may even function as a stepping stone of its own. Moreover, for all the talk of confrontation and containment, Young notes that trade is supposed to be win-win—indeed, the East-West Center paper estimates FTAAP could yield an income gain of 1.9% for world GDP.

"This is a long-term story—this isn't going to be something that's going to be resolved certainly not in the Obama administration or even before the end of [China's] 13th Five-Year Plan," says Kennedy. "Whatever they join they won't want it to be called TPP, it will be called FTAAP or a global multilateral deal…. I would say in 10 years then we would be looking at having a serious conversation about an extended TPP or regional agreement or something even beyond that."

Such a deal would be fraught with complications regarding SOEs, intellectual property and many more issues besides, not to mention all the other developments—technological, economical and political—that can occur over such a long timeframe. Moreover, Du suggests that the US might ask a lot of China when negotiating a trade agreement, in part because of criticisms that the US was "too soft" with regard to its WTO accession. Yet for the sake of the global economy, the world's two largest economies will likely need to find some kind of compromise.

Old is the *New* New

China's market for used goods is going from flea market to e-market

By Hudson Lockett

Image by Beibei Nie

The common wisdom—or perhaps, in retailers' eyes, the ideal—is that China's consumers only want the latest and greatest, and would sooner be dead than caught with anything older than the latest model iPhone.

Hence the outrage when rumors swirled in May that e-commerce platform JD.com had been selling refurbished iPhones passed off as factory-fresh. Even state broadcaster China Central Television (CCTV) got in on the action, reporting that the phones had been made with fake components.

Never mind that the accusations were based on a single customer's complaint about a phone sourced to an authorized distributor for Apple in China—the consumer rage was real enough that JD.com had to conduct an internal investigation and issue a statement refuting the claims. Such distrust is still the default, even toward new goods. And for used goods?

"Everyone knows people are going to game the system," says Jeffrey Towson, Managing Partner of Towson Capital, Professor at Peking University's Guanghua School of Management and co-author of *The One Hour China Book*, a guide to Chinese consumer behavior. "You buy an iron in a department store in China and they plug it in first to show you it works."

But it is an overstatement to say Chinese shoppers universally revile all that is secondhand. Perceptions of greater acceptance for gently used goods is reflected in investors' enthusiasm for the many start-ups that are now aiming to become the premier national platforms for used goods, ranging from cars to phones, to homes, to luxury items and even Han dynasty antiques.

Diverse as these markets are, they are all reputation-based businesses where success requires mechanisms to guard against users trying to pass off bad goods as good-as-new. Those solutions can come from the company or the users themselves—either way, without consumer trust, the growth prospects of an aspiring used goods platform will face serious limitations. But proving yourself to be the trustworthy exception in a market plagued by trust issues can make for a lucrative business.

> Perceptions of greater acceptance for gently used goods is reflected in investors' enthusiasm for the many start-ups that are now aiming to become the premier national platforms for used goods

All that's needed is for a used iron bought online to actually work when the buyer finally gives it a test run in their own home.

New Frontier

Yard sales may be beyond the ken of most Chinese consumers, but in some ways China is no stranger to used goods: in the era of high-Maoism, a paucity of economic activity meant that key goods were often in short supply, making it all the more vital to use every item to complete exhaustion.

Today, China's citizenry has taken to consumer culture with gusto, as amply demonstrated by the nouveau riche tendency to flaunt their wealth by each and every means money can buy. But when it comes to high-end consumer goods production where the target market is China, decades of experience can still be tallied on one hand.

There also appears to be a paucity of research into secondhand markets. Teresa Lam, Vice President of the Fung Business Intelligence Center and lead on the company's Asia retail and distribution research team, noted that she wasn't aware of any in-depth research or market studies on the subject. Nor were any other experts interviewed for this article.

Still, in Lam's opinion, "for most consumer [non-durable] goods, consumers would prefer new items," and increasingly, "online shopping allows consumers access to a wide variety of products at cheaper prices." Those who can't afford an iPhone, she notes, can still pick up a Xiaomi smartphone rather than look for an older model from Apple.

But even Taobao, the online retail platform of e-commerce conglomerate Alibaba Group, has launched its own secondhand goods site, Xian Yu, which now purports to facilitate daily sales of 200,000 used products. The platform seeks to distinguish itself from Taobao proper by pitching itself as a social as well as commercial experience in order to foster greater trust among users. In November, Tencent's tech news site cited an unnamed insider as saying Xian Yu would be spun off into its own business unit to seek outside investment sources.

More cautious consumer sentiment may also prompt more people in China to seek ways to save money where alternatives to the latest and greatest exist—in October, the Westpac MNI China Consumer Sentiment Indicator fell to its lowest reading on record since the gauge of buyers' economic expectations began in 2007.

Full Speed Ahead

Here, for once, Alibaba Group was late to the game. For years classified listings sites Ganji and 58.com acted as catchall platforms for used goods and more, though not without a few hitches. In 2012 Ganji had to launch a consumer protection plan for its secondhand goods channel that went so far as to pay for customers' return shipping when items arrived far less gently used than as pictured in their online listings.

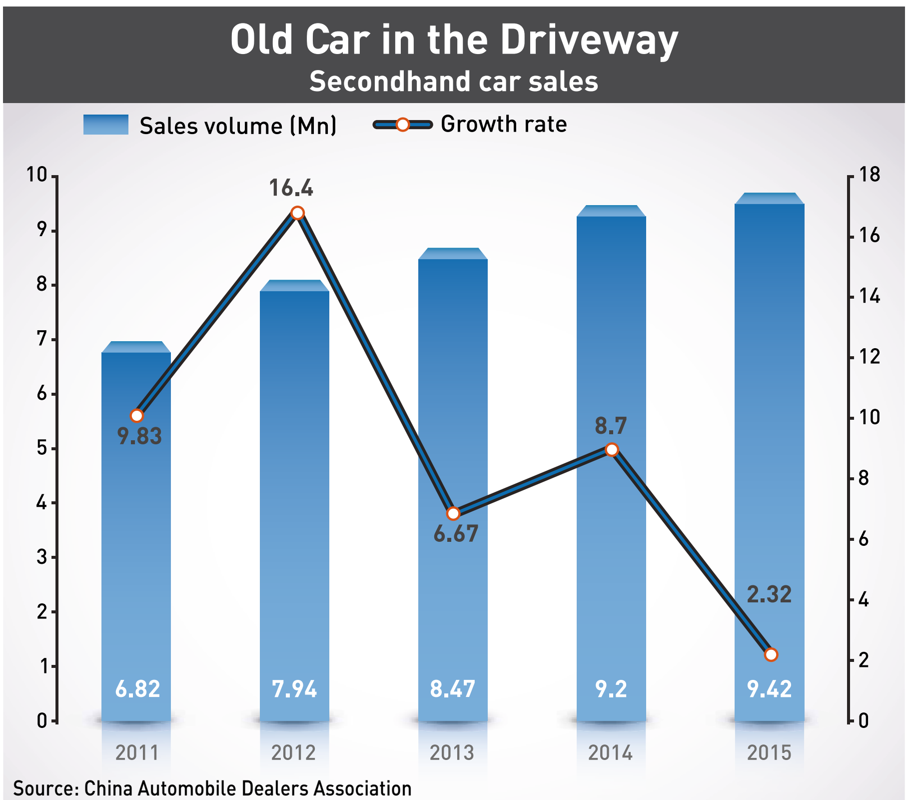
The two companies merged in April when 58.com announced it had bought Ganji for a price of $412.2 million together with 34 million newly issued shares. The former also acquired Ganji's secondhand consumer-to-consumer auto sales platform Guazi in the process, though by then it was hardly the only used car market in town.

At present, many used car platforms online focus mostly on business-to-business (B2B) sales between dealers, though that is changing. Notable names in the sector now include Youxinpai, which raised $170 million in March to expand into a national business-to-consumer (B2C) platform; Cheyipai, which raised $110 million in June; and Mychebao, which pulled in about $45 million in October.

Those investments reflect serious sector growth: in 2015 9.42 million used cars were sold in China for a total transaction volume of RMB 553.5 billion ($84.8 billion), up about 51% from 2014, according to the China Automobile Dealers Association.

But Towson notes that with higher value merchandise comes greater potential loss if buyers end up getting stuck with a lemon. "There's enough quality concern going on there—that [dealers] will buy it, fix it up and use cheaper stuff on a few key things. And you can't check everything on a car."

The industry is working to counter the sources of such prohibitive dangers. Cheyipai, whose focus is on B2B auction-style auto sales, aims to reassure buyers by doing the legwork itself—in 2015 it claimed to have built up an inspection team of 800 people who could provide on-site testing on behalf of potential buyers, with dozens of secondary service centers nationwide.



Easy Electronics

Buying a road-worthy car for a fair price in China might still be fraught with risk for buyers, but purchasing consumer electronics is increasingly just a click of the mouse (or tap of the screen) away for Chinese consumers.

Indeed, Lam said, that ease of access, coupled with a widespread desire to "trade up" to the next tier of consumer goods as income rises, might preclude widespread demand for used appliances: "Even [for] electronic products or smart products—like smartphones—there are cheaper alternatives."

While it's true that companies like Xiaomi and Huawei have made names for themselves by supplying smartphones for China's average Zhou, some companies have nonetheless managed to turn a profit off of used electronics.

Sites like Ganji and Xian Yu do let people sell their old smartphones, laptops and electronics, but perhaps the most innovative approach to this market comes in the form of a two-front strategy adopted by the platform Aihuishou. Rather than trying to earn user trust by guaranteeing the quality of goods out of its control, the company acts as a recycling service—in more ways than one.

The company buys used electronics on which it can turn a profit from users for money or store credit, with item quality independently verified and prices based on online prices for the product when new. The goods are picked up by a courier and sent to approved refurbishers, who sell the re-finished goods on Aihuishou. And even if a phone is too old for consumer tastes, the parts can be sold to a recycling center.

Florian Kohlbacher, Associate Professor of Marketing and Innovation at the International Business School Suzhou at Xi'an Jiaotong-Liverpool University, whose research focuses on consumer trends, says purchases of such refurbished goods reflected a pragmatic streak in Chinese consumers for a wide variety of goods.

"Even looking at secondhand," Kohlbacher says, "in the end it's really about the value you can derive from these things."

Clearly there is value in used electronics: in August Aihuishou's operator Yueyi Information Technology acquired $60 million in funding from investors, including online retailer JD.com, which has worked with the start-up since 2014. In December, the platform established a partnership with the popular Chinese smartphone maker Xiaomi.

Niche (After-) Markets

Of course, value is in the eye of the consumer—and for many in China that value comes from consuming conspicuously. To that point: in 2012 the country became the world's largest market for luxury goods. When it comes to such affluence in China, Kohlbacher notes, "If they can afford it, they want to show it. Buying secondhand would go to the contrary of that."

At the same time, the inherent high-value market of luxury goods made the sector an early and obvious target for online resellers like Secoo Jimai, which launched in 2008 and now has brick-and-mortar shops in major mainland cities where goods are evaluated and other services offered, such as after-sale maintenance and auction options.

Secoo has pulled in $205 million in funding to date, prompted in part by the company's exacting standards. In a 2014 interview with the *Global Times*, founder Li Rixue made clear that "the key thing for us is to ensure that the goods circulating in the market are not counterfeit", to the point of hiring appraisers from the United States and Japan to man its stores in China.

But while secondhand luxury goods may target a select demographic, there may be no used goods market with quite the level of consumer savvy—or history—as China's antiques market.

For this venerable trade the go-to platform is, appropriately enough, Kongfuzi, named after the philosopher Confucius himself. While the site's focus began with used books, its full gamut runs the course of Chinese history, with items and artifacts on sale from every era, be it posters from the rule of Mao Zedong or scrolls from the Southern Song.

Towson notes that the towering value of true antiquities in China poses a serious problem for buyers, particularly when they go to auction. "The whole fake aspect becomes a bigger problem when the price goes up, because there's more profit," he says. "You fake a pair of shoes, you're not going to make a lot of money. You fake a painting? You can make kind of a lot."

> The whole fake aspect becomes a bigger problem when the price goes up, because there's more profit... You fake a painting? You can make kind of a lot
>
> Jeffrey Towson
> Managing Partner
> Towson Capital

Here, however, the same economic phenomenon that strikes fear into the hearts of used-car buyers—information asymmetry—is likely on the side of consumers. Or at least the ones doing the big-ticket buying.

"In these markets you have consumer experts," Kohlbacher says. "The people buying are experts. They buy items because they have an interest in them—they acquire knowledge, study history and know a lot of the vendors."

Thanks to online communities of like-minded collectors, protection is built into antique markets by nature of everyone being an expert buyer. Information asymmetry is far smaller, and since many buyers are also vendors, reputation matters doubly. Those who try to pull a fast one face social exile.

Upper Limits

Few of China's secondhand markets are populated by such sagely spenders. The flipside of that truth is that trust issues help drive more consumers to those few outfits that do manage to establish themselves as a trusted name, whether through recruiting expert inspection teams or cultivating a user base where trust and key market information are in ready supply even to neophyte buyers.

But it's possible that not everyone gets excited at the prospect of a booming used goods markets in China being championed by scrappy e-commerce upstarts. After all, buying used means not buying new.

"There's a lot of vested interest in new auto and appliance sales, all those things that make the GDP number go up," says Towson. "It could be an issue with something big like cars. If Chinese did start buying secondhand cars that would impact the auto industry—which is by and large state-owned."

It's possible that growth will remain limited in many markets for secondhand goods for many years yet. But as in so many spheres, scale means that relatively small growth still means big business, and China's buyers have a reputation for fast adaptation and adoption when conditions are right.

"Chinese consumers change their behavior faster than just about any group I've ever seen," Towson says. "So it wouldn't surprise me if secondhand just leaps out and takes off in one segment."

Making a Meal of It

Chinese firms are betting on the acquisition of prime assets in the US and Europe to drive growth as the economy decelerates at home

By Matthew Fulco

Image by Wei Bingnan

The Chinese economy grew by 6.9% in 2015, down from 7.3% in 2014 and the slowest pace in 25 years. The slowdown is likely to last as China works to change the fundamentals of its economy and transition from a reliance on investment to more sustainable growth driven by services and consumption.

In November 2015, speaking at the Asia-Pacific Economic Cooperation Forum, Chinese President Xi Jinping said: "We will work hard to shift our growth from just expanding scale to improving its structure."

Overseas deal making is one way China is transforming its economy. Once used primarily to acquire energy and resources from developing countries, China's outbound mergers and acquisitions (M&As) increasingly involve the acquisition of premium assets in the US and Europe.

And while the Chinese economy decelerated at home last year, 2015 was a banner year for China's cross-border investment. Chinese companies moved aggressively to capture premium global assets in a deal-making spree that drove China's outbound M&A spending to an unprecedented $61 billion last year, up 16% from 2014, according to the Rhodium Group, a New York-based research firm.

"Many Chinese firms face limited growth prospects at home," says Bee Chun Boo, a partner in the Mergers & Acquisitions division of Baker & McKenzie in Beijing. As a result, they are looking to acquire firms with advanced technology that they can later take back to China, reproduce at a lower cost and deploy in new products, she says. Once they have done so, "they are able to scale up those new assets on the back of existing customer relationships."

In 2016, experts say China's overseas M&A will accelerate as Chinese firms search the globe for premium assets to help them boost growth amidst the weakest domestic economy in a quarter century and a weakening yuan. The Rhodium Group forecasts outbound M&A spending by Chinese companies will rise to $97 billion this year.

"It's going to be a very active year, and will most likely exceed 2015," says Joel Backaler, Associate Vice President at the Frontier Strategy Group consultancy and author of *China Goes Global*, a book exploring the international expansion efforts of Chinese companies. "[In late January] there were nearly $10 billion in deal announcements in the US and EU: Wanda-Legendary ($3.5 billion), ChemChina-KraussMaffei ($1 billion) and Haier-GE home appliance ($5.4 billion)."

> "Many Chinese firms face limited growth prospects at home
>
> Bee Chun Boo
> Partner
> Baker & McKenzie

Deal flow continued to pick up in February as Swiss agribusiness giant Syngenta accepted a $43 billion cash offer from state-owned ChemChina. The deal, which would be the biggest Chinese takeover of a foreign company ever, is pending approval by Syngenta shareholders and regulators in Europe and the United States.

Powering Up

For years, China's state-owned enterprises (SOEs) dominated its forays into global markets in pursuit of energy and resources. Their objective was to ensure China's energy security—helping to negate fallout from volatile global commodity prices—at a time when its economy was growing exponentially. From 1990-2014, the energy and resources sector comprised 40% of China's outbound M&A, by far the largest of any single sector, according to Boston Consulting Group (BCG) research.

"As the largest state-owned oil and gas firms in China interact closely with the government, they have a profound effect on governmental policy," says Hongyi Lai, an associate professor of social sciences at the University of Nottingham's School of Contemporary Chinese Studies.

Prior to ChemChina's takeover of Syngenta, the largest overseas deal done by a Chinese company was China National Offshore Oil Corporation's (CNOOC) acquisition of the Canadian energy company Nexen, valued at $15.1 billion. That deal has given CNOOC access to new energy technologies and the opportunity to operate in North American fields.

Yet deals like that are becoming less common as China makes structural changes to its economy, giving high-end manufacturing and the service sector a larger role. Just 20% of cross-border deals made from 2010-2014 sought to acquire strategic resources, while about 75% had the goal of accessing technology, brands and market share, BCG says.

To a certain extent, SOEs need time to consolidate the many assets they have bought in the past, observes Bee of Baker & McKenzie. "The need for them to do multiple deals has decreased," she says.

Meanwhile, some observers say President Xi Jinping's anti-corruption campaign has frightened SOE bigwigs, who are increasingly choosing to keep a low profile. "Among SOEs, there's a desire to wait out the storm," says Backaler of the Frontier Strategy Group.

Private Sector Ascendant

Since 2010, there have been a number of important deals by private-sector firms in the industrial goods, consumer goods, agriculture and technology sectors. An increasing number of deals are happening in the US and Europe, where Chinese firms can obtain "strategic assets" such as brands, distribution networks, technology and human capital, notes Lai of the University of Nottingham.

One of the most important of these deals was Chinese automaker Geely's 2010 acquisition of Volvo from Ford for $1.8

billion, widely hailed as a major success. Geely has invested $11 billion in Volvo since the acquisition, helping the Swedish automaker's annual sales to rise from 374,000 in 2010 to a record 466,000 in 2014.

Geely has benefited considerably from the deal. Buying a strong European auto brand known for the safety of its vehicles has allowed Geely to boost the quality of its own brands and make them more competitive in China—the world's largest auto market.

"Geely CEO Li Shufu wanted to show the world that a Chinese company could maintain Volvo's high standards—and they've been very successful," says Backaler of the Frontier Strategy Group.

With the $4.87 billion acquisition of US pork giant Smithfield Foods in 2013, Chinese pork maker Shuanghui gained access to world-class hog processing and pork production technologies. Given the concerns of Chinese consumers over food safety, those technologies will help Shuanghui increase its competitiveness in the China market, according to a 2015 report by the International Food and Agribusiness Management Review.

The 2014 acquisition by Wanxiang, China's largest auto parts maker, of US battery maker A123 was also important—for very different reasons, notes Backaler. Initially, US regulators had concerns that the "dual-use technology" used in A123's batteries could have military applications. "Chinese investors I speak to are often concerned about acquiring assets in the US because they think the security review process is too difficult," he says.

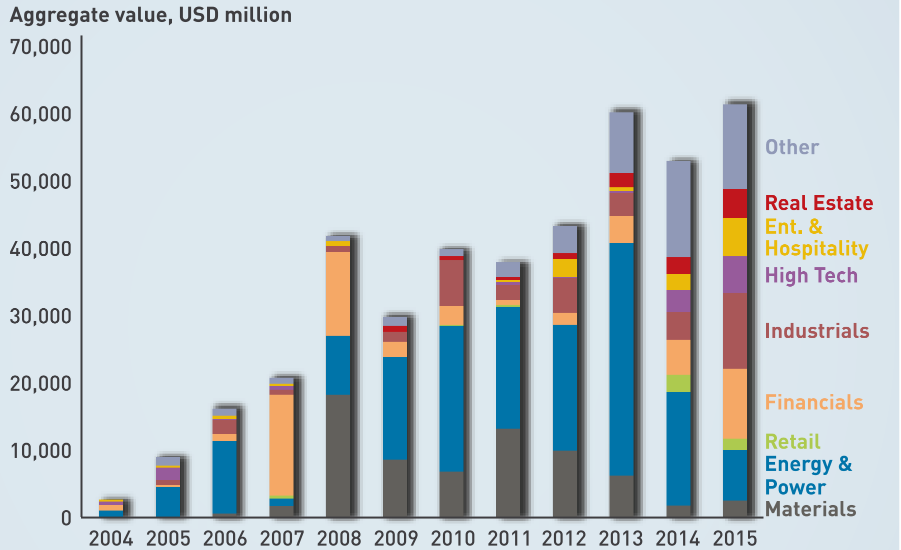
The security review process is overseen in the US by the Committee on Foreign Investment in the United States (CFIUS), an inter-agency committee chaired by the Secretary of the Treasury. It reviews transactions that could result in a foreign person controlling a US business to determine how those transactions could affect national security.

In September 2012, US President Barack Obama issued an executive order barring the Chinese firm Ralls Corporation from acquiring four wind projects located near a US naval facility in Oregon where drones are tested. The President did so based on CFIUS' conclusion that the transaction could harm US national security. Ralls Corporation has itself to blame: it failed to notify CFIUS of the transaction until construction had begun, two months after the deal closed—and only at the request of CFIUS.

By contrast, with the assistance of its advisors, Wanxiang was able to assuage the concerns of US regulators, says Backaler. The Wanxiang deal showed it is possible for a Chinese company to successfully navigate the American national security review process when there is sensitive technology involved, he observes, adding: "I visited the A123 factory in Hangzhou last summer and it's been a clear turnaround from a business perspective as well."

Mixed Mergers

Completed outbound M&A transactions by industry



Source: Rhodium Group

Shop 'til You Drop

During China's record cross-border M&A spree last year, one of the biggest players was Beijing-based Tsinghua Unigroup, the private-equity arm of Tsinghua University.

In the past two years, Unigroup has spent more than $9.4 billion in a quest to become a top global chipmaker. Its investments include the $3.8 billion purchase of a 15% stake in US data storage company Western Digital—the world's largest hard-drive maker—and the purchase of a $600 million stake in Taiwanese chip packager Powertech Technology last year.

State-backed Unigroup is leading a drive by the Chinese government to build semiconductor national champions, a policy that could include up to RMB 1 trillion ($170 billion) in support from Beijing over the next five to 10 years. As a result, Unigroup is one of the few SOEs making bold M&A moves amidst President Xi Jinping's ongoing crackdown on graft.

In November 2015, Unigroup announced it would invest RMB 300 billion ($47 billion) over the next five years in a bid to become the world's number three chipmaker.

"Tsinghua Unigroup has demonstrated its grand ambitions to conduct aggressive M&A moves worldwide," says Kevin Tu, a semiconductor analyst at the Taipei-based Market Intelligence & Consulting Institute (MIC).

For the Chinese, building a home-grown integrated circuit (IC) sector is "closely associated with national security," Tu says, noting China's current domestic IC production volume is low while demand is enormous. China is the world's largest and fastest-growing semiconductor market, comprising 50% of the $336 billion global market in 2014, according to a 2015 report by the United States Department of Commerce. Yet demand so far outstrips supply that 91% of China's semiconductors are imported, the report said.

The single biggest China outbound deal of 2015 was ChemChina's purchase of Italian tire maker Pirelli for $8 billion, also China's largest acquisition in Europe to date. ChemChina plans to combine the companies' truck tire businesses and incorporate Pirelli's expertise into its Chinese operations.

Meanwhile, HNA, owner of China's fourth-largest airline, agreed in July to buy Swissport, the top global provider of cargo and ground handling services, from PAI Partners SAS. That purchase is expected to increase HNA's access to a global aircraft leasing market where GE Capital and AerCap Holdings are dominant.

But for all the successes of China's outbound M&A last year, there were some notable failures. Both Tsinghua Unigroup's $23 billion bid for US chipmaker Micron Technology and the London Stock Exchange's plan to sell its Russell fund management business to Citic Securities for $1.8 billion fell through.

No Deal

On average, Chinese firms complete just 67% of their outbound deals, which compares unfavorably with their European, Japanese and US counterparts, according to a September 2015 report by BCG research.

One of the impediments to China's deal making is unclear M&A strategy. "Many companies lack a clear M&A roadmap, have only a vague idea of the purpose of any given deal and know little about the value of possible synergies or how to capture them," wrote BCG partner Ying Luo in the report.

Unigroup's failed bid to buy Micron indicates the Beijing-based firm's interest in NAND flash chips, used on mobile devices to store music, photos and other data, says Samuel Tuan Wang, Research Vice President of semiconductors at Gartner and a 35-year veteran of the IC industry.

> "The post-merger integration phase is by far one of the most challenging aspects of cross-border M&A deals involving Chinese firms
>
> Joel Backaler
> Associate Vice President
> Frontier Strategy Group

Yet an ill-defined strategy may have doomed that bid to failure, analysts say. "Over the years, Micron has shown it is determined to boost its market share in the memory sector with several M&As," says Tu of MIC. "Therefore, it is unlikely Micron would want to exit the memory industry in this manner [a buyout by Unigroup]."

Given the association of the IC sector with national security, it is also unlikely the US government would have approved the deal, especially given Unigroup's state backing, he adds.

Meanwhile, the London Stock Exchange Group's attempt to sell the Russell fund management business to Citic Securities collapsed following investigations into the Citic management team. By December 2015, at least 10 Citic executives had been ensnared in a government probe into China's July 2015 stock market tumult.

Once a deal has cleared regulatory hurdles, it can still be hamstrung by poor post-merger integration (PMI). Among Chinese firms, a common problem is the failure to develop a viable plan for the new entity's organizational structure in advance of the closing.

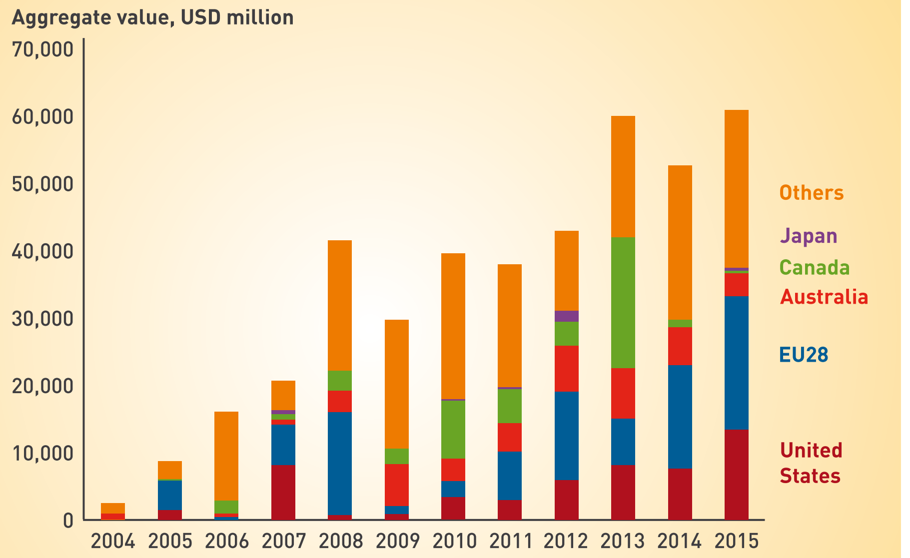
"The post-merger integration phase is by far one of the most challenging aspects of cross-border M&A deals involving Chinese firms," says Backaler of the Frontier Strategy Group. "Cross-border deals are always more complex, but when you take often relatively inexperienced Chinese buyers and they acquire companies in the US or EU, it's all that more difficult."

Cultural clashes can be heated. A notable case is the lease of Pier II of Greece's Piraeus port by state-owned shipping giant Cosco. When the deal was announced in 2009, it was hailed by Greek officials as a much-needed investment in the sclerotic Greek economy that would boost Piraeus's competitiveness. For Cosco, the pier serves as an important strategic gateway to bring Chinese goods into Europe.

Yet soon after Cosco took over operation of Pier II of the Piraeus port (Pier I is still operated by the Greek state-backed OLP Port Authority), Greek workers accused the company of mistreating them. The workers alleged Cosco forced them to work unreasonably long hours, failed to pay overtime and did not let them take a lunch break. Local union leaders warned Cosco was importing a harmful "Chinese labor model" to Greece.

Union leaders have observed frequent safety violations on the Chinese side of Piraeus, according to a December 2015 report by the Council For European Studies. For instance, crane operators work a four-hour shift—the maximum as stipulated by EU safety regulations—on the Greek side. But on the Chinese side, they work

Advanced Investment
Completed outbound M&A transactions by region



Source: Rhodium Group

for eight hours. Additionally, union leaders say several accidents on the Cosco-run pier have gone unreported. They attribute those accidents to sub-par worker training, poor equipment maintenance, and a lack of safety precautions.

Learning From the Best

How then can Chinese firms become more adroit overseas dealmakers? "They need to be able to find the right assets, get them at the right price (not overpay) and be able to attract the best talent from around the world to run the acquired firms," says Lai of the University of Nottingham.

At the same time, Lai urges Chinese firms to become more open, transparent and internationalized in their business practices.

To ensure greater success in cross-border deals, Bee of Baker & McKenzie says Chinese companies should involve advisors from an early stage. That will help Chinese firms be prepared to act decisively as slight hesitation can mean losing out to a rival bidder, she says.

Two cross-border deals done by Chinese firms stand out as exceptionally successful. The first is the acquisition by Mindray, China's largest medical equipment manufacturer, of the patient-monitoring unit of US data science consulting firm Datascope in 2008. According to BCG research, Mindray is unusual for a Chinese company in that its M&A team consists of experienced deal counselors from global investment banks and law firms. Moreover, at each stage of a transaction Mindray has also clearly defined the roles of its management team, core M&A team and professional advisors.

By 2015, Mindray had become one of the top three companies in patient-monitoring systems globally and a leader in the ultra-competitive North American healthcare market.

The second—and most celebrated—example of a Chinese cross-border deal is Lenovo's 2005 acquisition of IBM's personal computing unit. Lenovo came to the conclusion it wanted to buy IBM after first launching a targeted global search for acquisitions, according to BCG. With its strong brand, technology, market channels and cost structure, IBM presented an attractive proposition to Lenovo.

The success of the acquisition has been clear: Lenovo achieved a compound annual growth rate of 41% from 2005 to 2015, BCG says.

After the acquisition, Lenovo adeptly integrated its own culture and IBM's at the senior management level, and now a decade later, they have one of the most internationally diverse senior management teams of any Chinese company, notes Backaler of the Frontier Strategy Group. "This 'global perspective' only helps them be more successful as they attempt future acquisitions, as demonstrated by their successes including Medion, Motorola Mobility and IBM's enterprise server division," he says.

Lenovo has been prudent rather than opportunistic in its deal making, observes Tu of MIC. In the case of its 2014 acquisition of IBM's server unit, "servers are not tied to national security in the same way as ICs," he says.

Lenovo's disciplined approach to deal-making is something for other Chinese firms shopping for overseas assets to consider. Over time, persistent failure to complete deals or smoothly execute post-merger integration could harm the global growth prospects of Chinese companies. Acquisition targets could grow wary of Chinese buyers—especially if they believe the buyer is not serious.

Tsinghua Unigroup should take note. Its informal $23 billion bid for Micron in July 2015 looked like a crass publicity stunt. Gartner's Wang doubts Unigroup was sincere about the bid. Even if it was, cultural differences between the two companies "would have been extraordinarily difficult to bridge," he says. "It would not be advisable for Micron to accept that deal."

The offer was not serious, says Backaler, who spoke with a senior representative from Unigroup during during a site visit to Micron's production facility the week that the bid made headlines in July 2015. That person said he did not expect the bid "to go anywhere beyond the headlines."

"While many Chinese companies now have the cash to make high profile international acquisitions, what they often lack is the savvy and technical expertise to approach the deal in a way that is right for the overseas market," he concludes.

Safe Havens

Chinese companies are snapping up foreign commercial real estate, but the nature of the buyers is evolving

By Matthew Nitkoski

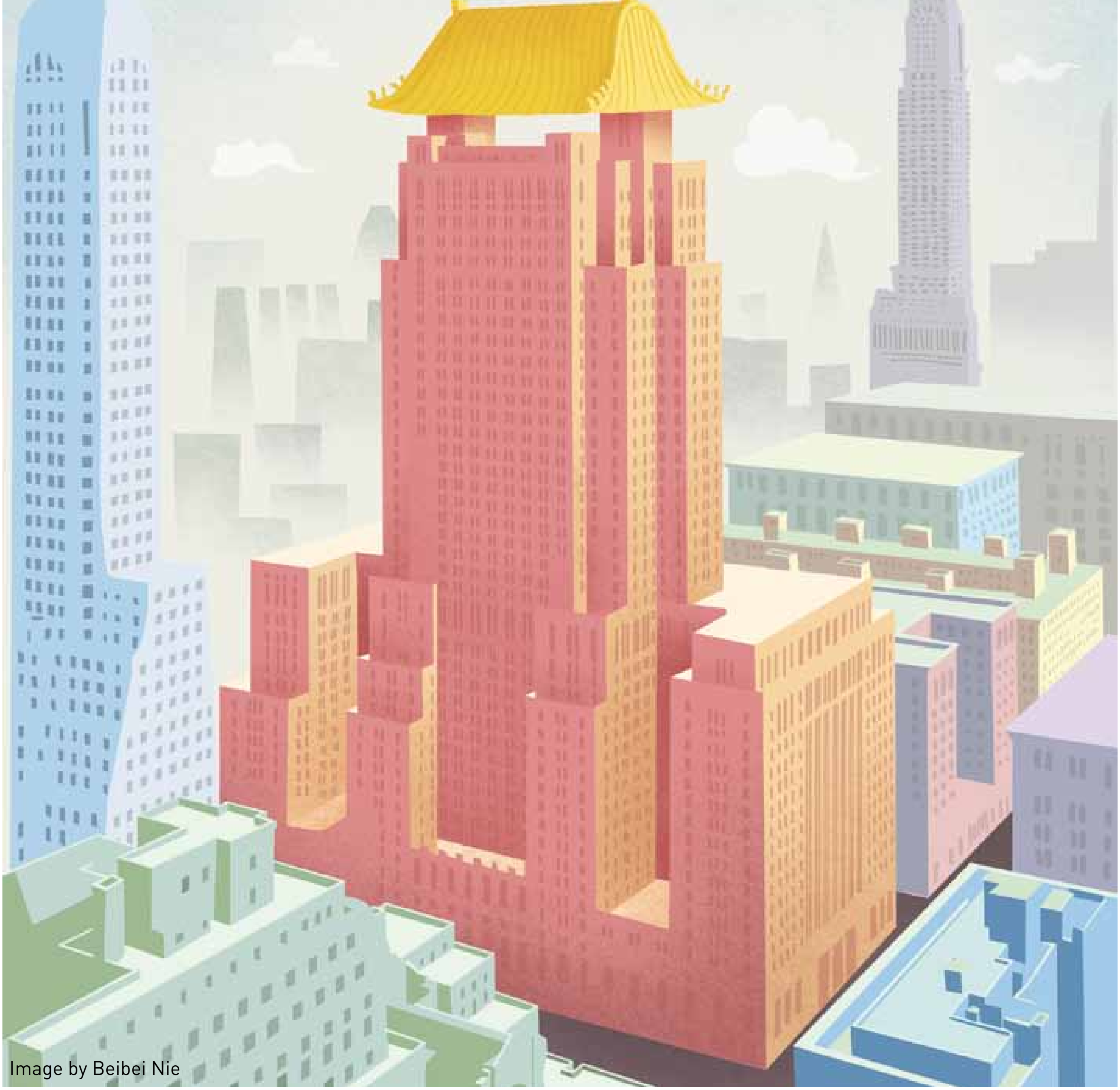


Image by Beibei Nie

The 47-storey Waldorf Astoria Hotel stands only a few blocks away from famous New York icons such as 5th Avenue, Madison Square Garden and Grand Central Station. Occupying a central location in Manhattan, the hotel has played host to countless high-profile events that have seen US diplomats, foreign dignitaries and celebrities mingle in ballrooms boasting famed Art Deco-inspired fixtures and décor.

Although the hotel regularly makes headlines when it hosts noteworthy guests, in October 2014 the Waldorf Astoria made the news for very different reasons when Anbang Insurance Group formally purchased the building for a cool $1.95 billion. The bottom line turned some heads, but the Obama administration's decision to break with tradition and stay at the nearby New York Palace Hotel for September's UN General Assembly drew particular attention. As a Chinese company buying property in the United States, Anbang suddenly found itself a victim of tense bilateral relations.

Anbang's purchase stands out for the controversy it created, but, in reality, the Waldorf Astoria deal only represents one foreign commercial real estate purchase among the many others carried out by mainland Chinese investors over the past few years. Other notable real estate acquisitions made by Chinese firms include One Chase Manhattan and the luxurious Baccarat Hotel in New York, a choice plot of land in Beverly Hills and the upscale Sheraton on the Park Hotel in Sydney.

The list of expensive acquisitions continues to grow and, with Chinese foreign commercial property purchases totaling over $10 billion in 2014, the trend looks set to continue. "Chinese capital will increasingly move abroad as investors look to expand their portfolios and enhance their investment returns in stable property assets," says Ada Choi, Senior Director of Research at CBRE Asia Pacific, an American commercial real estate company.

Laying the Foundations

One catalyst for this trend was the 2008 financial crisis, which originated in the US subprime housing market before spreading to Europe and endangering markets worldwide. The rapid and sustained drop in real estate prices in the United States and Europe gave Chinese investors an opportunity to purchase assets that had lost a significant chunk of their original value.

> Chinese firms have chosen to make their first forays into real estate in the relative safety of 'gateway cities'

Adding strength to Chinese investors' positions was the rising value of the renminbi, which made solid gains on the US dollar and the British pound from 2008 to 2014. Despite economic uncertainty roiling developed Western markets, Chinese investors continued to see real estate in mature markets as a safe investment. David Ji, Head of Research and Consultancy for Greater China at Knight Frank, says, "In mature markets such as New York or London, it is relatively safe to invest in a high-priced office building. You are guaranteed that these units will be leased to quality tenants such as banks, financial institutions or multinational companies, thereby ensuring reliable rent."

Significant regulatory overhaul also eased restraints on Chinese capital seeking stronger returns in overseas markets. In 2013, China's National Development and Reform Commission increased the overseas investment approval limit from $100 million to $1 billion, which allowed companies to make investments under $1 billion without needing prior government consent. Then in 2014, the Ministry of Commerce further loosened restrictions on foreign investment by eliminating prior approval requirements for the majority of outgoing investments.

These two landmark changes marked substantial steps in China's "going out" strategy, which combines incentives and regulatory overhaul to encourage firms to be global in their outlook and ambitions. Research conducted by CBRE illustrates how rapidly Chinese firms have responded to Beijing's global push.

In 2009, Chinese outbound real estate investment only reached $600 million. But the next year a new trend began as foreign commercial real estate investments steadily increased. The total figure for outbound commercial real estate investments climbed to over $10 billion in 2014, representing a dramatic increase in only five years. While different cities offer varying risks and returns, most Chinese firms have chosen to make their first forays into real estate in the relative safety of 'gateway cities'.

These cities, mainly located in the US, UK and Australia, are seen as the most attractive and reliable investment opportunities for inexperienced property investors. Familiar names such as London, New York, San Francisco, Washington, Los Angeles, Melbourne and Sydney offer Chinese investors a comfortable return on investment while they gain a foothold in new, developed markets. Moreover, the economic, political, and regulatory stability afforded in these cities ensures that assigned investments can't be rolled back. Once they've gained a better understanding of local regulations, companies then feel more comfortable to push outward into less developed markets.

"Failed investments in emerging economies have reinforced the belief that mature markets represent the safest investments," says Ji. Unsurprisingly then, according to a 2015 CBRE Research Report, London accounted for 52% of all Chinese commercial real estate purchases in Europe in 2013 while the purchase prices of hotels and offices in New York and Los Angeles accounted for approximately half of all investments in US real estate.

Unlocking Potential

Regulatory overhaul has been overwhelmingly successful in allowing companies to diversify their investments and spend their capital abroad, with mainland insurance companies in particular benefitting from relaxed rules.

"Chinese insurance companies have been quite active recently," says Junwei Lu, a Senior Associate with Berwin Leighton Paisner LLP. "These companies have traditionally been conservative, but with recent law changes relaxing investment regulations, insurers have sought to diversify their assets into safe havens such as the US, UK and Australia." Mainland insurers' investing power was unleashed in late 2012 when regulators allowed insurance companies to purchase real estate in 45 different countries. Subsequent reforms enabled insurers to invest up to 30% of their assets in real estate, with 15% of such investments overseas.

As a result, mainland insurance companies have been some of the biggest movers in recent years. Ping An Insurance purchased Lloyd's Building in London for $387 million in 2013, while Sunshine Insurance Group bought the 557-room Sheraton on the Park in Sydney for $401 million in 2014. Parking money in high-class hotels and cutting-edge offices guarantees that insurers will earn solid, if not spectacular, returns.

Wielding the country's considerable foreign exchange reserves, China's two largest sovereign wealth funds—China Investment Corporation (CIC) and the State Administration of Foreign Exchange (SAFE)—have also made their presence felt in global markets.

CIC has increasingly targeted Australia. Following its purchase of the towering Centennial Plaza in 2013, CIC purchased an additional nine office properties from Morgan Stanley in 2015. SAFE has made a string of purchases throughout Europe, with a 70,000 square meter office complex in Belgium standing out for its sheer size. With combined assets of an estimated $1.3 trillion, these two funds will continue to make waves in commercial real estate for the foreseeable future.

State-owned enterprises have also made significant plays in the foreign real estate market, with Sinopec, Industrial and Commercial Bank of China (ICBC), and the People's Bank of China making purchases in key cities throughout the US, UK and Australia. These state-owned corporations are at the forefront of China's "going out" strategy and, as such, purchase foreign properties with eyes on gaining access to new lucrative markets. For example, China's largest petroleum and petrochemicals company Sinopec recently purchased an office in Houston, Texas that will allow closer collaboration with local partners.

As China's largest bank, ICBC has rapidly expanded its operations in the United States after opening its first New York-based office in 2008. In 2014, ICBC formed the US' first offshore RMB trading center in Los Angeles, and in September 2015 announced plans to open another branch office in Seattle, Washington.

Yet for all their activity, these institutions are actually relative late comers to the field. "Private companies have been involved in foreign markets for longer than many of the big institutions," says Lu, a fact attributable to a much lighter regulatory burden.

Of these, Dalian Wanda Group has emerged as one of the most aggressive. In addition to buying multiple cinema chains around the globe, it has plans to develop a five-star hotel next to the Thames River in London. These high-profile acquisitions fit into China's "going out" plan as well as the company's larger diversification strategy that has seen it purchase stakes in a European soccer club and acquire a Hollywood film company. Additional plans to con-

Staking a Claim

Types of investors and their real estate purchases

Sovereign Wealth Funds

- **CIC**
  2013
  Centennial Plaza in Sydney
  Chiswick Park in London
- **SAFE**
  2015
  Covent Garden in Brussels
  2014
  Fosse Park Retail Development in Leicester

Insurance Companies

- **Anbang Insurance**
  2014
  Waldorf Astoria in New York
  2015
  717 5th Avenue Office in New York
- **Ping An Insurance**
  2013
  Lloyd's Office Building in London
- **Sunshine Insurance Group**
  2014
  Sheraton on the Park in Sydney

State-owned Companies

- **China Construction Bank**
  2014
  Offices in Seoul, London, and Frankfurt
- **China Cinda**
  2014
  Office building in Chicago
- **ICBC**
  2014
  Offshore RMB trading center in LA
  2015
  Office in Washington State

Private Companies

- **Fosun Group**
  2013
  One Chase Manhattan in New York
- **Dalian Wanda Group**
  2014
  Retail store in LA
  2015
  Office building in Sydney

Source: CBRE

struct the world's third-largest skyscraper in Chicago highlight the extent of Dalian Wanda's global ambitions.

Another privately held company, the Shanghai-based Fosun Group, has made over 10 real estate purchases in the last two years including 28 Liberty Street—formerly One Chase Manhattan—near Wall Street and a new residential tower near the Empire State Building. With investments in a wide variety of industries and asset classes, Fosun Group and Dalian Wanda have demonstrated that they have a greater appetite for risk than insurers, banks and sovereign wealth funds. Rather than simply parking money in buildings and waiting for returns, these private companies proactively use their real estate assets as they expand into new industries.

Taken together, institutional investors, developers and insurance companies constitute what Ji of Knight Frank calls "three waves," but the market is evolving once again. "Now the fourth wave is a mixed bag of small-to-mid cap investors, wealthy individuals, private equity funds and regional companies who are seeking more profitable markets overseas. This fourth wave of investors is less predictable than the first three," he says.

Naturally, this diverse assortment of investors have different motivations and target different types of real estate based on their interests and available capital. What remains clear is that commercial real estate will continue to be a target for investment in the coming years. One important factor to consider, says Ji, is that, while a new fourth wave is beginning to delve into foreign markets, the first three waves have not stopped buying and investing in properties.

Long-term Stay

The list of recent commercial purchases by private companies, insurers, sovereign wealth funds, and SOEs illustrates how quickly Chinese appetite for real estate has grown. While real estate in mature markets is generally perceived as a safe investment, commercial real estate encompasses a broad range of asset types that includes office buildings, hotels, distribution warehouses, assisted living centers and student housing. Among these, office buildings are often the easiest asset class for new Chinese investors to purchase. "Offices are quite straightforward," says Lu. "Investors can purchase the office property and use the asset to generate a stable income stream for the next 10 to 20 years."

> "This fourth wave of investors is less predictable
>
> David Ji
> Head of Research and Consultancy, Greater China
> Knight Frank

It is this simplicity and stability that has lured Chinese companies towards profitable office building purchases in gateway cities. Fosun Group's $725 million purchase of an office building in 2013 garnered significant press, but privately-owned companies as well as state enterprises have also made significant buys in Houston, Chicago, Seoul, London and Frankfurt. These properties can then be leased out to generate a stable revenue stream or kept in-house for use in expanding operations abroad, as with Sinopec in Houston and ICBC in Europe and the US.

Office buildings may be the safest, most easily managed commercial real estate assets, but the purchase of a luxury hotel brings the prestige and global name brand recognition that ambitious companies crave. The cachet of the renowned Waldorf Astoria or the elegant Marriott on the Champs-Elysees can provide the intangible boost a company needs to succeed internationally.

Naturally, these high-profile assets are out of the price range of all but the largest companies, but the potential returns on a hotel property are so great that even smaller investors are getting involved. "Hotels provide effective diversification of investment assets, and, in large gateway cities such as Los Angeles and Sydney, there is always a demand for rooms," says Ji.

In addition to stable returns, Chinese-owned hotels have a leg up over foreign firms in drawing on the ever-increasing number of Chinese tourists abroad. According to the China Tourism Research Institute, over 61 million Chinese traveled during the first half of 2015, a figure that represents a 12.1% increase over the same period of 2014.

With Chinese continuing to travel and study and move abroad, Choi is confident that hotel assets will remain attractive options for investors. "Capturing the increase of Chinese travelers around the globe will continue to be a motivating factor in mainland Chinese companies' hotel purchases," he says.

Offices and hotels are the glitzy, high-profile buildings that carry large price tags and generate significant returns, yet their more humble counterparts, retail stores and warehouses, offer buyers another set of advantages. "Companies that purchase stores and warehouses are often looking to capture technology and knowhow that they can then bring back to mainland China. By getting involved in retail and logistics overseas, Chinese companies can gain an advantage over competitors at home," says Lu.

Dalian Wanda's $420 million purchase of a retail space in Los Angeles in 2014 is one clear example. Fosun Group has also announced plans to redevelop downtown Manhattan's 28 Liberty Street with new restaurants and high-end retail stores. Although home appliance giant Suning has yet to expand abroad, its recent advertisements in New York's Times Square beckoning pedestrians to visit "Suning Smart City," a cosmopolitan zone blending shops, hotels and entertainment, may presage future acquisitions.

Real Estate Replay

Given the rapid entry of Chinese investors into developed markets, it is easy to draw parallels between ongoing trends in outbound Chinese investment with similar purchases made by Japanese investors decades earlier. Throughout the 1980s, Japanese investors bought skyscrapers, golf courses and hotels as they sought reliable returns for their considerable foreign exchange reserves.

In 1988, Japanese investors' spending on US properties reached its peak at $16.54 billion (equivalent to $31.5 billion in today's money), prompting fears of a "Japanese takeover". Investors were quickly brought down to earth, however, when the bursting of an asset bubble stalled a Japanese economy that had enjoyed decades of rapid economic growth, ultimately leading to the offloading of some of the most prestigious real estate, including the Rockefeller Center in New York, and often with heavy losses.

The impressive list of recent Chinese acquisitions coupled with a surge of wealthy mainland individuals buying up properties throughout mature markets are prompting similar worries of a "Chinese takeover". In reality, Chinese investors are just one slice of international investors pouring capital into global hubs such as Los Angeles, New York and London. A research report by CBRE reveals that investors from the United States, Canada and Germany were in fact the top three sources of cross-border investments in commercial real estate for the first half of 2015.

China only ranked fourth in that list, but ongoing regulatory reforms, coupled with mainland firms' growing confidence and experience, will likely contribute to further outbound investment in commercial real estate. Continued stock market uncertainties and currency devaluations will also increase Chinese desires for the relative safety of real estate in developed markets. "We know that the extent of Chinese available capital tends to be huge. At the moment, only a small part of those reserves have been deployed. The growth potential is enormous," says Ji.

Potential investors are also monitoring the regulatory environment in foreign countries. In December 2015, President Obama signed a new bill into law that eliminates taxes on foreign pension funds seeking to invest US real estate. While fears of a Chinese "invasion" could prompt a backlash, such as the one that derailed Huawei's attempted acquisitions of US technology firms, for the moment, regulations on the mainland and overseas are relatively relaxed.

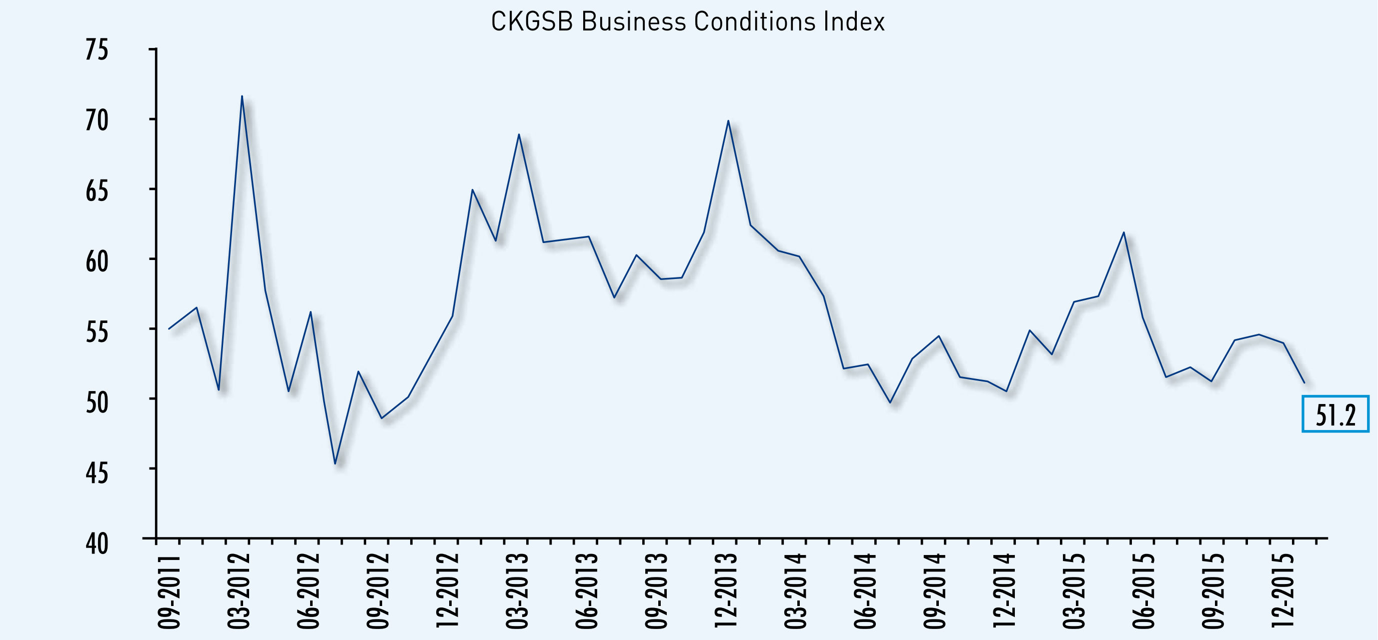
The Waldorf Astoria stands as a towering symbol of Chinese investors' growing clout in commercial real estate markets. And despite the presidential snub, the downtown Manhattan hotel will continue to attract wealthy clientele and substantial income. No investment is ever certain, but, for now, the relative safety offered by tangible assets presents an attractive alternative for Chinese investors wary of unstable stock markets and currency devaluations.

Waning Optimism

Confidence is down, but it's not out

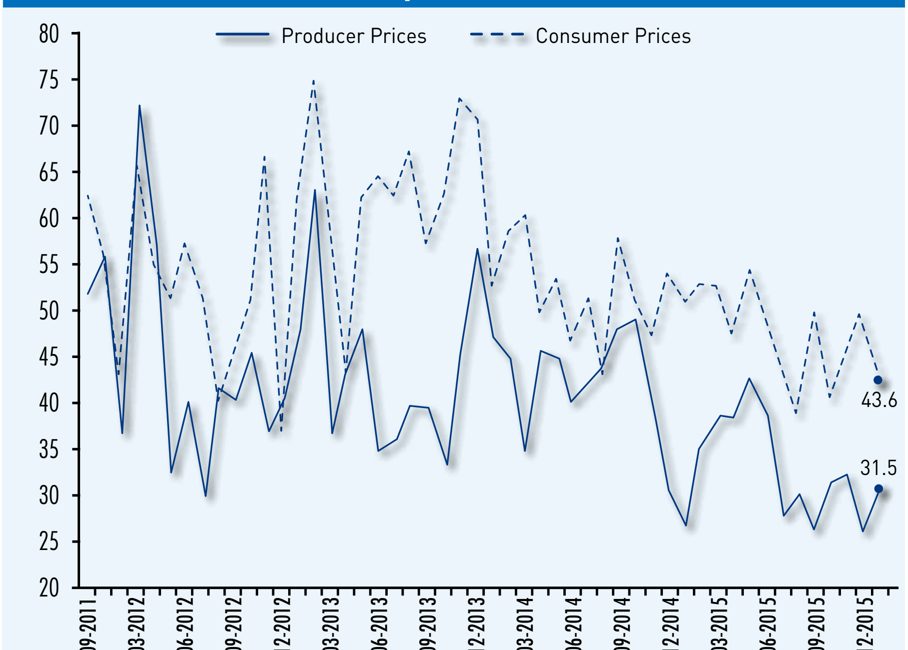
In January, the CKGSB Business Conditions Index (BCI) posted a figure of 51.2, a slightly lower overall reading than the previous monthly reading of 54.0 and slightly above the confidence threshold of 50. In May 2015, the BCI was at a considerably higher level of 61.3, but from July to September it was only just above 50. From October until December, the overall index has hovered around 54, but it has now slipped back towards the confidence threshold. This shows that for the majority of relatively successful firms in China, optimism about business conditions over the next six months is waning, and the current forecast for business operations is cautious optimism. The BCI, directed by Li Wei, Professor of Economics at the Cheung Kong Graduate School of Business, asks respondents to indicate whether their firm is more, the same, or less competitive than the industry average (50), and from this we derive a sample competitiveness index (see Industry Competitiveness Index). As our sample firms are in a relatively strong competitive position in their respective industries, the CKGSB BCI indices tend to be higher than government and industry PMI indices.

Business confidence takes a dive...



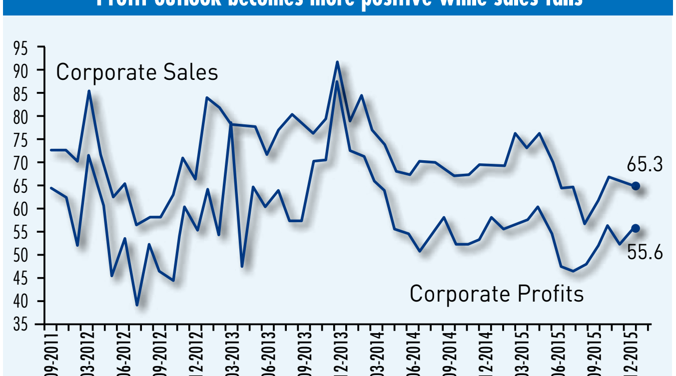
...but competitiveness is on the up

Producer and consumer prices move closer to each other

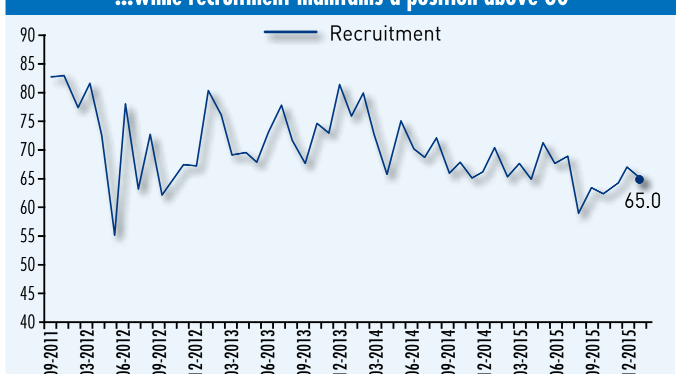


The consumer prices index fell from 50.0 to 43.6, and producer prices continued to hover at a low level, edging up from 27.8 to 31.5. Since January 2014, consumer prices have looked comparatively healthier and been mostly above 50, however the situation has deteriorated markedly, with the future trend unclear. Corporate sales fell from 66.3 to 65.3 in January, but the profit index rose, from last month's 53.4 to this month's 55.6. Although in recent months a sharp decline has been seen, this year profits expectations returned to over 55, showing that the profit outlook is becoming more positive for the upcoming six months. The labor demand index fell from 66.0 to 65.0—it has only been between 50 and 60 twice, and has remained above 60 for the rest of the time.

Profit outlook becomes more positive while sales falls



...while recruitment maintains a position above 60



Delivering Growth

Although constituting a major policy shift, the two-child policy might not help balance the books

By Xin En Lee

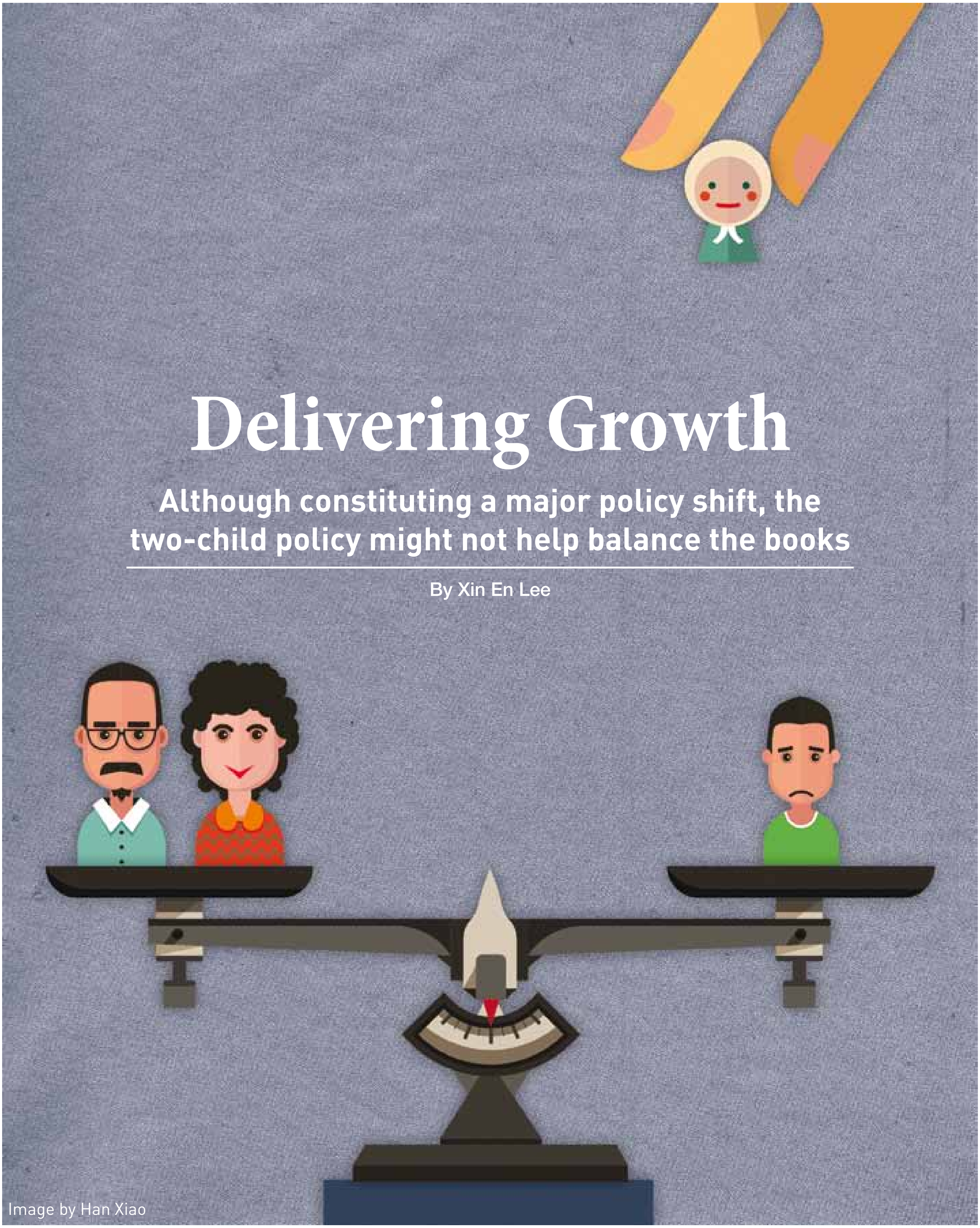


Image by Han Xiao

The announcement of the two-child policy in late October sent Mary Yang on a rollercoaster ride of emotions.

"I was overjoyed when I heard the news. At dinner time that evening, I asked my husband if we should have a second baby, and he was absolutely for it, and we were all happy and excited. For years, we had thought we could not jeopardize his job in the civil service, but here comes the opportunity."

But that night, overwhelmed by worries, she couldn't sleep. In her late forties, Mrs Yang was afraid that her pregnancy would be too risky. Moreover, she wasn't sure if they could afford a second child, given the already high expenses for their ten-year-old son, and she wasn't sure whether her employer, an insurance company, would keep her job if she did have a second child. By the morning, the couple said they weren't as certain any more. They have decided to wait a little longer before deciding on what to do.

Like Yang, since China's announcement that married couples could now have two children, thousands of couples in China are likely to have spent sleepless nights ruminating on the possibility of adding to the family.

The landmark announcement, which came after 37 long years, caught many observers off-guard and was passed by the Chinese legislature in December last year. Oxford demographer Stuart Gietel-Bastern said he was "shaking", while noted Chinese author Xin Ran, who has written extensively about China's one-child policy, said she "shed a tear". Chinese social media went into jubilant overdrive, reflecting the policy's deep social reverberations.

While Chinese authorities cited the official reason for the change as being "intended to balance population development and address the challenge of an ageing population", their projection that the abolition of the policy would yield a 0.5 percentage point boost in economic growth over the long term, without specifying a time frame, suggested that there were economic motivations behind the end of the one-child policy. But whether it will really deliver a boost in growth for the economy is an open question.

> "There is a bigger demand to have fewer children
>
> David Howden
> Professor of Business
> Saint Louis University

Demographics Askew

While most observers date China's one-child policy to the late 1970s, China began demographic planning from as early as 1964, when China established its first Birth Planning Commission to lead birth control efforts after China's population growth rebounded after the devastating Great Chinese Famine.

As part of China's 4th Five-Year Plan in 1971, China began setting official goals of reducing population growth and launched the "Later, Longer, Fewer" campaign. The campaign pushed for citizens to marry later—at least after age 25 for women and 27 or 28 for men in the city, and for citizens to have fewer children, with longer time periods between the births of children. During this campaign, there were penalties for those who did not comply, and by 1979 the country's total fertility rate had halved to 2.7, down from 5.5 in 1970.

But in 1979, in spite of the drastic decline in birth rate in previous years, Deng Xiaoping's government decided that more drastic action was needed and the one-child policy was officially introduced. According to researchers, action was taken after doomsday scenarios of overpopulation generated in the West found their way to China through Song Jian, a ballistics specialist who had the ears of Chinese leaders.

While Chinese authorities have claimed that the experiment was enormously successful and helped prevent 400 million births, thereby ushering China into an age of economic prosperity by saving resources and preventing overpopulation, the most significant long-term effect of the one-child policy was its sending China's demographic structure off-kilter.

The fertility rate fell below the replacement rate shortly after 1990, reaching 1.65 children in 1992 according to China's National Fertility Survey. But it continued plunging, causing China to face the situation of a prematurely and rapidly ageing population.

Driven by the one-child policy, the share of China's population under the age of 20 fell from 51% in 1970 to 27% by 2010, while the share of people older than 60 years old rose from 7% to 14%. There is increasing pressure on this shrinking population of working adults as the working-age population is estimated to fall by 9% from this year to 2030, according to the UN. In fact, the announcement of the two-child policy was officially justified based on addressing the challenges of an ageing population, according to the Chinese government.

But Lu Bei, a fellow at the University of New South Wales's Centre of Excellence in Population Ageing Research says she does not think that the new policy was driven solely by the ticking time bomb of the ageing population.

While she says that fiscal transfer is urgently required to address the budgetary shortfall caused by an increasingly smaller ratio of working adults to pensioners, she thinks that the policy has more long-term aims

"The two-child policy is aimed at solving this fundamental population structure challenge, but it might take more than 50 years to take effect," she says. "Since fertility change will take a long time to alleviate the demographic structural pressure, I do not think the budget constraint caused by the ageing population is the main reason today for this policy."

She added that the new policy is "a strategic population policy for future fiscal balance" to "ensure sustainable economic growth."

Will China Take to Two?

Despite its name, the one-child policy is in fact a misnomer, with a significant group of citizens who were allowed to have a second child. By 2007, a senior official from the National Population and Family Planning Commission claimed that the one-child policy applied only to 36% of residents, reported *China Daily*.

In her book *One Child: The Story of China's Most Radical Experiment*, journalist Mei Fong also shows that there was an indication of a move towards ending the policy during the 2000s, beginning with the folding down of the gargantuan National Population and Family Planning Commission.

The bureaucracy had half a million employees on its payroll, as well as 85 million part-timers involved in everything from recording women's menstrual cycles, to conducting pharmacological research to enforcement. With the folding of the commission into the health ministry, the policy easing was set in motion.

Official rhetoric also relaxed around the same time, when in February 2008 Zhao Baige, then vice-minister of family planning, told reporters that China would ultimately scrap the one-child policy. The rules were also substantially loosened in November 2013, with an exemption allowing two children for families where one parent is an only child.

These exemptions offer an insight to what China's fertility rates will look like with the removal of the two-child policy. Yong Cai, a fellow at University of North Carolina's Carolina Population Center, is convinced that the number of babies born will be far lower than the government's estimation of 8 million more babies a year.

"Two years ago, China lifted the policy to allow two children for parents who are only children, predicting 2 million extra births. Instead, only 1.5 million of about 11 million qualified applied to have a second child, and an even smaller number of that, roughly half a million went on to have a second child, which suggests that the government's estimate is quite far off," he says.

Cai stands by his research from 2007, where he and a group of Chinese demographic scholars conducted a survey of 18,000 women in six counties in Jiangsu province. They found that of 30% of women qualified to have a second child, only 4% went on to have a second child. Shocked by the low figures, he returned to Jiangsu to interview women and returned with the conclusion that the cost of raising children was a significant deterrent to many.

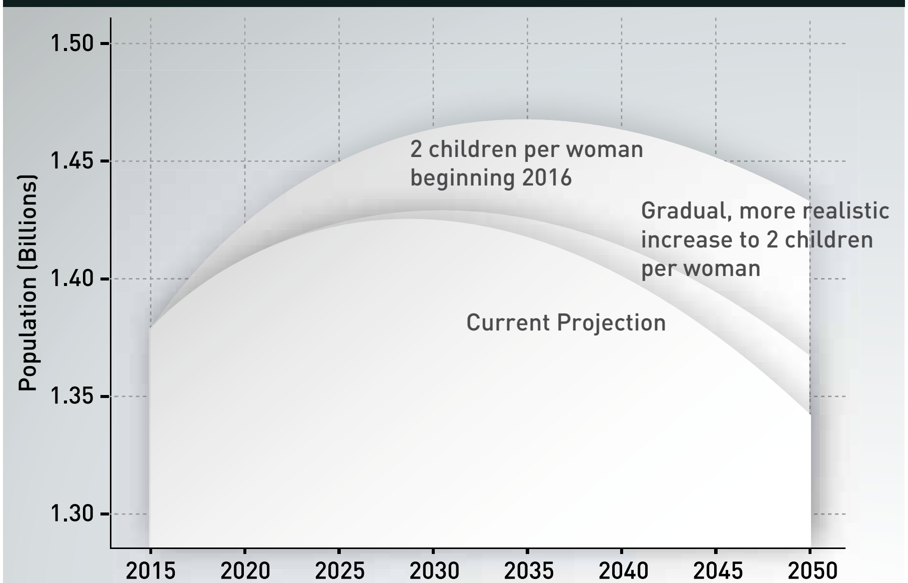
"Of those who had or aspired to have two children, their main distinguishing characteristic was that they could afford a second child, and that they usually had better time flexibility in their job," he says.

But the case of Yicheng in Shanxi province—one of four towns which quietly allowed its residents to have two children from the beginning of the one-child policy—offers an interesting counter point to Cai's findings.

While Yicheng is a little poorer than the national average, the town, which at first sight looks like any other small town in China, had a fertility rate of about 0.3 points above the national average in 2000, *The Economist* reported. Fertility has fallen more slowly in Yicheng, implying that some parents, if given the chance, regardless of wealth, would have more than one child. The estimates of China's baby boom still remain anyone's guess, with couples like Mary Yang and her husband unsure of what to do.

It Takes Two

Possible effects of the two-child policy



Source: Population Reference Bureau

Baby Bull Market

The market, however, reacted enthusiastically to the policy's potential ability to boost consumption. Shares of stroller and car seat maker Goodbaby rose by 7.4% after the announcement, while milk powder producer Biostime saw an increase of 5.5%.

Chinese brokerage Citic Securities also put the predicted the number of births at the high end of estimates, saying in a report that the new policy could bring in six million more new births a year, creating a market worth $55 billion.

Vic Edwards, a visiting fellow in Banking and Finance at the University of New South Wales Business School, highlighted that Australia stood to be the country which would benefit the most in the short term, with increased demand for Australia's highly sought after pharmaceutical goods, milk powder, eggs and meat.

Meanwhile, local media such as *China Daily* and the *South China Morning Post* reported on a surge in demand for larger homes. *The Post* cited Cai Shiyang, a real estate agent saying that the policy had a "huge" impact on real estate. While larger units used to account for less than 30% of all deals, the policy had greatly altered demand, with half of his deals now made up of larger units.

Xinhua also reported that the year of the monkey, which began on February 8, is considered an auspicious year for babies, which would encourage more parents to have children. Postnatal service providers are reportedly short of well-trained maternity matrons, said *Xinhua*, which reported that salaries were being doubled with the increasing demand for matrons.

Jin Keyun, a professor of economics at the London School of Economics, says that the new policy will drive China's consumption growth, noting that boosting domestic consumption has been a longstanding macroeconomic goal of the Chinese government in moving from an export-led growth model to one based on domestic consumption and services.

Citing a 2009 urban household survey comparing families who had twins under the one-child policy and those who had just one child, Jin says that the policy would reduce aggregate savings and drive consumption. Urban households with one child spent an average of 10.6% of total income on education and saved 21.3% of total income, while those with twins spent 17.3% and saved only 12.8% of total income.

"As the number of households with two children increase, the two-child policy is likely to be the most effective way to increase consumption," she says, adding that while initial sectors such as children's products would benefit first, other sectors such as housing, life insurance and pharmaceuticals would also see a ramping up in demand.

While David Howden, a professor of business at the Saint Louis University in Madrid, agrees with Jin that Chinese people spend more money on children when they have more, which would result in a decrease in savings and increase in consumption, he is skeptical that the new two-child policy will have much effect in the short run because the Chinese no longer look at children as "savings plans". That contrasts with people in developing countries, who, instead of paying into social security plans, typically prefer to have their children look after them in old age.

> "Economic growth... is not entirely driven by the extra number of people
>
> Yong Cai
> Fellow
> Carolina Population Center
> University of North Carolina

"Typically in developing countries, children are a way to save for retirement… but Chinese people are now reluctant to have many children as they save more of their income in real assets, rather than in the form of children. With undeveloped financial markets and high inflation, Chinese savers put money into real estate and real assets as their only savings vehicle," he says.

"In China now, there is a bigger demand to have fewer children and to give more opportunities to each child, while they invest in real assets like housing for their retirement," he adds, noting that he still expects a labor crunch in the future.

Not an Economic Fix

While all experts agree that the scrapping of the one-child policy was well overdue, the majority think it will not have a significant impact on China's economy.

Most experts point to the fact that the birth of more babies is too late and too little to reverse Chinese' unbalanced demographics.

Shamel Azmeh, a fellow at the London School of Economics's (LSE) International Development department, wrote in an LSE blog post that China's challenge for economic and political stability will be determined by the key issue of economic upgrading from labor intensive manufacturing to higher value-added industries to match the demographic shift. However, he cites World Trade Organization data that the foreign value-added in China's manufactured exports have increased since the late 2000s, indicating that the process of upgrading China's industrial abilities has stagnated.

While "relaxing the population policy to boost labor supply" could help to rebalance the dangerous trends of its slowdown in exports and stagnation in upgrading its industrial abilities in manufacturing, Azmeh adds that the step could be seen as being taken too late as China's labor force will continue to shrink in the coming years, making the need for innovation that much greater.

And while Cai thinks the long-term benefit in demographic balancing is significant, he also hesitates to imply that there will be significant economic impact.

In recent years, China has seen about 16 million births annually, Cai says, estimating that about 10 million more babies could be born in the next three to five years. There could be 2 million more babies annually, bringing the yearly total to about 18 million, although he cautions that his figures are optimistic.

To put that into context, Cai says that even with more than 20 million babies born each year in the 1990s, the impact was not considered substantial. Two or three million more babies will not have a substantial impact, he adds.

"There will be a short-term economic impact, but I really doubt that any economist will say that it will boost GDP growth," he says. "Economic growth is not so mechanical and is not entirely driven by the extra number of people."

Apple's Shine

Does the iconic tech giant have staying power in what is now its number two market?

By Matthew Fulco

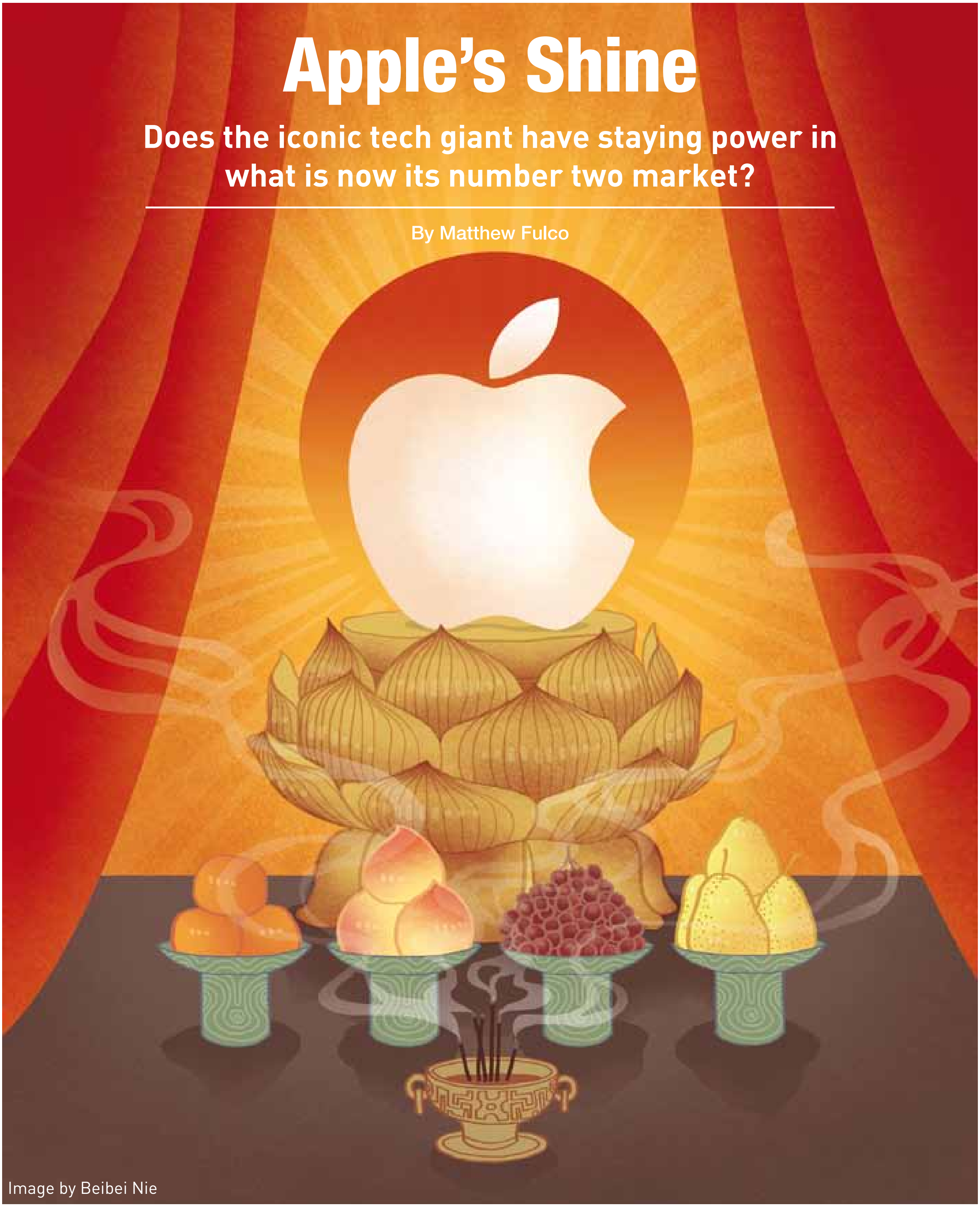


Image by Beibei Nie

Apple is riding high in China as the tech brand of choice for the nation's newly minted upper middle class. Android vendors might be selling millions of phones in the world's largest smartphone market, but not to consumers like Julie Ma, a 36-year-old Shanghainese marketing manager for a global property services firm.

Ma has an iPhone 6, an iPad Mini and a MacBook Air. She has been using Apple products since 2010 when she purchased her first iPhone.

"Apple products are gorgeous in every way," she says. "They're beautifully designed, they feel pleasant to the touch, they function smoothly."

In what she says was a rash decision, Ma once switched over to an Android-powered Samsung. But her Android affair didn't last: when she accidentally dropped the Samsung phone into water, she never thought twice about replacing it with a new iPhone.

Millions of Chinese consumers share Ma's affinity for Apple. Greater China (the Chinese mainland, Hong Kong and Taiwan) is now Apple's number two market after North America, comprising 24% of its business. One of Apple's largest stores in Asia is in Beijing's Wangfujing neighborhood. In October, Apple CEO Tim Cook told investors he expects Greater China will eventually become the company's top global market.

To be sure, Apple faces challenges in Greater China. Sales in the region rose 14% in the company's first fiscal quarter ended December 26 to $18.4 billion, compared to 70% in the same period a year ago. In a January earnings call, Cook said Apple is starting to see "signs of economic softness" in Greater China. That could bode ill for the US tech giant as it launches its mobile-payment service, Apple Pay, on the Chinese mainland, especially with its entrenched local competition.

And there are concerns that Apple's innovative capacity will ebb under the leadership of Tim Cook. As a supply chain expert, Cook approaches business very differently than late Apple founder and CEO Steve Jobs, who is widely hailed as a creative genius.

"Steve Jobs' approach was to tell consumers: 'You don't know what you want, so I will show you,'" says Eddie Han, a smartphone analyst at the Taipei-based Market Intelligence & Consulting Institute (MIC). "Now, Apple is behaving more like a regular tech firm—having launched a large-screen smartphone because there is high demand for that product right now."

Patience is a Virtue

Apple did not always flourish in China. It was a latecomer to the country's handset market, entering in 2009 via an agreement with China Unicom after two years of secret negotiations with Chinese carriers. At the time, Unicom's 3G network was the only one that was technologically compatible with the iPhone.

By the time it became available to Chinese consumers in October 2009, rivals like Nokia, Samsung and Motorola were firmly ensconced, having benefited from long-term investments in the Chinese mobile market. Apple also faced fierce competition from local brands Huawei and ZTE.

Apple's strategy in China was then—as it is now—to target the premium market, allowing the company to maintain high profit margins. There have never been discounts, even though the iPhone is pricier in China than in the US because of import duties.

Aiming high helped build Apple's image as a premium brand in the minds of Chinese consumers, but sales were initially modest as fewer Chinese could afford an iPhone than today.

In 2012, upper middle class consumers, defined by consultancy McKinsey & Company in a 2013 report as having household incomes of RMB 106,000 to 229,000, accounted for just 14% of urban households. By contrast, the mass middle class, with household incomes of RMB 60,000 to 106,000 annually, made up 54% of urban households.

An iPhone 4 without a contract cost about RMB 6,000 in 2012, which was unaffordable for most of China's mass middle-class consumers at the time. Yet household incomes have steadily risen since, giving a boost to Apple's China fortunes.

However, the key catalyst for the company's surge was the deal signed with China Mobile in December 2013, says Han of MIC. That agreement gave Apple access to the massive state-owned carrier's then 700 million subscribers, he notes.

Since then, Apple has risen from number 5 to number 3 in China's smartphone market, trailing only Xiaomi and Huawei.

Far From the Tree

China is currently Apple's fastest-growing market. Even as sales slowed globally in its first fiscal quarter ended, which ended December 26, Apple managed double-digit growth in the Greater China region.

For the fiscal year that ended September 2015, the company reported 84% annual revenue growth—an increase of roughly $27 billion—for Greater China. Operating income nearly doubled from $11.04 billion to $23 billion, boosted by sales of high-margin 64 GB and 128 GB iPhone models.

The iPhone is driving Apple's success in China. Stifel, a US brokerage, estimates non-Android (primarily Apple) smartphone sales jumped 33% year-on-year in China in the fourth quarter of 2015 to 24.3 million units.

Strong adoption of the iPhone in China is driving a parallel surge in app store downloads. From the fourth quarter of 2014 to the fourth quarter of last year, iOS downloads in China increased by 20%, according to Beijing-based analytics firm AppAnnie. Apple's iOS app store spend "exploded in 2015 as revenue doubled year over year" on the back of brisk games sales, AppAnnie notes in a January 2016 report.

In China, Apple relies largely on sales in brick-and-mortar stores that CEO Cook has said "are among the busiest in the world." The US tech giant currently has 33 stores in China, and plans to have 40 in the Greater China region by October.

"We've been going gangbusters since 2011," says a person close to Apple's China retail business, speaking on condition of anonymity. "There was a bit of a lull in 2014, but since the launch of the Apple Watch, we have accelerated to a record pace."

Apple had sold over 1 million of its smartwatches in China as of early September 2015, according to Beijing-based analytics firm Talking Data.

In addition to official Apple stores, the company is opening a large number of 'shop-in-shop' locations inside other retailers—cellular carriers and authorized Apple resellers. "When Apple says it is opening four stores in January, that is just the [official Apple store] retail program," the person says. "They will probably open 30-40 other [shop-in-shop] locations as well."

Meanwhile, for China's tech-savvy upper middle class, Apple's brand power is irresistible. Its products are attractive, reliable and iconic, especially compared to the drab Android competition, consumers say.

"Android phones aren't stylish at all, and the operating system is unstable," says Anna Zhou, 28, an e-commerce sales manager for a European fashion brand in Shanghai.

Google's absence from China has been a boon for Apple, whose official app store is more trusted by Chinese consumers, says Han of MIC. "It's not just that iOS is a closed system and Android is open. Google doesn't have control over the apps sold in China's own Android stores, so it's inevitable that Android phones end up with more malware on them than iPhones."

Pay to Play

Looking to China as a long-term growth source, in February Apple launched its mobile payment service Apple Pay in the Middle Kingdom. There is strong potential in China's ascendant mobile payment market, analysts say. The Beijing-based research firm iResearch reckons Chinese consumers spent RMB 9 trillion (about $1.4 trillion) using mobile payment apps last year. Spending will double to RMB 18.3 trillion by 2018, iResearch says.

Apple Pay works best on the newest iPhone models, like the iPhone 6 and 6S. Using near-field communication technology, the service allows users to tap their devices on readers at store sales counters and make purchases by scanning their fingerprints.

Apple Pay can be used with the iPhone 5, but only when paired with an Apple Watch: fifth-generation iPhones cannot perform contactless payments independently.

To bring the service to the country, Apple has teamed up with China UnionPay, which has a monopoly on processing bank-card payments in China, and 15 Chinese banks.

"Cooperating with a strong local partner like UnionPay will help Apple penetrate the Chinese market fast," says Nephy Hu, a mobile payments analyst at MIC.

Just as it has partnered with mobile point-of-sale (POS) provider Square in the US, Apple may work with similar local firms in China to boost use of Apple Pay at physical retail locations, Hu says.

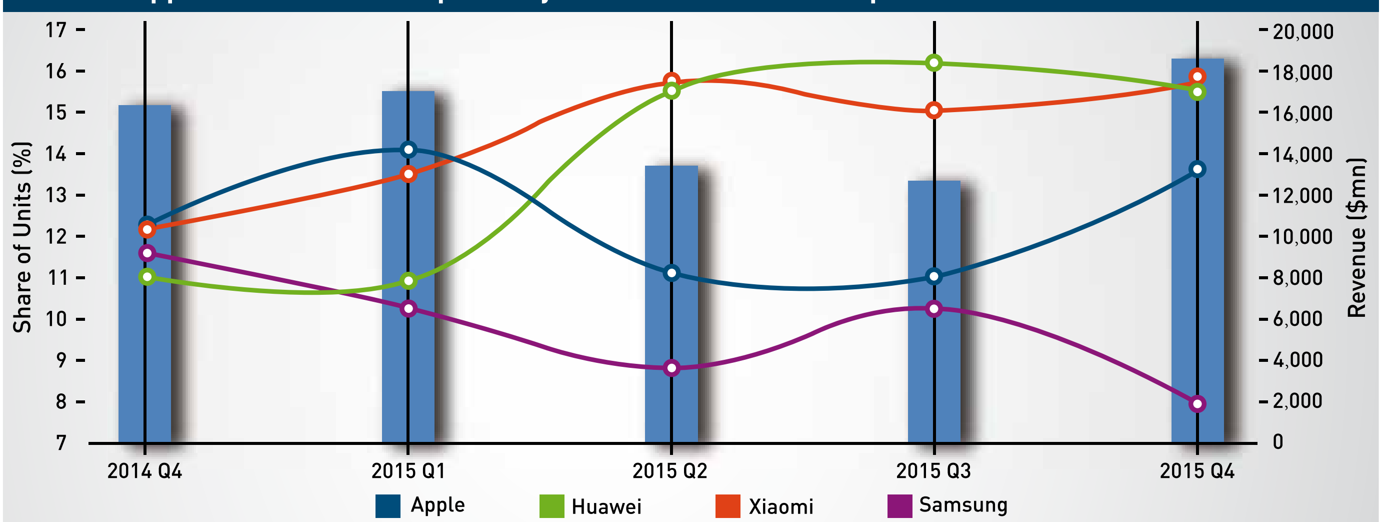
Also, Apple may team up with a local online payment service provider as it did with US payment startup Stripe to encourage online shopping with Apple Pay, he says.

But Hu believes Apple Pay will face considerable headwinds in China, where Alibaba's Alipay and Tencent's Tenpay together control 90% of the market. Compared to Apple Pay, both of those platforms are "deeply rooted in local consumer habits", which involve using a mobile phone for everything from paying utility bills to making investments. Alipay and Tenpay reach a larger user base as well, as they can operate on either an Android or iOS phone.

Apple could expand the user base for Apple Pay by integrating the service with Alibaba's Taobao and Tmall shopping sites, which together with the business-to-business site Alibaba.com form China's largest e-commerce marketplace. In 2014, those three sites had combined sales transactions of $248 billion, exceeding the sales of Amazon and eBay together.

Apple's Core

Apple's Greater China quarterly revenues versus smartphone market share in China



Note: Revenue time adjusted to account for the timing of Apple's fiscal quarters

Source: Canalys, Apple

In October 2014, speaking at a tech industry conference in California, Tim Cook and Alibaba CEO Jack Ma said they would be open to working together in China. A formal partnership between Apple and Alibaba is yet to be announced, but the two companies are believed to be in ongoing discussions.

The partnership is unlikely to be a priority for Alibaba, which already dominates online payments in China with Alipay, says Hu. Still, Hu believes Apple Pay has a reasonable chance of success in China. "Apple Pay has a lot of things going for it—the brand loyalty Apple commands, the company's strengths in software, compatibility with the Apple Watch, a high level of security."

The Clock Is Ticking

Even if Apple Pay doesn't catch on in China, Apple's devices remain popular with the nation's consumers. Alex Zhu, a 28-year-old editor at a Shanghai lifestyle magazine, says she is committed to the brand. "An iPhone is expensive but it's worth the money," she says. "It's more user friendly than Android and I don't have to worry about malware infecting my phone every time I download an app."

Demographic trends are moving in Apple's favor as well. By 2022, McKinsey estimates China's upper middle class will account for 54% of urban households and 56% of urban private consumption. By contrast, the mass middle, for whom an iPhone is usually out of reach, will fall to just 22% of urban households.

Chinese brands will be targeting the growing upper middle class market too, analysts say. James Yan, a Beijing-based handset analyst at the research firm IDC, says Chinese smartphone brands Oppo and Vivo could eventually compete with Apple. Both Chinese brands offer phones with excellent hardware, and they have customized Android operating systems that are more secure than what is typically found on an Android phone, he says. Compared to Apple, "the price is right, too."

Nicole Peng, the Shanghai-based APAC research director of research firm Canalys, agrees Vivo and Oppo will move to tap China's burgeoning high-end handset market.

> "What [Apple] also needs to do is innovate more
>
> James Yan
> Analyst
> IDC

But "Huawei [the top-selling Chinese handset brand overseas] has a stronger brand and wider appeal," than Vivo or Oppo, says Peng. She notes Huawei's global success has boosted its popularity at home.

Meanwhile, Chinese smartphone brand Xiaomi has moved into China's booming TV market, an area where Apple is absent (Apple TV launched in the US a decade ago). The Xiaomi smart TV sold briskly in China's e-commerce shops last year, according to the Beijing-based company.

Some observers say Apple's reliance on retail sales in China, where e-commerce is ascendant, is a mistake. China's e-commerce platforms have shown little interest in promoting Apple's products because of low profitability for the online shopping providers, according to DigiTimes, a Taipei-based research firm. Retail stores also require much larger investment than e-commerce channels.

But for a premium brand like Apple, iconic brick-and-mortar stores are integral to the brand image and shopping experience. "Apple is right to open a lot of retail stores," says Yan. "What they also need to do is innovate more." The company's ailing innovation is evident from the disappointing global sales of the iPhone 6S and iPhone 6S Plus, he adds.

Meanwhile, Evelyn Huang, a PC and tablet analyst at MIC, sees a similar issue with falling iPad sales. The iPad's sales continue to be eroded by the iPhone 6 and iPhone 6S, "mainly because the iPad appears to have hit an innovation bottleneck," she says.

To maintain its strong position in China, Apple will need to diversify its product lineup, says Peng of Canalys. She expects the company's innovation to be seen in "gradual improvements rather than something radical." To that end, she points out Apple has a stronger research and development program than its local competitors, who lack the US tech giant's resources.

The company's recent moves suggest it is expanding into new sectors, Peng notes. For instance, Apple executives met last year with officials from the California Department of Motor Vehicles to discuss the company's plans for a self-driving car. More recently, Apple acquired the virtual-reality start-up Flyby Media and hired Doug Bowman, former head of Virginia Tech's Center for Human-Computer Interaction.

In China's smartphone market, an advantage for Apple is its loyal customers. Apple can channel their brand loyalty by giving them reason to upgrade their iPhones sooner, Peng observes. She points out the replacement cycle is stretching to three years in China. "This is not something Apple wants to see, so they need a renewal program, perhaps running on an annual basis."

And to expand its customer base further, the company will have to win new customers accustomed to cheaper Android phones: "Apple needs to look at how Huawei, Oppo and Vivo are attracting middle-class consumers and convince those consumers to spend RMB 1,000-1,500 more," says Peng.

Although enjoying strong revenues in China, Apple can by no means remain complacent then. As Han of MIC points out, further down the line Apple's increasingly conventional business strategy could falter: "Apple used to be innovation-driven but it is now focused on maximizing operational efficiency." Unless it prioritizes innovation, "Apple will only be left with its brand value," he concludes.

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"Now the ball is in the hand of the buyers"

Jacques Daniel, CEO of Dongfeng Renault, on navigating a slower and more competitive Chinese market

By Li Hui and Neelima Mahajan

French carmaker Renault has finally begun production in China after selling imported cars here for more than a decade. In February 2014, Renault signed a 50-50 joint venture (JV) agreement with Dongfeng Motor Corporation. Dongfeng Renault Automotive Ltd recently began production of the Kadjar SUV (sport utility vehicle) at a newly built plant in Wuhan, Hubei. Speaking at the launch, Carlos Ghosn, chairman and CEO of the Renault Group, said that he hoped that going forward Dongfeng Renault could get 3% of the Chinese market.

Jacques Daniel, CEO of Dongfeng Renault, has his work cut out for him. Renault is beginning production in China at a time when the market is slowing down and rivals are already well-entrenched. In this interview Daniel, who has worked for Renault in several countries, including Colombia, the Netherlands, France and Romania, explains how the company is adjusting its strategy for a slowing Chinese market, marketing to the Chinese consumer and the opportunity in electric vehicles.

Excerpts:

Q. You've worked in other countries as well. How different is the Chinese auto market compared to other markets?

A. To some extent there is a lot of difference, but in the end it is more or less the same. One of the major differences is that maybe one year ago was it was still the biggest market, it was also a very profitable market. Since the end of 2014 it has changed a lot and China is becoming just like the other markets: fierce competition and prices are going down. It has moved from a sellers' market to a buyers' market. Now the ball is in the hand of the buyers, and "Do I have enough cars to sell?" is a question that doesn't exist anymore. There is much more capacity than customers to buy this capacity.

Q. That's a big shift for you as a multinational company—China was big and profitable and now it's changing. How is that reflected in your strategy?

A. Like any company, we are supposed to be profitable at the end of the year, so when the price is going down, you have to make sure your costs are moving on the same trend. So we just put pressure on cost in order to ensure our competitiveness. We cannot change the market, so we have to adapt. We can also learn from competitors to see which strategies were successful, which were not, but because commercial pressure exists now, we have a much bigger focus on costs than before.

Q. Who is your target customer in China and how are you positioning yourself in the market?

A. Somebody who can afford to buy a car, so not every Chinese person. Rather young, between 35-45, with the focus around 35 years old. A family with one kid who really [wouldn't] like to get the same car as their parents. [People] trying to find their own way in this Chinese life, for which Renault represents a European way, which can be attractive.

Q. What kind of marketing strategies do you adopt to target this group of customers?

A. We try to get in touch with them. You can go through TV—every channel claims to have an audience of one hundred million but it's very expensive. And in the end, most people [watching] TV are maybe not buyers, so the ratio is not the best. So we can go through key opinion leaders. Everybody today says, "I'm innovating" in the car industry, but all the carmakers are telling the same story. In the case of Renault, we've got some things that are maybe a bit different from the others—a very long history. We are one of the oldest carmakers in the world. We went through all the crises, wars and so on and still [here] we are.

Since the end of 2014 it has changed a lot and China is becoming just like the other markets: fierce competition and prices are going down

Second, we are very active in auto sport with a lot of titles. It means we have a lot of technology and we can demonstrate it through racing. We have a very rich art collection, that a company like Louis Vuitton would like to have, but it's for a car business, so obviously very different from the others. By having [art] exhibitions we try to get in touch with customers who would never consider visiting a Renault dealership. Those people are really opinion leaders. We are already selling more than 10,000 units every year so we already have a group of happy customers and that's what we can also claim—when you go to blogs or to internet sites you can see that Renault owners are rather happy with the relationship with the car and with their dealer. That is something I feel where we can take a bit of an advantage. We signed a contract with Wanda Plazas—they have a location in most of the cities and we have an exhibition of cars for maybe one week or 10 days in order to be closer to the public.

Q. You are aiming to sell locally produced vehicles in 2016. You're coming to that stage much later compared to companies like Volkswagen, GM or Toyota. Do you think there's a lot for you to catch up with?

A. To some extent it's really a handicap because we [will] not enjoy as much growth as [we would have] years ago when every year the market was moving plus 15 or 20%. The growth will continue for sure, but one digit growth, one digit on a market that is maybe 20 million cars, it's something we can deal with. If I compare with what Nissan did 12 or 13 years ago, they were the latest Japanese car maker to enter China—everybody was [thinking they] came after Toyota, after Honda, and they are number one now. So there is no relationship [between] entering last and finishing [as] the first one. I am not aiming to be first. [I plan] to move from nothing to something; I don't think it should be so complicated. We can learn from our competitors as they faced a lot of difficulties at the beginning within the JV—who's doing what, what's the best way to work with Chinese partners and we can probably avoid a lot of difficulties. So we are late, but we know most of the pitfalls.

Q. To what extent will the cars be localized for Chinese consumers?

A. First, we are going [with] what we call localization in our industry, [which] means which part of the car will be produced in China. So it's not just a factory to assemble components you buy abroad: 82, 87 and below 90% of the car will be made in China. That means we have control over what we want to do, what we want to change. We have had a very high level of localization since the beginning, and that's something we have learned from our competitors: the best way to be competitive is to make sure that your costs are local so there is no currency effect. With more than 80% I cannot say I have no risk, but I have limited the risk.

Second, when we design the car we try to make it suitable to the Chinese tastes, so there are some small, [and] some bigger changes. The car is maybe a bit longer to provide a bit more space for the rear seats. Of course everything is going to be written in Chinese in the car. We have a very big open roof, which is not the case for our competitors and which is not the case for the Kadjar in Europe. Chinese customers want this spec[ification], so we decided to implement it.

Q. How do you view the electric vehicle (EV) opportunity in China?

A. If there is one country for which EV cars make sense, it is probably China. The lifecycle of a car is nine years on average. You will see on the street cars which are maybe 14 years old; 14 years old for a car is probably not the best one in terms of emissions, so [there's a] need [for] policies to really clean the street of old, contaminating cars, scrap them and help the customer replace them. This market is very promising in terms of EV.

There are still a few questions, first the car is much more expensive than what we call ICE cars—internal combustion engine. The normal car is much cheaper because the cost of the battery is extremely high, so it's clear there is no business model which flies without any subsidies basically. Only freaks of new tech are ready to buy a car maybe twice the normal price just to say, 'I've got an EV car'. Basically [if] you have to pay two times the price, you would probably consider having a normal car.

The second limitation is [that] it's very easy to tank a car—you will find a station everywhere and in five minutes you will have the car ready for another 500 kilometers. With EV, it's less obvious. Of course there is electricity everywhere but in the way that you can plug in your car [is] maybe not so easy. Second, with the time to load the car we're not talking about a few minutes: depending on the quality of the infrastructure it may take up to one day or 10 hours. If I need to load my car, I cannot wait 10 hours. There is what we call a quick charge, which allows you to get your battery loaded at 80% in maybe less than one hour, but the real autonomy of the EV car is around 200 kilometers, probably less, and customers are afraid that it's not enough.

No car maker in China has a strategy [of] relying only on EV cars, and when you look at competitors, they are talking much more than they do

The day we will have much more cars in the street it will, of course, push everybody to work on it—universities, to try to find a new battery, new tech; car makers to decide to have a full range of EV cars and not just one to say I've got one. It will take years to really see a change.

Q. Are you also planning to get into that market?

A. Of course. We decided a few months ago to introduce our first EV car in China end of 2017. We need it because the Chinese regulations [mandate] that… if you want to send [traditional] cars you need at the same time to provide the market with a given number of EV cars.

Q. How important will this car be to your portfolio?

A. At the beginning it's not going to be the biggest part. First of all, we have no license today to produce these cars. So Dongfeng Renault has the license to produce small SUVs, medium SUVs and big SUVs and MPVs [multi-purpose vehicles]—no sedans, no EVs, so we need to request additional rights in order to produce these cars. We are in the process, but it's clear that no car maker in China has a strategy [of] relying only on EV cars, and when you look at competitors, they are talking much more than they do because everybody's afraid to be out of the game. So you see every week an announcement: 'We are going to launch an EV.' At the end when you look at the figures, just a few cars are sold.

Q. In five years, where do you see Renault in China?

A. In five years I hope we are going to say we've been successful. It's very easy to make a beautiful presentation with slides where you have graphs which show you're rocketing. Real life is sometimes a bit different. The first part of the project is under very good control and execution. We entered China at the end of 2013, we signed our JV contract in December 2013, [and] during the last two years we have built an engine factory, assembly factory, we have localized one car, we are in the process of localizing a second one, we have built an engineering center, we have recruited and trained 2,000 people. We're going to introduce our first car for sale in March. So far, so good. Now the biggest challenge is not to produce a car, it's to sell the car. We have done a lot of things—is it enough? Probably not, because there is something we didn't plan, or the change of the Chinese market was really very quick. Until last year, some of our competitors enjoyed a very favorable position to sell the car without a discount, but with a markup because there were many more people wanting to buy a car. [That] time is over. It's like everywhere—you really have to fight to sell cars, and discounts are becoming more normal. We have a plan to make sure that we are competitive enough in order to make sure that we can be profitable.

Supercharged

Sydney Finkelstein, author of *Superbosses*, explains how to master the art of handling talent

By Chris Russell

Throughout our careers, each of us will encounter a wide range of management styles, with mixed results. But what is it that distinguishes a regular boss from a truly great boss? Why is it that some help us to reach new heights, while others can make us feel constrained in our abilities?

These are deceptively simple questions with many possible, and much more complex, answers, the latest of which comes from Sydney Finkelstein, Steven Roth Professor of Management at Dartmouth College's Tuck School of Business, in his new book *Superbosses: How Exceptional Leaders Master the Flow of Talent*. Taking as his guide a range of figures from disparate industries, including everyone from the jazz musician Miles Davis to newspaper editor Gene Roberts, Finkelstein examines the key traits of those who have spawned extensive networks of talent, the titular superbosses, and ultimately brought greater success to themselves as a result.

For Finkelstein, the lessons to be taken from these extraordinary leaders represents a kind of revolution, and a sorely needed one at that: "There's innovation in so many parts of business and organizational life, and the innovation in the world of talent I think has lagged behind."

In this interview, Finkelstein sets out some of the key lessons from the superboss playbook.

Q. Why do you think it is that some bosses, unlike the superbosses of your book, overlook the importance of talent?

A. I find that very often, especially in modern business with all the pressures that exist, many bosses feel overwhelming pressure to hit the numbers, to accomplish what they need to accomplish, and they just kind of plough through people to try to get there. And so in a way it's a very short-term way to think about the world because if you just pause for a moment most people would realize you actually could accomplish so much more if you have great people around you, if you build great teams, if you energize them to be contributing. And so if you're a much better boss, or even a superboss, you actually will be much more successful yourself. But I think a lot of people don't get to that stage because of the incessant pressure that they're feeling because of the modern global economy.

Q. What is it that distinguishes a superboss from a merely good boss? What do you consider to be the most important aspects?

A. Well first of all, a superboss is someone that helps their team members or others accomplish more than they ever thought possible, and that's a pretty high bar compared to how most even good bosses think about it. And so the difference to me is twofold.

One, compared to a good boss, a superboss is more intense and does more of all the good things that a good boss does like mentoring, respect, spending time [with employees] and motivation. They go deeper and they go further into that.

And then secondly, a superboss does some things that most good bosses don't actually do, and specifically I'm thinking of this almost apprenticeship type of approach to managing people that I talk about in the book. Even though apprenticeships have been around for centuries, very few think about their job as the master and the apprentice, someone that they should be working so closely with, where your job is very much about teaching, so they seldom do that.

I think another thing most good bosses don't realize that superbosses do is kind of the mixed sense of talent retention. I'd say if we surveyed most bosses in general, but particularly good bosses, they'd say, "Well, I want to hold on to my best talent, I want to hold on to them as long as I possibly can."

> A superboss is someone that helps their team members or others accomplish more than they ever thought possible

Of course that is understandable and in a way it makes sense, but what superbosses understand as well is that sometimes some of those best people are going to move on, they're going to want some huge opportunity, they're going to want to run the show, they're going to want to be the boss or they're going to want your job, and if that's the case you have to decide are you better off helping them get to where they want to in their career or not, because it's going to happen anyways. So as soon as you realize that's going to happen and then you think about the upside to helping other people accomplish more by moving on, in fact even helping them get other jobs, certainly being supportive when the time comes if they want to go, you get into this whole discussion that I had in the book about networks and the power of networks and how that can continue to pay dividends for the superboss.

Q. As I was reading the book one thing I thought was a kind of underlying element to it was the vision of superbosses, and how this feeds into their approach towards motivation, innovation and hiring; it's something deeper that kind of guides these things. To what extent would you say vision is a key aspect of a superboss?

A. I think vision is critical, but I think it's important to have a better sense of what that word means because that's a word that's thrown around in business all the time and everybody talks about vision. I think in superboss world, vision means that anyone who is a leader of a team, and I'm not just talking about CEOs or some of the famous people that are in the book, but anyone who has a team should have a vision of what they want to accomplish and what it is that is possible because that is going to help motivate people.

The second thing I would say about vision is superbosses are very, very clear on what it is they want to accomplish. I've often thought in doing this research that for most of these superbosses they would have kept on doing what they were doing even if it didn't make them any money. Obviously many of them are wealthy to extraordinarily wealthy, but I feel like that was so central to their view of the world that they would keep on doing it and they weren't doing it because it was going to make them a lot of money—they weren't going to turn down that money to be sure, but that wasn't the prime motivation. And that's a really powerful vision, and it does play out—it does play out in kind of their open mindedness to doing anything and everything that they possibly can to fulfill and even exceed that vision, and that requires you of course to have great talent and motivated talent, but specifically to the innovation point it calls for a leader who is willing to unleash the talent, the creative talents of people around her or around him and not be afraid of that, which many leaders of course are. And that's because again vision is really primary and they're open to any kind of cool ideas anyone can come up with that can help them get there.

Q. How can people begin to implement the superboss playbook, as you call it, in their workplace in the face of certain constraints or limitations? Perhaps they're in a company that has a very rigid structure or per-

haps it's more just about the practical considerations of drawing in talent.

A. There's no question that there are constraints that everyone faces and it's even true for some of the CEOs, maybe all of the CEOs, certainly of publically traded companies with the pressure of quarterly earnings and the need to justify very high compensation and what have you. But bringing this back to the wider audience, there's certain things you can't fix either because of internal cultural things or these broader economic or climate issues, but there is actually a lot that you do have some leeway on.

So for example if you look at identifying and finding great talent, two or three of the things that are part of the superboss playbook in this regard could be applied by anyone. For example, you don't have to follow the traditional model of just having a job description and then doing a search and checking all the boxes to see who has more of the criteria than anyone else. You could be open to and, I call it a talent spotter, always be on the lookout for great talent. You can kind of internalize that so you're always thinking about that—you could be anywhere, and you just see someone who's got something. Either they're underemployed, or they haven't had the opportunity, or nobody came to them with this, or they might be ready for a change, and you strike up a conversation, you learn about them and then you've got to be willing to take a bit of a chance sometimes in hiring someone. And even where there are constraints because of employment laws, so you don't want to hire someone because it's hard to fire somebody, which is true in Europe in particular, well you don't have to hire them, you can bring them in as a contractor, as an independent agent so to speak. There are ways around all kinds of things.

Also with respect to talent it's not just about not becoming beholden to the job description or being a talent spotter, but with this shift to motivation it is absolutely the case that any manager that has people working for them could make a difference. You look at some of the things that superbosses do and they have very high expectations and they raise the bar, they create a very performance-oriented culture. These are good things to do and then they add

It's really, really important for people to realize... that what superbosses do is accessible to others, to anyone, and so it is teachable

this other element that I think is critical and that is a big differentiator from many other, say, more typical companies, and that is how they inspire people. They infuse their people with confidence, they help people see and believe that they are actually the ones that can accomplish these great goals. These are things where there is no one that can tell you you're not allowed to do that. In fact, most companies would say that would be great if you can pull that off.

One other thing I'd say is that while superbosses sure sound pretty impressive, and they are, you want to avoid becoming intimidated, believing you can't do that. You don't have to do everything they've done over a career in one week—pick and choose. Go through the various chapters and there are different ideas—pick one or two that you think could work in your environment, your world, and test them out and try them and then expand from there.

Q. One of the things you mention briefly in the book is that you think the superboss playbook is particularly well suited to managing millennials. Why exactly do you think that is?

A. I didn't think anything about it [to begin with], but over time it started to occur to me, and then I started to test it out in seminars and when talking to students—my students are 27, 28 on average, so that's right in the center of the millennial generation. One, millennials, maybe more so than historically with previous generations, are looking for engaging work, work where they can have an impact. And speaking myself as a baby boomer it's not that we didn't want that, but I think we were more of the sense that well eventually you get there but you've got to pay some dues, and I think millennials maybe have a shorter time horizon to accomplishing that goal, and by the way I think the world of technology is one of the reasons why they have that time horizon—the speed of everything is just accelerated incredibly—and so superbosses do create an environment where work becomes exciting and energizing and superbosses trying to accomplish big things, and they expect everyone on their team to be a player, to be creative, to be innovative. And so that plays very closely to this idea of employee engagement and what millennials really want. More broadly by the way, employee engagement as you know is one of the key metrics every company is looking for and they want to increase it and I think the superboss playbook is going to be hugely important in accelerating or improving that employee engagement.

A second point is, maybe most fundamentally I suppose, millennials are generally thinking—I hesitate a little bit because it's a gigantic generation, there's a lot of variation—be that as it may, with that caveat, millennials are not thinking about working somewhere for 25 years—they are much more likely to be thinking about shorter time horizons, and so they fit into this new model of thinking about talent retention in a different way that superbosses spearheaded. Millennials are more likely to say after one year, two years, five years they're done and they want to move on to a new challenge.

This is going to be more common and with the superboss approach to understanding that that's not just occasionally going to happen but it's perfectly okay and that we can take advantage of that, we can be strategic in managing the flow of talent, which is the subtitle of the book after all.

Q. A lot of the superboss figures you cite are extraordinary individuals, they're idiosyncratic in their own ways and a lot of their own unique processes of managing rely on intuition and whatnot. So given those things, what is it that makes you nonetheless convinced that the superboss playbook is still teachable?

A. I think that's a core premise of the entire project, the entire book, that, in fact, everything that superbosses do can be learned, can be taught. I looked at very well-known people because that was part of the research process and of course it's fascinating to learn more about Larry Ellisons of the world and Ralph Laurens of the world, etc., but that doesn't mean there's not superbosses up and down an organization, and in my case I didn't do research on those people because they're harder to find. But I'll tell you what's happened as a consequence of writing the book—you start talking to people and I've been talking informally with people for some time and giving a couple of presentations as well and it's inevitable that people come up to me and say, "I had a superboss, let me tell you about her, let me tell you about him." And it's not this famous CEO, but it's some boss at some stage in their career. I think it's much more accessible and I think it's really, really important for people to realize that, that what superbosses do is accessible to others, to anyone, and so it is teachable, it is learnable because there's many of them out there. We just haven't known what to look for or thought about it and nobody's really analyzed who these people are and what they've done in a way that lays out the specifics of what they do and how to do it.

I'm not saying that some of these superbosses in the book, say a George Lucas, sat down and created an HR plan of how to develop talent, in fact I'm quite certain that didn't happen, but when you study these people and you dissect what they did you actually could see that, yes, maybe they had some genius to get there, but for the rest of us that don't have that kind of natural intuition or that genius we now have a plan, we now know of a playbook, we now know how they did it, and when you dissect that and see it in detail in a very specific case as it is in the book, well yeah you could do exactly those types of things, tailoring them to your particular situation, but you could do those things.

Working for a superboss is a way to turbo charge your career and get gigantic opportunity

Q. At what point do superboss behaviors and qualities—for example their confidence or their demanding nature—run the risk of bringing about failure or poor results. Are there any sorts of limits or drawbacks to the superboss playbook do you think?

A. I think there might be and I think part of this is a fit story—they are demanding, they are challenging, they know what they want and so for some people they might just not want to work for a superboss. It might not be the right place for them because they're not willing to have that, for whatever reason, and I'm not criticizing because different things they need in their life or want in their life or different aspirations might mean they're just not willing to make that type of commitment and that type of dedication. Of course I think there are many, many, many more who will be willing to and are actually almost waiting for that opportunity as they're in jobs where they're not engaged, they're not energized—working for a superboss is a way to turbo charge your career and get gigantic opportunity.

But not all of them are easy to work for—that varies. I have these different types that I describe (glorious bastards, iconoclasts and nurturers) and the glorious bastard type, they're not easy to work for, there's no question about that. The nurturers are much more supportive and they are a bit easier, but they are also not looking for just getting along or not looking for just satisfactory results—they're looking for exceptional results, they all are. So I look at it and say this is a fit question and this is going on independent of superbosses anyways all over the world.

Q. From a superboss perspective what are the most important things to consider when it comes to the boss-employee relationship?

A. Superbosses very much customize their supervision or their interaction to individuals. And if I can just elaborate on that a little bit, I find it really remarkable if you think of the world of marketing and sales and what has happened with the internet, when we're on Google doing something there are ads that appear. Well those are ads specifically for us because of where we've surfed, etc. The world of marketing has unbelievably customized opportunities, if you will, for people to buy stuff. The world of HR, the world of leadership is in the dark ages compared to that. And I know we don't have the same level of technology—we don't have all that data, maybe we don't want to do that in the context of managing people—but nonetheless we just don't customize nearly as much. So for what should superbosses do working with employees, I think customization is an important factor. And that's day-to-day and how you're working with them, but also with respect to thinking about their career and their career track, again, managing the flow.

Positive Priorities

Emma Seppälä, author of *The Happiness Track*, on the benefits of wellbeing

By Chris Russell

In an 'always on' world enabled by hyperconnectivity, divisions between office and home, and work and rest are becoming increasingly porous, with a new email notification never far away. As such, the attendant stresses and strains of work are multiplying all the time.

But is it really necessary, and does it even get the best results? In her new book *The Happiness Track*, Emma Seppälä, Science Director of Stanford University's Center for Compassion and Altruism Research and Education, draws upon the latest research to argue that these high-intensity work styles are fundamentally misguided, and it is time for change. As she writes in the book, "We have simply accepted overextension as a way of life." In this interview, Seppälä, who previously lived and worked in Shanghai, sets out why that's a mistake and what we can do to improve our wellbeing.

Q. Just to begin with, could just briefly set out what are the main problems with our conventional understanding of success. What are the negative by-products of that?

A. Well, we tend to have a misconception that in order to be successful we need to sacrifice or postpone our happiness. So for example many people feel like they have to work themselves into the ground—that you can't have success without stress and they feel that they have to be constantly focused on the next thing and getting things done constantly, and so forth. But what research actually shows is that if they prioritize their own wellbeing as well as that of the people around them, they're going to be more productive in the end. They're going to be more creative, they're going to be more charismatic and get more done.

Q. In what way do different personality types affect the issue? In cases where people are very career driven, they are go-getters so to speak, how does that affect the way that their wellbeing interacts with their *working life and with these intense work styles?*

A. In a lot of ways go-getters are rewarded because that is the kind of modus operandi—it's that you need to be working non-stop, workaholism is good, you need to burn the candle at both ends because that's just how it works. But what research shows is that with that kind of attitude to work we are seeing very high levels of burn out across industries because we're living in this high adrenaline mode constantly—constantly going, going, going—fueled by coffee, fueled by packed schedules, tight deadlines, waiting 'til the last minute to finish things, etc. It's basically chronic stress—it really impairs your health and it exhausts you… it actually impacts your mental faculties, your cognitive faculties, your memory and attention and so forth.

There's nothing wrong with stress, stress can get you through a deadline and so forth—it's great when it's a short-term thing—but when it's something that you're constantly involved with because you're constantly in that high-adrenaline mode, it's actually leading to burn out. So I talk about energy management, and by staying in that constant high-achieving mode we're not managing our energy. A much better way to manage your energy is to learn to stay calmer, it's learning to not just tap into your fight or flight nervous system but your rest and digest system, the part of your nervous system that helps calm you down and that helps your body restore itself, and your mind as well. If we are able to stay calmer, we are able to manage our energy so we don't exhaust ourselves continuously.

The other thing with staying calmer also is that you're going to be more creative because when you're constantly in a very highly focused, very high-intense state, that is not a place where the brain comes up with its most breakthrough ideas, most innovative, creative moments. 'A-ha' moments, eureka moments come when the mind is at rest. So that's another reason to unplug. We need to detach from work and research shows when you detach from work you come back to work more engaged, you come back more creative. A lot of people are not taking their vacations—they come home and they take their work home with them. But it's not serving them.

Q. Something you just touched upon there—companies reward go-getters, these are the kind of metrics that a company might look for or often they're the ones that align with that kind of go-getter, intense work style. To what extent then do companies make it hard or maybe in some cases preclude these various sorts of strategies to manage our wellbeing?

A. Absolutely. Workplaces may not adopt these ideas yet, although they will with time because they are supported by data. But in very few cases do people have actual control over their environments—you cannot control the demands placed on you by your workplace, by your managers and so forth. You can't do much about the environment, but you can do something about the state of your own mind. For example, one practical tip is let's say everybody always has a number of different activities that they need to do at work—some require a lot of high intellectual focus and others don't. For example, high intellectual focus might be preparing a PowerPoint presentation, and less intense would be entering some data, filling out some paper work, doing some administration, cleaning your desk. So what someone could do is alternate during the day the high intensity activities with the more low intensity activities. That allows you moments of recovery, it also allows you moments where you mind can drift a little bit and that's where it can access its creativity. The other thing you can do is that no matter where you are and what your schedule's like, you can always take five minutes—after all, we take five minutes to go to the bathroom, right. You could take five minutes to close your eyes and just do some deep breathing and relax your nervous system, restore yourself in that moment and then you'll still have more energy to keep going and you'll also be calmer.

Q. For managers, what can they do to help engender a culture of happiness and well-being in their workplace?

A. What research shows for managers and employees alike is that if you were actually kinder with people around you, if you're helpful and supportive, if you're compassionate when your colleagues or employees are going through hard times, you will actually end up doing better and being more productive, your team will be more loyal and overall the results will be greater for everyone. Not to mention that your psychological health will be better, your physical health will be benefitted and even your longevity is impacted by living with an attitude that's more oriented towards kindness, service and supporting others. So what managers can do and leaders can do is adopt that more compassionate stance to the people that are working with them. Find out what's going on in your employees' families—is anyone going through a hard time?—being there for them as a human being, adding the human touch back into the workplace, which is sorely missing these days. You know we're not just robots working and completing our tasks—we are first and foremost human beings who need social connection desperately as a very fundamental predictor of happiness and well-being, we know that from research. So that is what I would say: reintroducing the humanness back into the workplace and that is through kindness, through creating an environment that's characterized by trust, by respect, by forgiveness, by understanding and by empathy.

Q. What are the signs that someone is overworking and approaching burn out? How can you identify this first in yourself and also in your colleagues or your employees?

A. Well, if someone's feeling exhausted, if they continue to feel exhausted in the morning when they wake up, if they are having trouble focusing, if they are having a hard time concentrating, if they are having memory and attention difficulties, they're having trouble sleeping and winding down when they get home, those are all some signs, and they're things that most of us have probably experienced at one point or another, and that's really a sign that the body is telling you that you're burning out and it's time to restore yourself. A lot of people think, "Well, I have no choice, I just have to keep going", but if you just take a few steps back and take care of yourself you'll see that you'll actually do better.

And taking care of yourself can take other forms too—it has lots to do with your own relationship with yourself. A lot of people are self-critical because they think that will lead to self-improvement, but they couldn't be more wrong because self-criticism actually leads people to have greater anxiety and depression and it leads them to be less likely to learn and grow from their mistakes and the challenges and failures that they face. On the contrary, there is self-compassion, which is basically treating yourself as you would a friend, in other words understanding when you've made a mistake and giving yourself a break rather than berating yourself. Not saying that you're letting yourself slack off or letting yourself off the hook at all times, no, it simply means not being overly harsh with yourself, you know the way we would with a friend. So your relationship with yourself has a lot to do with the outcome of whether you learn from the mistake. We all, especially in business, face challenges, mistakes, failures—how resilient we are, how quickly can we bounce back, a lot of that has to do with your relationship with yourself.

Q. Obviously during our working lives there are some particularly intense moments because of, say, a particular project or deadline. When you're in that very intense moment, what is it that you can then do to try and manage the pressures and the stresses when there is that intensity around you?

A. So I was talking a lot about the fight or flight system—we're constantly activating that stress response in our body and when we're in a situation like that it's very high, and that's why people take a lot of anxiety medication, and so forth. But what can you do in the moment? Well, there is one thing that you can do which will immediately calm your nervous system and it's breathing. And it sounds simplistic, but the breath is tied into your nervous system, so when your nervous system is in fight or flight mode your breath is short and shallow, but if you can deepen your breath, if you can slow your breath, if you can breathe with longer, slower exhales in particular, you actually start to activate the other side of your nervous system, which is the calming, the soothing response—it's the rest and digest response. So something that you can do when you're in the moment and it's a big stressful episode is just take longer, slower breaths; lengthen your exhales; breathe into your abdomen—it sounds simple, but it's backed by research. When your body slows down and calms down, your mind calms down and you can think more clearly, you can be more emotionally intelligent, you can make better decisions.

The Six Keys to Happiness

Live in the moment - don't always think about what's next

Tap into your resilience - train yourself to bounce back from setbacks

Manage your energy - manage your stamina by remaining calm

Do nothing - make time for fun and rest away from work

Be good to yourself - be compassionate with yourself, not just self-critical

Show compassion to others - maintain supportive relationships with those around you

Q. Technology is one of the things that can lead us to overwork and is just such a drain on our time and attention and so on. That's the negative side of it, but how can we manage the negative effects of technology and are there even ways we can perhaps use technology in order to assist with our well-being?

A. Absolutely. On the one hand it can really lead to more stress, it can help you bring your work home with you—a lot of people sleep with their phone under their pillow. I mean, that's really letting your work come right into your bedroom and that can lead you to never shut off, so you're constantly in that mode of being on, being focused and you can never be in that moment where you relax, you let go, where you restore yourself, where you have these moments of creativity and insight. In that sense, technology can really interfere with your life.

However, if you can work from home a day a week and that's more restful for you then that's great and you can do that thanks to technology. It can also be a way where you really connect with others, and we're seeing that there's a loneliness epidemic happening where more and more people are living further and further from their families, they can feel really isolated due to the intense work hours, and so technology can be a way to connect. You can also be introduced to ways in which you can do some humanitarian work online or donate or anything like that. Those are all things that are tremendously beneficial for you as well.

Q. You said that living in Shanghai was almost what got you thinking on this track, so in what way was it that living and working in Shanghai informed your work? And are there any kinds of cultural differences?

A. Well, in particular I met some elderly people who had been through some challenging times due to just the historical fact of the things their generation has gone through, and one of them in particular, he was a very well-known professor at Fudan University and very respected and genius kind of guy, but he was also so happy despite having gone through a very difficult life, and I looked at him and saw this happiness even though he didn't have much. And then in the US I saw how people have so much and they're not happy and that's when I realized: happiness, it does not lie in material possessions. Happiness is a state of mind, happiness has a lot more to do with how you approach the world. It's an approach to yourself, it's an approach to the world, and that's what led me to go more deeply into this investigation. A lot of the things I talk about are quite East Asian in their approach—whether it is about staying calm or whether it is about doing practices that involve meditation and things like that. Some of them are, I think, very tied into a more traditional East Asian perspective that the West really needs right now. But I think that China also really needs it because everybody is moving more towards that incredibly intense, very competitive work life—it's inevitable.

Smart Work

Caroline Webb, author of *How to Have a Good Day*, on the science of more fulfilling work

By Chris Russell

Whether you're working at your dream job or you've been plotting your escape for months, chances are that you've experienced your fair share of days that simply can't end soon enough. From snarky colleagues to grim commutes, the possibilities for our working day taking a wrong turn are seemingly endless, and what's more obvious remedies aren't always in sight. Thankfully then, Caroline Webb, CEO of Sevenshift, an advisory firm focused on performance in the workplace, and a senior advisor to McKinsey, has put together a guide for improving our work life with her new book *How to Have a Good Day*.

Drawing upon extensive research in the fields of neuroscience, behavioral economics and psychology, Webb draws out key lessons on how we can make our work smarter, productive and ultimately more satisfying. In this interview, she introduces *CKGSB Knowledge* to some of the main takeaways.

Excerpts:

Q. In the book there is an emphasis on priorities and focus. How does the science indicate that those things are so important?

A. Well the importance of being deliberate, let's say, about our priorities and our goals comes from the way that our brain processes information. The truth is that our conscious brain can only process a portion of reality around us at any one time, which is kind of hard to accept, because subconsciously we're filtering out most of what's going on around us, and we don't really like to think of ourselves as not being objective observers of the world. But what the brain decides to consciously prioritize and make sure we notice are things that resonate with what is already top of mind for us, and you can see where this is going. It means that if you've decided that something is a priority, you are way more likely to see it and to notice it than if it isn't. So let me give you an example. There's a classic study which is done with a bunch of radiologists who are looking through a pile of lung scans and there was a gorilla printed on the last one and the vast majority of them, 83% of them, didn't see the gorilla even though eye-tracking devices showed they'd looked directly at it and even though the gorilla was huge compared with the average lung nodule, the sort of thing that they were looking for. And the reason is it wasn't their priority. If we go into a meeting looking for a fight, we'll probably get it. If we go in looking for collaboration, we'll probably get that. It's really remarkable how the facts can appear to change once we've decided what our priorities are.

Q. You talk about the discover-defense axis (how we are subconsciously on the lookout for threats and rewards) and how even small slights can put us into this place where we're less productive, we're less smart and so on. In a modern-day office environment, feedback, evaluation and criticism are so important. So how should these things be handled by those who are giving out this criticism? Are *there any considerations for those who are receiving it? And on the flipside are there any considerations for how we should be handling praise too?*

A. You're absolutely right that critical feedback is almost perfectly designed to put a brain on the defensive and when someone's brain is on the defensive they're not able to think as clearly because the brain is devoting some effort to that defensive response, whether it's fight, flight or freeze. And in the modern workplace fight, flight or freeze does not look like someone actually punching you [laughs]; it's much more subtle. Someone can be on the defensive and all you're aware of is that they're maybe seizing up a little bit or they're not thinking straight about what you're saying, and obviously then what happens is the change that you're hoping for doesn't manifest itself. So, absolutely right to think about how can you give feedback in a way that doesn't put people on the defensive, and there are actually three brain-friendly feedback techniques that I talk about, and one of them for example is to be really, really explicit and clear and fulsome and specific about the things that you like about what they're doing so that the framing is: "What I really like about this is… specific thing, specific thing, specific thing, what would make me like it even more is…."

There are two things going on here. One is that people talk about the 'praise sandwich' and the fact that it's a good idea to say something positive before you say something negative, but the problem with that classic approach is that it only solves a fraction of the problem. We're all geared to be more sensitive to threats than to rewards. So you have to be aware that one piece of negative feedback will drown out positive feedback unless you make sure that the positive feedback is as believable and credible as it can be. And the way to do that, and this is the second thing to note, is that the brain much prefers concrete examples to generalities. So if you hear someone say, "You're great, you're great, now here are five things that I think you could do differently…." It's obvious when I say it like that, but the truth is that is often the way that feedback is delivered. You think, "Well, I'm generally saying you're amazing, so surely that should be enough", but no, what you remember are the specifics, the stories, the examples. And so that's why the format of what I really like about 'specific, specific, specific, and then what would make me like it even more' is it's just a really good way of keeping people off the defensive, while telling them exactly what they need to hear, so it's not a soft option.

> It's really remarkable how the facts can appear to change once we've decided what our priorities are

Q. Obviously the title of the book is How to Have a Good Day, *but if, for whatever reason, we're having a bad one, how can we react to that?*

A. I actually split [the part of the book on resilience] into three. The first one is staying cool in the moment. You're in the meeting and it's going badly, how do you stay calm? But then there's also after the fact, how do you move on? Because they're almost like two different skills. Then there is sort of an even longer-term skill, which is just recognizing all the things we were touching on before, which is that the way you treat your body helps your emotional resilience over time. So there are a few different dimensions of resilience and handling a bad day.

One thing that I find super helpful when you're in the middle of a situation that isn't feeling great is to use the distancing technique, and that's where you put yourself in a different perspective and you look at the situation from the different options. You can look at the situation from the perspective of someone who might be a stranger passing by—what would they see? I personally like the distance of saying, "What am I going to think about this looking back in a year's time?" I have a client who really likes the idea of saying, "What would my best self say about this?" There's a CEO I was coaching who likes saying, "If someone else was CEO of this company, what would I advise them?" All of these distancing techniques have been shown to reduce the level of defensiveness, the activation of threat defense system in our brains.

There's another killer technique, which is called reappraisal, which is where if it's a kind of recurring thing that's going on or is something dragging on and is just something you're finding it hard to move on from, it's really helpful to use this technique of reappraisal, which is essentially telling yourself a different story about what could be going on. The way it works is that you first home in on what the facts are and strip it of interpretation. Instead of saying, for example, "My boss never pays me any attention"—that's a generalization, it's also a tiny bit emotional even though it sounds fairly sensible—what you do know for sure is that perhaps that's something more like "My boss didn't invite me to speak at this week's team meeting". In fact what you actually know given the brain's filtering and the fact that reality is subjective is "I don't remember my boss asking me to speak at the team meeting". So the first step is getting clear on the facts, and then you say, "Okay, what could be an explanation of that?" And it almost doesn't matter if you believe the stories that you make up, it's helpful of course that you come up with explanations that could be reasonable, but just simply saying, "Maybe my boss thinks that I've had plenty of exposure and is trying to give a chance to someone else." You don't have to believe it, but the very fact of starting to contemplate other explanations than "I'm being ignored and this is awful" has been shown to really not only improve your resilience to specific situations going on wrong now, but actually boost your resilience longer term to something that goes wrong later.

Q. From a boss's perspective, what role could they have in making sure that their employees are having a good day?

A. I'm really hoping that people who are in management and leadership positions read the book and see how all of these techniques can be built into their leadership style. We talked about the importance of setting clear intentions, the power of setting clear intentions. If you're very clear on what matters and therefore where you want to put your attention, then you're basically going to experience things differently.

Another thing is being aware of the fact that even a difficult task can be enough to put people on the defensive and therefore have them not thinking as clearly as they might. Thinking about framing tasks using something I call positive task framing, which is where you say, "Okay, what's the ideal situation? How do we move towards it?" You'll get better thinking out of your colleagues if you do that than always focusing on the negatives and the problems that need to be solved. You still think about the problems that need to be solved, but by framing them positively by thinking about what's the ideal.

So you can help people experience reality differently [laughs], you can help them think more clearly—we've already talked about giving feedback and helping them develop in a way that's going to be easier to hear the messages and to act on them. And I think there's actually an example that I use in the section on resilience, which is a CEO dealing with a really massive screw up at his company and using all of the techniques that he uses on himself for resilience in a group setting to help people get through this difficult crisis, so for example saying, "When have we handled crises like this in the past really well and what does that tell us now? And when we look back on this in five years time, what do we want to say about how we handled this?" All of these things can be done with colleagues, not just in your own head.

Even a difficult task can be enough to put people on the defensive and therefore have them not thinking as clearly as they might

Q. When it comes to team relationships, what are the most important considerations?

A. In the book I talk a lot about techniques that you can use. Obviously again I'm talking about them again in a one-to-one setting a lot of the time, but they can be used in group settings too.

One of them is the power of actually showing curiosity about other people, which is so blindingly obvious and yet most conversations at work are really one of a couple different types. They are very factual conversations—"When is this due?" "It's due on Friday"—or it's a sort of oiling the wheels, superficial kind of conversation—"How was your weekend?" "Fine, how was yours?"—or it's let's have a conversation which is like a game of tennis where I'm really just kind of getting ready to return the ball and I'm not really listening to what you're saying—pausing to reload, I call it. It's actually quite rare in a work context to really show curiosity about where someone else is coming from and to just listen.

Another thing that I've seen work really well is there's a neuroscience concept called 'in-group', which is where people who are perceived to be like us in some way are treated by the brain quite differently to people who are perceived to be not like us, and people who are perceived to be outside our in-group are actually processed as a threat first and foremost until there's some sense of 'we have something in common'. So the bad news is that we're quite tribal, the good news is that we're actually able to feel like someone's on our team with actually very, very little—it's been shown that merely assigning people randomly to a team will actually create a sense of camaraderie that means that they will immediately treat people in that totally random team more positively than someone who is just randomly assigned to a different team over the other side of the room. So it doesn't take much to look for those points of commonality, and that's why we sometimes talk about the weather, that's why we sometimes talk about sports. These moments of small talk are actually very important social interactions that create a sense of being on the same team and that's one of the reasons why leaders who really emphasize a shared goal and shared visions tend to get more out of their teams. If they're not treating each other like a threat, if everybody feels as if they're on the same team truly, then you get better behavior out of everybody.

The other thing in that chapter which is interesting and useful in a team setting is reciprocity, and by that I mean sharing something of yourself. And it doesn't have to be personal stuff, it can actually be things that [team members] are doing at work and things that they're worried about and things that they need help with. The more that you can encourage that kind of free-flow of discussion so that people feel that they're opening up to each other, the more that you create a sense of trust within the team.

Abstract Value

China's burgeoning art market means serious money, and also a richer cultural scene

By Erica Martin

Image by Beibei Nie

Half an hour before closing time on a characteristically dreary and polluted Sunday in January, about two dozen people—mostly Chinese couples in their 20s—have sought shelter by meandering through the stark, airy rooms of the West Bund branch of Shanghai's Long Museum. Except for traveling exhibitions, all of the art in both this museum and the Long Museum's Pudong branch is owned by boisterous self-made billionaire Liu Yiqian.

Tucked in a corner lies the contemporary Chinese painting section, a who's-who of the biggest living Chinese artists and their work, some of which is surprisingly political to be displayed here on the mainland, like Wang Ziwei's 1996 painting *Hopeless: Greeting*, which depicts Mao waving to a crucified Jesus in saturated primary colors. Hanging nearby is one of Yue Minjun's self-portraits with his famous eerie grin—1994's *On the Lake*, next to Liu Ye's 1995 work *Golden Avenue*, in which two Chinese children with wings dance under a rainbow as a flaming airplane plummets to earth in the background.

"At the beginning, Chinese collectors would only be interested in works thinking in terms of decorating their homes," says Yu Hong, an oil painter from Beijing who has sold several of her paintings to Liu Yiqian for display in the Long Museum. "The beginning" is the early 80s, when Yu was an art student at the China Central Academy of Fine Arts (where she now teaches) and China was in the initial stages of opening its economy. "Now," she says, "they are establishing comprehensive collection systems and their own private museums."

Though the Long Museum West Bund was the largest private museum in China when it opened in 2014 and remains a gem of Chinese contemporary art, it's not the reason Liu has been making international headlines. Western newspapers began covering the tycoon when he caused a scandal in April 2014 by spending $36.3 million on a 500-year-old Ming Dynasty cup, known as the Chicken Cup, and then sipping tea out of the historic piece of porcelain. In November 2015, he spent $170.4 million, the second-largest amount ever spent on an artwork bought at auction, on the purchase of *Nu Couché* by Italian painter Amodeo Modigliani.

The Long Museum in Shanghai is a testament to the health of China's art scene

Liu and Chinese collectors like him are driving the attention of both the media and the world's biggest auction houses toward China, but the nation's art scene is also flourishing domestically as Chinese artists gain international acclaim and both galleries and museums open all over the country—China has seen over 100 new museums a year every year since 2008. In 2015, Shanghai especially experienced rapid development on all levels—in terms of large-scale museums, high-profile touring exhibitions and grassroots support for young artists and forward-thinking work.

Masters of the Art

Liu Yiqian is the most infamous of China's art collectors, but there are many others making an impact on the market worldwide. According to the 2015 edition of the TEFAF Art Market Report, the global art market reached €51 billion ($62 billion) in 2014. The US had the highest percentage of the market at 39%, while China and the UK were tied for the second highest at 22%. This Chinese presence in the market is a relatively new phenomenon—in 2000, China had less than 1%, according to Citi.

The major Chinese art buyers are a handful of ultra-rich businessmen. May 2014 saw Huayi Brothers Media Group Chairman Wang Zhongjun drop $66.3 million on Van Gogh's *L'allee des Alyscamps* ("Some people simply want to fall into a reverie, cigar in hand, staring at a painting," he told auction house Sotheby's in an interview explaining his purchase), while Dalian Wanda Group, which is owned by one of China's richest men, Wang Jianlin, has several times spent tens of millions on 19th and 20th century European artwork.

But Liu outdid them all with his Modigliani purchase, and has been vocal about his reasons for collecting modern European art. In a November 2015 interview with *The New York Times* about the painting, he said: "The message to the West is clear: We have bought their buildings, we have bought their companies, and now we are going to buy their art." His wife, Wang Wei, is also a collector who focuses more on the buying of the contemporary Chinese art that fills their two Long Museum branches.

Based on sales figures, early 20th century European art is most coveted by Chinese collectors, though Chinese contemporary art is undeniably on the rise. Many of today's most established Chinese artists, like Wang Ziwei, Yue Minjun (whose 1993 painting *Gweong-Gweong* sold at auction in 2008 for just under $7 million, ranking it as one of the top 10 all-time sales at auction of a work by a Chinese artist) and Liu Ye owe a good portion of their success to Western collectors, who began purchasing their works in the 90s.

"Art created during each stage of the remarkable post-1979 change that China has undergone captures a moment in history that will never happen again," says Claire Van Den Heever, author of *Paint by Numbers: China's Art Factory from Mao to Now*. "Potentially high returns on investments in contemporary Chinese art are one part of the picture, [but] Western interest undoubtedly went beyond money, too."

According to the Fine Art & Design Price Database from Artnet.com, Chinese fine art pieces totaled $4.4 billion at auction in 2014, a sum that contributed approximately 25% to the global auction market that year. The highest-ranking Chinese artist of 2014, Qi Baishi, ranked sixth overall among fine artists that year.

Trickling Down and Bubbling Up

China's spate of new museums, most notably in Shanghai, Beijing and Nanjing, are in many cases spearheaded by wealthy young collectors like Adrian Cheng, the Chairman of Shanghai's K11 Art Foundation and one of the world's youngest billionaires. The mainland's first Claude Monet exhibit was held in March 2014 at K11's Chi Art Space, while the internationally celebrated Rain Room opened at Shanghai's Yuz Museum (a private museum owned by prominent Chinese-Indonesian collector Budi Tek) this past fall.

2015 was an especially developmental year for Shanghai thanks to a purposeful government venture called the West Bund Initiative. West Bund now rivals New York's Museum Mile in terms of density—when the Oil Tank Art and Performance Center opens in 2017, there will be six museums on the strip. Even so, this lightning speed of development and deep government involvement has raised some eyebrows in the art world.

"The scene has grown significantly in size and reach, and some of that has included 'organic' growth," says Van Den Heever. "But it is worth distinguishing this growth from the (often insincere and shallow) state-funded efforts to 'create' innovation through cultural hubs and similar projects."

The organic growth of Chinese art may be bubbling up elsewhere, however. From the galleries in Beijing's long-running 798 Art District to the privately-owned small ventures scattered throughout Shanghai, some Chinese cities are developing an underground art scene as their mainstream one solidifies, in a similar fashion to their international counterparts decades ago. "In every art district, you now find dozens if not hundreds of galleries searching for new artists," says Yu.

Joseph Zhang, 25, an artist based in Shanghai who made his gallery debut last year as part of annual LGBT festival ShanghaiPRIDE, describes a supportive atmosphere for young artists fueled by word of mouth and crowd-sourced event promotion on sites like Douban.

"It's a good time now in Shanghai if you're an artist," he says. "You meet someone through someone else, and people don't judge you for your age or your background; they just care about what you're doing."

The smaller-scale galleries that nurture up-and-coming artists like Zhang vary from established names like Hong Kong gallery owner Pearl Lam, who exhibited a group show of leading contemporary Chinese female artists in Fall 2015 at her Shanghai showroom, to locally-owned spots like Leo Xu Projects, which displayed a slick photography installation exploring China's youth and nightclub culture by Beijing-based artist Chen Wei this past winter.

These happenings couldn't seem farther from Liu Yiqian and his larger-than-life purchases, but they're part of the same developmental cycle. After all, less than 30 years ago Yu Hong was an art student who "could only get badly printed catalogues or look at old foreign magazines to find out about the greater art world." Now, her paintings are on rotation in the Long Museum West Bund, where Liu has stated that he'll eventually display *Nu Couché*.

"The contemporary art of any country is a sort of compressed expression of that country's contemporary cultural situation," says Yu, "and this is a time of upheaval."

Filling in the Gaps

Fraser Howie on achieving a more rounded view

I think I have over 2,500 read books in my house. And the topics are varied: Iran, Central Asia, China, India, theoretical physics, maths, the Middle East, marine biology, language, Russia and its literature, and so on. It's long been my habit to pick topics that I don't know about, and as I've gotten older, I've found that my interests have expanded, rather than narrowed.

Fraser Howie is co-author of Red Capitalism

For China, *Marketing Dictatorship* by Anne-Marie Brady is a book I always recommend. The difficulty for many people trying to understand China is that if you don't understand how words and information are used here, then you simple come away with the wrong understanding about everything. What you shouldn't do, and what's tempting, is to just look at the numbers. You need to understand what's behind the numbers. What can you actually trust, in terms of numbers and words? That's an important thing to understand.

Tim Clissold's *Mr. China* is another excellent book, because real-life experiences of people on the ground are just so vital. Any time there is a "debunking of the myth", or a more critical look at something that's been talked about superficially—I love that. So often in China there is a certain facade of confidence, a facade of ability, a veneer over everything that is nice and shiny. Of course you then look behind it and find that the reality is much murkier.

In this same vein is *Poorly Made in China*, by Paul Midler. Again, here is a guy who actually has first-hand experience dealing with manufacturing in China and the problems that one encounters—having people screw you over, even people that you've worked with and trusted. You need to be aware that you can come with good intentions, and then find that the system conspires against you. Sometimes that's just because how things work, the structure. Other times it's because people really are out to get you. To understand that you need to listen to people who have really lived here, that have experienced what is sometimes the absurdity of China, and can explain it. You really need to get under the surface. Evan Osnos's *The Age of Ambition* does just that, and it provides a good summary of many of the issues in China. Jonathan Fenby's books, and Jasper Becker's, also do a good job at that.

For me, reading is all about filling in the gaps—that's why I read on so many topics. Many of my favorite books are histories, which I think can help us to interpret more current world events. I just read *The Liberation of the Camps: The End of the Holocaust and Its Aftermath* by Dan Stone. So much had been written about the Holocaust itself, but he focused on what happened after the camps were liberated. It wasn't that everyone just went home—Jews in particular, many had no homes to go back to. It made me think different about the so-called "migrants" from Syria—actually refugees—that are similarly homeless. Whenever the hostilities are over, their stories will keep going.

Finally, although in general I am a non-fiction reader, just by virtue of reading a lot, I also have many fiction books I love. In the past few weeks I have re-read a couple of Graham Greene novels, *Travels with my Aunt* and *The Quiet American*—the latter of which is a must read for anyone coming to Asia. I'm also a big Kafka fan. And in all these books, there is a dark side, a farcical and absurd side, that chimes with a lot the experience of China. They also hint that life is far more complicated than what it would appear—it could be that that little old lady is in fact a currency smuggler. The simple, easy narrative is almost certainly the wrong one. That's the attitude to have when approaching China.

Business Bestsellers in the US

1. The Life-Changing Magic of Tidying Up — Marie Kondo
2. Strengths Finder 2.0 — Tom Rath
3. Originals — Adam Grant
4. The Industries of the Future — Alec Ross
5. The 7 Habits of Highly Effective People — Stephen R. Covey

Source: Amazon.com

Business Bestsellers in China

1. Zero to One — Peter Thiel, Blake Masters
2. Influence: The Psychology of Persuasion — Robert B. Cialdini
3. Centered on Strivers — Huang Weiwei
4. The Solution Tango — Louis Cauffman
5. Positioning: The Battle for Your Mind — Al Ries, Jack Trout

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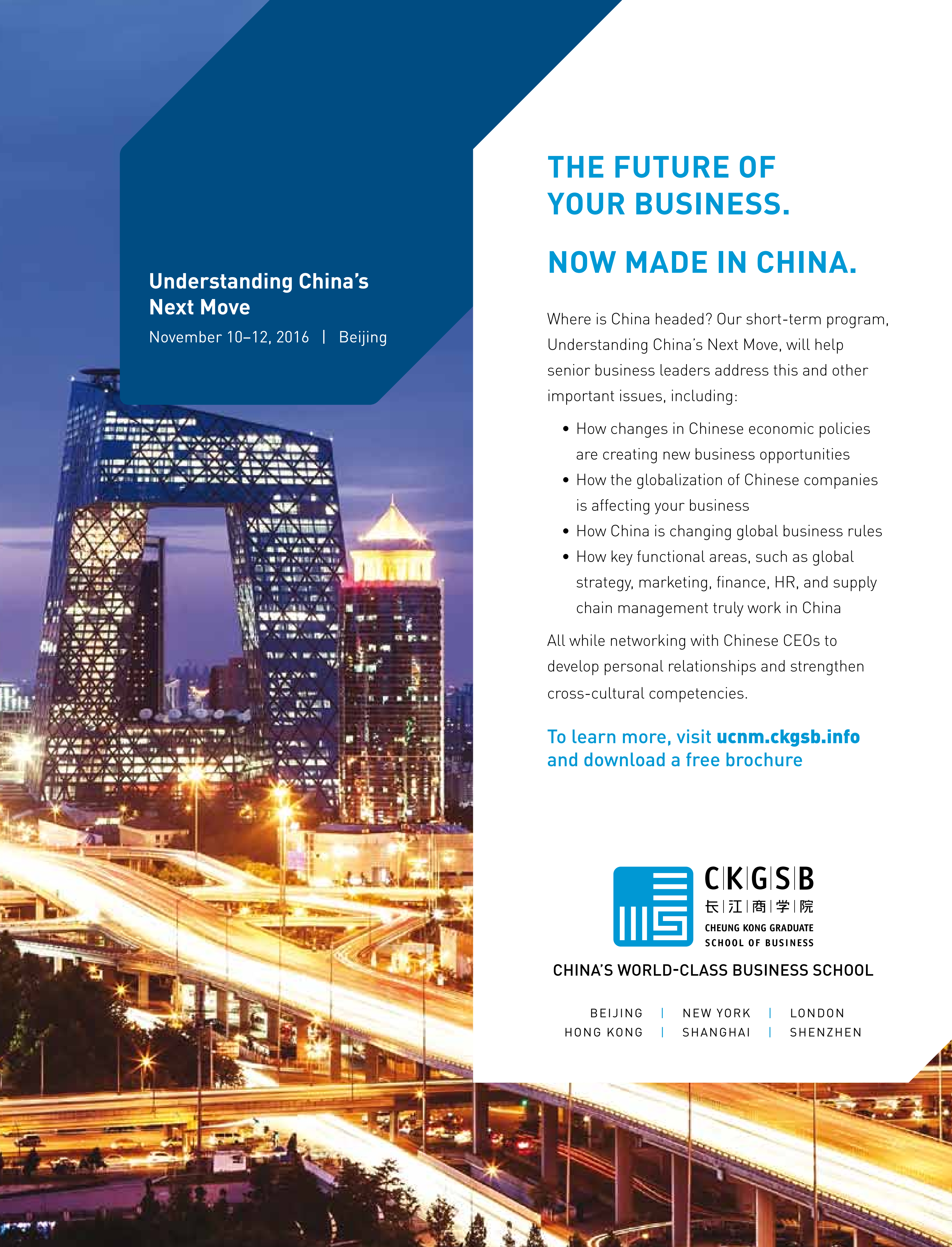
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