

# CKGSB

CHEUNG KONG  
GRADUATE SCHOOL  
OF BUSINESS  
MAGAZINE  
MAY 2012



## Beyond Profits:

**The rise of China's social entrepreneurs**

**Hollywood and China are getting lovey-dovey but the honeymoon might not last**

**So close, yet so far: Chinese firms struggle with M&As in Japan**





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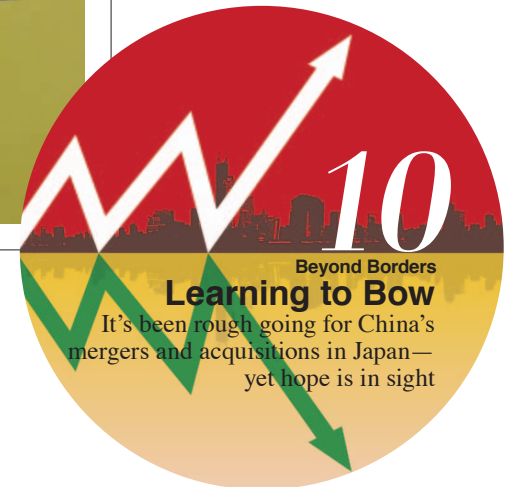


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Addressing the challenges of the future through an integrated business model is now becoming a cornerstone of entrepreneurship and successful business in China

**T**he Year of the Dragon is turning out to be an exciting year for us at CKGSB. As we inch closer to our 10th Anniversary celebrations in November, we have started to look ahead at the next 10 years. New possibilities of Chinese and global business growth are emerging. CKGSB is also forging new paths and unlocking new possibilities as it expands globally.

Even as China's economic growth creates new opportunities, a handful of enterprises are blazing a trail in unlikely areas. This issue of *CKGSB Magazine* delves deep into themes that are increasingly gaining prominence in the world of business – such as social entrepreneurship and culturally creative commerce.

The significance of China's creative industries was a key point of discussion at the CKGSB Annual Forum held in Sanya, China, in January this year. Entrepreneurs from China's fashion and film industries shared their aspirations and the challenges they expect to encounter as China refocuses its attention on its creative industries. Government and business leaders concurred that the success of Chinese enterprises is contingent upon a deeper understanding globally of China's complex cultural roots and creative potential.

Chinese enterprises have global ambitions, and in recent years, many have acquired companies in Japan. One would think that geographical proximity would translate into easy acquisitions and easier post-merger integration. As recent experiments show that is not quite the case (read 'So Close, Yet So Far' on page 10). The highs and lows of these ventures reflect the implications of cultural differences between the two Asian economic leaders and raise the question: how can the spread of China's soft power be leveraged to reduce friction in global partnerships?

Talking of soft power, opportunities for cultural exchange through commerce between China and the world's leading economies exist. From Los Angeles to

London, huge opportunities exist for taking China's diverse cultural offerings global. China's film industry might be one of the pioneers in this regard (read 'Romancing Hollywood' on page 6). With the relaxing of restrictions on foreign film imports to China, cooperation between major Hollywood film studios and local Chinese production companies is already showing signs of growth. Negotiating successful ventures in this uncharted territory will test the creativity and challenge entrepreneurs from Hollywood to "Chollywood". Preparedness and mutual understanding of industry best practices in each market will determine whether creative industry joint ventures will succeed or are doomed to fail.

Social entrepreneurship is fast becoming a sector to watch out for in China. Addressing the challenges of the future through an integrated business model is now becoming a cornerstone of entrepreneurship and successful business in China. We take a look at some of the early experiments in this space in our cover story this issue (read 'Beyond Profits' on page 18). As these examples show, building a social enterprise is far from easy, but in the long run, the rewards outweigh the pain and the risks involved.

These social enterprises and creative industry leaders are gutsy trailblazers. They seem to have the wherewithal to overcome daunting barriers, communicate from different cultural perspectives and usher in change in their respective industries—and in the case of social enterprises, in people's lives as well. We have a lot to learn from their experience.

I invite you to share CKGSB's insights into these emerging best practices and consider the exciting possibilities they represent for us all.

Xiang Bing  
Founding Dean, CKGSB

The cost of living and dying are both on the rise, China's elite consumers and corporations move up the ranks and new developments emerge for China's banks and bonds.

### Cost of Living

China is no longer a land of cheap living. Hong Kong and Shanghai have now surpassed New York City as two of the most expensive cities in the world, according to the Economist Intelligence Unit's Worldwide Cost of Living Survey, which compared prices in 140 cities across 160 products and services. Seven other Chinese cities, Dalian, Shenzhen, Beijing, Guangzhou, Suzhou, Qingdao and Tianjin, made the list as well. But Chinese cities were still considerably cheaper than the most expensive cities. That honor goes to Zurich, Tokyo and Geneva, who topped the list at No. 1, 2 and 3, respectively.

No. **22** / Hong Kong

No. **42** / Shanghai

No. **47** / New York

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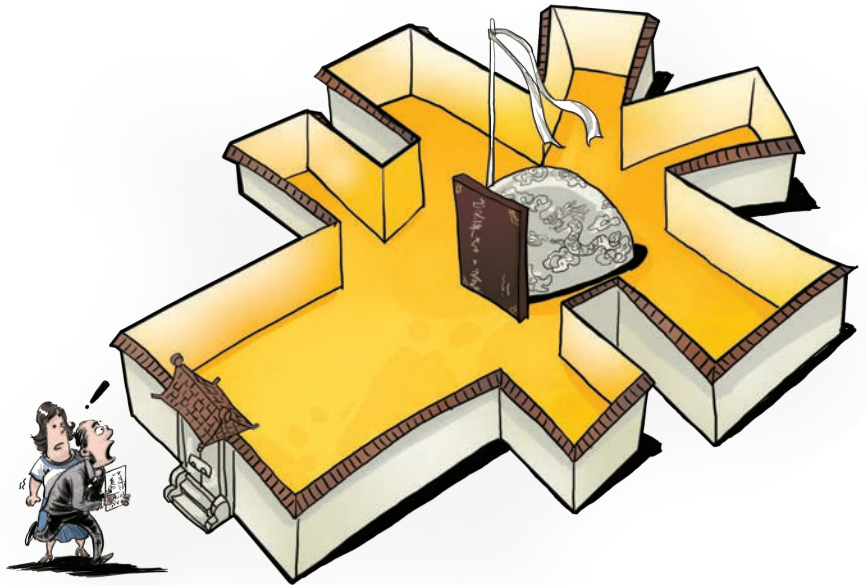
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### Cost of Dying

If the cost of living in China is getting you down, don't even think about dying. That's even more expensive. The cheapest grave in Shuangfeng Graveyard, located in Eastern China's Jinan, Shandong Province, is priced at RMB 12,600 per square meter, almost 40% higher than the city's average housing price. A tomb with good *feng shui* is even more. The most expensive graveyard in Beijing is an eye-popping RMB 350,000 per square meter, according to *China Economic Weekly*.

### Tourists on the Move

Next time you're strolling down Champs Elysees or 5th Avenue, the noise of furious clicking you hear might just be coming from a throng of Chinese tourists, merrily snapping away photos. Planeloads of Chinese tourists are taking the world by storm. By the end of this year, China, with 78.4 million tourists, will become the world's largest outbound tourism market. In 2011, China's number of outbound visitors grew by 22% year-on-year. Shopping is listed as the top motivation of Chinese tourists, with some \$80 billion of spending abroad expected this year, according to China National Tourism Administration.



### Taking Flight

For the Chinese elite, Beamers and Bentleys are so passé. The next play toy is the private jet. While the country only has around 1,000 business and general-aviation aircraft, that number is expected to soar tenfold over the next decade. While still a far cry from the US's 225,000 private aircraft, this new market has foreign private jet makers jumping for joy. In March, over 150 of them thronged the 2012 Asian Business Aviation Conference & Exhibition in Shanghai, hoping to hawk their products, which start at RMB 3 million (\$475,000). Quite affordable, if you're one of the 63,500 Chinese people who have more than RMB 100 million in assets, 13% of whom intend on purchasing an airplane. (See 'Big Spenders')



Photo:CFP

### Big Spenders

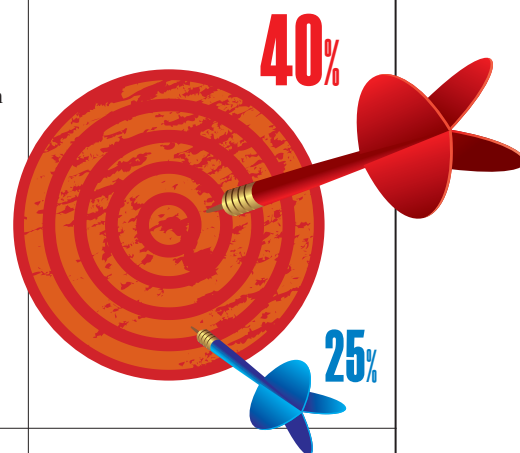
Ever wanted to know what life was like on the top? Now you can peruse the spending habits and attitudes of the China's rich, thanks to The Chinese Luxury Consumer White Paper 2012 released by the Industrial Bank and the Hurun Report Research Institute. Seventy percent of those surveyed who have an Executive MBA want to go back and get another one and 85% plan to send their children abroad to study. Two-thirds have fancy collections. Watches and traditional Chinese paintings are the most popular. But the Chinese wealthy class isn't just buying for themselves. At least 10% of their spending is on gifts, 80% of which are for business purposes.

### Dim Sum Bonds

H SBC plans to issue a RMB-denominated bond in London worth at least RMB 500 million. This is the first issue of a 'dim sum' bond in the city, marking a milestone in London's efforts to become a center for offshore RMB trading alongside Hong Kong. The proposed issuance of the three-year bond comes amid reforms Beijing has made to advance its plans to make the RMB an international currency. London has been working to make itself into a center for offshore RMB trading after an agreement that was reached between Britain and China last year.

### Improved Hit Rate

The success rate of Chinese mergers and acquisitions overseas is 40%, higher than the global average of 25%, according to the Ministry of Commerce. A ministry spokesperson said that in general, Chinese companies are cautious in making overseas mergers and acquisitions. Most M&As took place during the financial crisis due to low costs. Chinese outbound direct investment in non-financial sectors almost doubled in the first quarter from a year earlier as Chinese companies were encouraged to invest abroad and opportunities arose from European debt troubles and the global financial crisis.



### People's Daily Goes Public

For those of you wondering if the *People's Daily* really belongs to the people, now it actually does (well, not entirely). The Communist Party mouthpiece's website went public in April, its stock soaring a whopping 79% on the first day of trading in Shanghai. All told, the government-backed website raked in RMB 1.38 billion (\$219 million) in the IPO, nearly three times the amount it initially sought. The *People's Daily* owns 80% of the stock, with state-owned telecom carriers, China Mobile, China UniCom and China Telecom making up much of the other 20%. People.cn Co., the website corporation, now has a market capitalization of \$872 million, not far from the New York Times Co.'s \$954 million.

### Joining the Elite Group

The Forbes Global 2000 listed 136 Chinese companies this year, 15 more than last year. The highest ranking of them was the Industrial and Commercial Bank of China (ICBC), which is worth \$2.8 trillion in aggregate market value. ICBC made number five overall on the list; Petro China ranked 7th, followed by the China Construction Bank at 13 and the Agricultural Bank of China at 19. China boasts the third-largest number of companies on the list, after the US (524 firms) and Japan (258 firms). The top three spots on The Global 2000 are taken by Exxon Mobil, JP Morgan Chase and General Electric.

### Forbes Global 2000

05

Industrial and Commercial Bank of China

07

Petro China

13

China Construction Bank

19

Agricultural Bank of China

### Shaking up Banking

Last year's lending scandal in the coastal city of Wenzhou, Zhejiang, sent shockwaves throughout the country. Millions of dollars passed through illegitimate lenders who charged usurious interest rates. In response, the government announced in late March that Wenzhou will morph into a pilot zone for new regulations on private financing. The zone will also design offshore investment schemes for individuals, establish regulatory rules for private lending activities, and develop a bond market for local small- and medium-sized businesses. Some experts believe these reforms could finally break the major state-owned banks' monopoly over financial services in China.



# Romancing Hollywood

The US and China are trying to tie the knot with new film deals,  
but will politics and culture intervene?

By Wang Fanfan



**W**ould *Die Hard* still be a classic if Jet Li had played the lead role? Would it have made a difference if *Spiderman* had been set against the backdrop of the Great Wall? And could Zhang Ziyi have played Keira Knightley's role in *Pirates of the Caribbean*? If everything goes according to plan, we'll find out soon.

In mid-April, Walt Disney Co. announced that the third installment of its wildly-successful *Iron Man* movie series will be a co-production with Beijing-based DMG Entertainment. The percentage breakdown of investment has not yet been released, but *Iron Man 3* is sure to have enough Chinese money in it to get it past the government's stringent imported film quota.

Less than a week after that, director James Cameron arrived in Beijing. He is said to have met the state-owned China Film Group to discuss the potential of making sequels of his blockbuster movie *Avatar* as Chinese co-productions. Cameron, whose films have scorched box office charts in China, is unlikely to ignore the power to circumvent China's film quota policy.

That quota, originally set up to protect the local film industry, has become less stringent in recent months. In February, China's Vice President Xi Jinping signed an agreement in Los Angeles to raise the number of foreign films allowed in to the country from 20 to 34 each year. It also raised the foreign filmmakers' share of mainland China's box office takings from 13% to 25%.

Last year, China's box office set records at RMB 13 billion (\$2.1 billion), up 28.9% from 2010. Of that, foreign releases took roughly RMB 6 billion, according to data from the State Administration of Radio, Film and Television. Across the Pacific, things didn't look as rosy – a report released by the Motion Picture Association of America showed that ticket sales from US and Canadian theaters had slipped by 4% to \$10.2 billion.

With declining audiences in the West, it's no surprise that Hollywood directors are turning the spotlight on the East for new opportunities. "Every executive in America's film studios is fascinated by the growth and potential of the Chinese market," says Jason Squire, who teaches courses on the movie business at the School of Cinematic Arts at the University of Southern California. "I am convinced that in the next five years, the amount of money made on movies in this market will make China the number one market in the world."

China has a booming box office and Hollywood has the knowhow and the means to make great movies. It seems like a match made in heaven. What is not clear yet is whether the two will live happily ever after or end up heartbroken.

## Cashing in on Culture

China's film industry is getting tremendous support from the government's 12th Five-Year Plan (2011-2015), which aims to increase the share of culture in the GDP by at least 5% by 2015. The goal is to increase the added value of cultural industries by 20% a year. Currently China's cultural industries account for less than 2.5%. This is a stark contrast to countries like the US where they account for more than 20% of the total GDP.

From the get-go, Beijing's plan to boost culture had striking effects on the capital market. Cultural enterprises, which are usually slow-moving, began to gain momentum in 2011, mergers and acquisitions took place among film companies and media outlets, and many listed on the stock exchange. Fourteen cultural industry-orientated equity



Hollywood actor Keanu Reeves is co-producing *Man of Tai Chi* with Han Sanping, the head of China Film Group

funds were launched, with a collective plan to raise RMB 45 billion.

By October 2011, China's commercial banks held a total balance of RMB 230 billion loans for the cultural industry, according to a report issued by the China Center for Information Industry Development, a Beijing-based consulting firm.

The Five-Year-Plan also offered tax breaks to cinema builders, and last year alone, 800 new cinemas popped up. Many started offering high-definition and 3D capabilities, according to Entgroup, a Beijing-based firm that researches the Chinese entertainment industry. China's famously fast pace of construction meant that around 8.3 new screens were set up every day. For companies like IMAX, business started booming; and overnight China became the second-largest market for the picture format after the US with roughly 25 IMAX theaters located throughout the country.

However, this thriving market is dominated by Hollywood blockbusters instead of local films. Last year two of the top-grossing films were imported. *Transformers: Dark of the Moon* took RMB 1.1 billion at the Chinese box office, while the second-highest grossing film—*Kung Fu Panda 2*—raked in RMB 610 million.

One of China's most internationally recognized directors, Zhang Yimou, and his film *the Flowers of War* managed to take third place on the rankings with RMB 590 million, according to Entgroup. The lackluster performance of what was the most expensive Chinese film ever made came as a surprise to the film industry, which had seen Zhang make a bigger splash with blockbusters like *Hero* and *House of Flying Daggers*.

"The important thing for a powerful film-producing country is that local language films have the absolute advantage in the local market, and a competitive advantage in the overseas market," says Yu Dong, the president of Bona Film Group Limited. He pointed to India's Bollywood model as an example.

Yu suggests that India has fulfilled the first criterion at home, making it a force to reckon with in the film world. But China can't even claim dominance of its own market. The commercial reform of the Chinese film industry only started a decade ago, Yu adds, after it had spent 50 years fulfilling a state-mandated public service and propaganda role.

"Chinese language movies need first to appeal to the local market

and garner both profit and popularity in the culture of their origin. It's very difficult for any local language movie to be exported outside the culture of origin," added USC's Squire.

### Two-Way Street

Beijing's newfound openness to the foreign film market has immediately boosted traffic in both directions. In addition to Disney, other major Hollywood studios have announced joint ventures with Chinese media conglomerates while both private and state-backed film funds from China have visited the US in pursuit of investment opportunities.

At the end of last year, Beijing-based Galloping Horse partnered with Hollywood visual effects and animation giant Digital Domain Media Group to establish a studio in Beijing. "We are seeing a strong need among Chinese audiences for blockbusters with heavy visual effects elements in them," Ivy Zhong, the CFO of Galloping Horse, told the press in an announcement.

She may have been on to something. Jeffrey Katzenberg, CEO of DreamWorks Animation, told *Caijing Magazine* that Oriental DreamWorks, the largest joint venture in the cultural industry in China, was about to start work on new projects. Backed by cash and intellectual property valued at \$330 million, the company has chosen to work on seven stories based on classical Chinese cultural and historical topics, but declined to go into specific details.

Some Chinese heavy hitters like Yang Buting, chairman of the China Mainstream National Film Capital Hollywood Group, backed by both state and private funding, are also busy searching for projects in Hollywood that combine American talent with Chinese stories.

Squire praises Chinese entrepreneurs for having the courage and confidence to make a global foray, but warned of the high risk of investment in the industry. "Hollywood is always looking for investment, and because it is so risky, the numbers [regarding the cost of film production] are so high," he says.

### Global Ambitions

In 1999, Yu established his own company, Bona Communication Co., the first private firm ever to receive a film distribution license. His business later branched into film production and cinema construction, expanding to attain the second-largest share of the distribution market by the end of 2011. In order to boost competitiveness at home, it merged with the state-owned conglomerate China Poly Group in 2003.

However, Yu's ambitions extend way beyond the domestic market. In November 2010, Bona became the first Chinese film company to get listed overseas. Its NASDAQ debut was not a pretty one. It tumbled 22.59% from the issuing price at \$8.50 and its share performance has continued to underwhelm ever since.

"It is not the best financial sense for a Chinese film company to get listed on the American stock market. I might have had much higher returns if I had listed on China's A-Share Market," says Yu. "I chose the most difficult path, because I want to compete with the best film companies in the world."

Bona is not the only Chinese film company to display less than astute financial sense. Last year, Huayi Brothers planned a joint venture with Legendary Entertainment, but the deal fell through when the investor, Hong Kong-based civil engineering firm Paul Y. Engineering backed out. The construction company was hoping to diversify its portfolio, even though it had no experience or understanding of the film industry.

Despite the lower returns, Yu believes that his vision will pay off, if and when China decides to open the film market further to Hollywood. "Bona will be in a prime spot for a partnership with Hollywood film companies when they want to enter the Chinese market. This is because we are a Chinese company listed in the US, and can offer a complete chain of industry from production to distribution and release," he says.



### Domestic Barrier

There are many complex reasons that might deter a potential investor from dealing with a Chinese film company, the most notable of which is a possible over-involvement by the Chinese government in the industry.

These fears are not unfounded. *The Beginning of the Great Revival*, released in June 2011 to celebrate the 90th anniversary of the founding of the Chinese Communist Party, was widely panned by audiences. That was because the government pushed back the release of the popular *Transformers: Dark of the Moon* and *Harry Potter and the Deathly Hallows Part 2*, and made *Revival* mandatory viewing for schoolchildren and the many employees of huge state-owned companies. In the end it raked in RMB 400 million, taking it to number seven on the box office charts, and signaling that quality is not the only determinant of box office success.

Further, China's top directors routinely run afoul of the censors. Jiang Wen, director of the successful 2010 cowboy movie, *Let the Bullets Fly*, languished in creative exile for seven years after making a



Edward Norton and Naomi Watts starred in the 2006 film, *The Painted Veil*, one of the first Chinese-American co-productions with a major Hollywood studio and A-list actors

film that touched on sensitivities surrounding the Japanese occupation of China. Jiang Wen is not alone, which means many of China's greatest directors are out of the talent pool for years at a time, further retarding Chinese cinema's development.

Even before companies reach the negotiating table and encounter language or cultural barriers, the image of China as the world's factory and a counterfeiter looms large. Matthew Bakal, CFO of Mandate Pictures, a subsidiary of Lions Gate Entertainment, feels that these fears of plagiarism and counterfeits in the film industry are unfounded.

"The difference with film and TV [rather than clothing and electronics] is that each product is unique. The product has to make something commercially successful, artistic and be interesting to millions of people," says Bakal. "Each time you are doing it brand new and each one is a little bit of a gamble."

Bakal believes that once more co-productions have been successfully completed, opportunities for bigger, longer-term deals will arise. "It's not that Warner Bros, Sony or News Corp have 25% of these projects that meet everybody's requirements sitting on their desks waiting to go. So it's a matter of finding those projects and doing one or two movies together to learn about the process," he adds.

### Clashing Ideologies

Karin Chien, an independent film producer based in New York City works on the frontier of co-production. With experience of co-production on two documentaries and two on-going narrative films, she understands that when it comes to actual cooperation, cultural differences are more likely to create problems than ideological ones.

"Almost every producer who wants to start a production in China faces the same questions: Can I trust this person? Can I trust this company? Do they really have the relationships and experience they say they have?" says Chien. "For people who do not know the culture or the language, it's even harder."

The administrative climates are also different. Chien points out that the US has a strong infrastructure for film production: unions, vendors, a supply chain, a distribution chain and laws that govern investments and labor. But, like the Chinese film industry itself, all of these are still in their infancy in the country.

The nature of the production can also be a problem. China puts strict regulations on the content of films. A script has to be reviewed and approved by the China Film Co-Production Corporation, a subsidiary of the China Film Group Corporation, to comply with Beijing's restrictions. The restrictions include, but are not limited to: sex, religion, time travel, and the vague "anything that threatens social stability or public morality". The film has to be reviewed again after it's completed.

According to Australian screenwriter and producer Mac Harwood, the filming permit for the Chinese version of *High School Musical* was withheld because the film was seen as encouraging disrespect between students and teachers. He blogged that the production needed a total script rewrite before shooting could begin. The Chinese version was a flop, although critics attributed the bleak box office reception to bad timing, poor distribution and a failure to understand and adapt to the tastes of the target audience.

"The audiences' expectations are very different. In general, Americans like to watch a film with a happy ending, but sad films do really well in China," says Chien.

One American screenwriter based in Beijing admitted that cultural differences can destroy a quality artistic endeavor. The long running joke, he says, is that the role of supporting actress is always reserved for the Chinese investor's girlfriend. He declined to be named as he is negotiating between his American company and the Chinese investors.

Chien says that cultural differences also shape production style. In the US, a producer is the one in charge of keeping the director on budget, on schedule and in control. Without such a Chinese counterpart, she adds, the management of the project becomes more challenging.

She recounted the story of an American producer giving money to a Chinese film company, only to have the money change hands through outsourcing to other directors until the film's budget was next to nothing. The rest of the money was pocketed by the original director.

It's difficult to judge how China and Hollywood will get along in the future. The last few months seem to have been a honeymoon period of pulling together finances and testing the waters. Ultimately, the acid test will be how they cope with cultural differences across the Pacific. If they can deal with that, there's only one question that lingers.

"How can you bridge that gap and make films for both audiences?" says Chien. "Right now that is the billion dollar question and anybody who can figure out the answer will be very rich."



# So Close, Yet So Far

**China's M&A forays into Japan have posed considerable challenges—but hope is in sight**

By Michele Scrimenti

Last year, Zong Qinghou, founder and president of Wahaha, China's biggest beverage company, was holding a run-of-the-mill press conference in Beijing. Although Zong was the richest man in China by some estimates, it seemed as though nothing of interest would come out of his speech that day. Then an ostensibly throwaway comment sent stocks soaring.

"We might buy out a Japanese dairy company. The Japanese are very hard workers," Zong said. "In terms of milk production, their technology is outstanding." That was all the reporters needed. Within a few hours, websites were posting the news: "Chinese Beverage Giant Wahaha Eyes Japanese Dairy Firm Buyout."

Zong didn't name the company he was talking about. In fact, he spoke only a few sentences on the buyout. But that was enough to drive up the stock prices of Megmilk and Moringa Milk, two of Japan's biggest dairy firms. Buyers of Megmilk were particularly enthusiastic; shares jumped 7%, even after the company denied any knowledge of such a deal. As of now, Wahaha is not pursuing any acquisitions in Japan.

The moral of the story is more than "investors can be trigger-happy". It's that, five years ago, no one would have reacted to Zong's press conference. That investors went wild last year means something more: Chinese companies are going abroad in full force, and nowhere is that truer than in Japan.

Chinese companies conducting M&A in Japan have seen mixed results, as evidenced by a new case study by Dr. Xiang Bing, Dean and Professor of Accounting at Cheung Kong Graduate School of Business. But before delving into the specific cases, it's important to look at the first wave of foreign M&A into Japan to understand the challenges these types of takeovers present.

### Not So Big in Japan

In January 1990, the bottom finally began to fall out on Japan's real estate market. Stocks slumped, housing prices plummeted, businesses went belly up, and banks buckled under the weight of unpaid loans. In the succeeding years, Western companies and investors combed through the debris, seeking opportunities for mergers and acquisitions. By most accounts, they failed.

According to Dr. Daniel Duane, an investor who spent 30 years on Wall Street managing global investments for several major funds and investment banks, there were several reasons why.

"These investors had several common characteristics," says Duane. "They had US-style activist investor skills, but no knowledge of Japanese customs or culture."

This cultural ignorance proved fatal, according to Duane. The investors swooped in launching hostile takeovers, seizing complete control of companies, and taking on troubled firms and bloated conglomerates. These takeovers, Duane says, often meet with opposition from the Japanese workers and public.

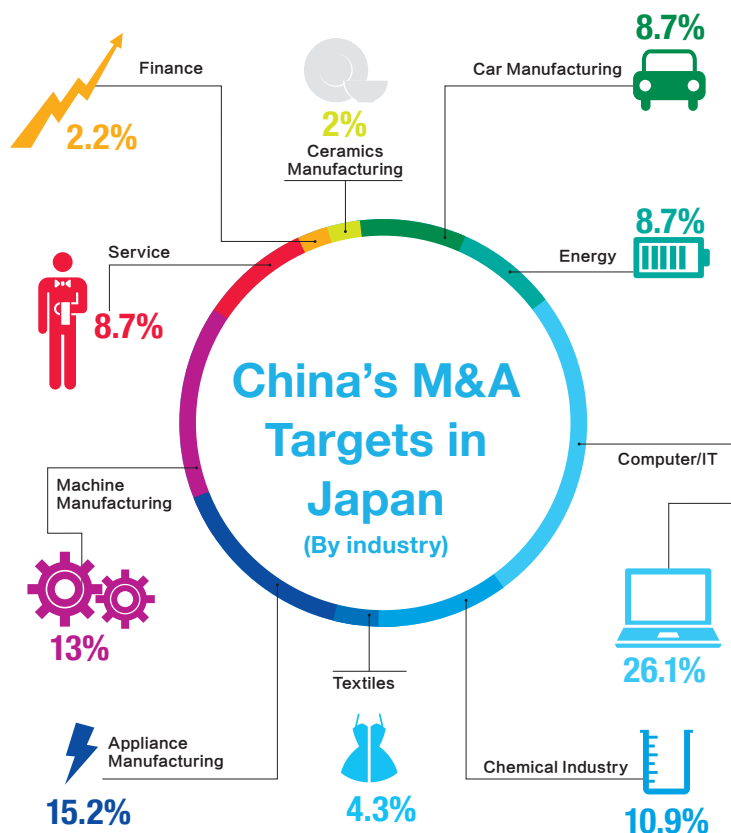
But Duane says there was another crucial mistake the Western firms made:

"They wanted to restructure, including changing management, laying off excess workers and streamlining operations, in order to restore them to profit." For a society based on strict hierarchy and lifetime jobs, on seniority and stability, this was far too much to swallow. In the end, most of the Western investors either scaled back their plans or completely gave up on Japan.

### China's Turn

Over the last decade, however, as Western firms pulled out of Japan, Chinese companies have appeared on the scene. Have they fared better than their Western counterparts? The story of Suntech, one of the companies profiled in CKGSB Dean Xiang Bing's recent case study, sheds some light on this question.

Shi Zhengrong was a typical returned Chinese scholar when, in



“

One of the biggest mistakes Chinese companies make when conducting overseas M&A is that they go for giants, especially giants in deep trouble. Chinese firms don't have a strong track record (in turning around failing firms)

*Prof. Teng Bingsheng, Associate Dean of CKGSB's MBA program and Associate Professor of Strategic Management*



2001, he approached the Wuxi municipal government's with a plan to start a company. Having earned a PhD in Australia under a scientist who won the Nobel Prize for research on photovoltaic (PV) cells, Shi was eager to launch China's first serious solar contender.

Although installed solar capacity in China was virtually non-existent 10 years ago, the government saw potential in the PV manufacturing sector—and Suntech was born. At the beginning, Shi owned a quarter of the shares and the Wuxi government held the other 75%. As in the early stages of many industries that have shifted manufacturing to China, initially Suntech was able to compete on price due to the country's low labor and production costs. Within three years, Shi's firm had broken into the top 10 global solar enterprises in terms of generation capacity. In 2004, however, China's first wave of mature PV companies began buffeting Suntech—low costs alone would not let the firm hold onto its country-leading position.

At the same time in Japan, the Koizumi government, known for pushing free market policies, suddenly withdrew their generous

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Buying a Japanese firm is very difficult. But if you give up because you're afraid of all of the challenges, you'll be missing a great opportunity

*Shi Zhengrong, CEO of Suntech*

PV subsidies, which had helped make Sharp the world-leader in the solar space. Under new pressure to reduce costs, Sharp severed contracts with many Japanese component manufacturers and turned to foreign original equipment manufacturers, which were offering lower prices. MSK, a 50-year-old solar battery maker, was left in the lurch. With much of its revenue coming from its contracts with Sharp, MSK knew they were in trouble unless they could find a savior who would buy them out.

The business savvy Shi seized on the opportunity to take over MSK—not only did the Japanese firm have advanced technology for several components, but it could also give Suntech access to the massive Japanese market.

In 2006, Suntech snapped up the suffering MSK for \$300 million. At the time, it was the biggest overseas buyout by a Chinese firm in history. Suntech's stock price soared, and *Forbes* named Shi China's richest man. But Suntech's honeymoon in Japan wouldn't last. While struggling to turn around MSK, the Chinese firm ran into many problems—everything from public opposition to infighting.



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Chinese  
companies are  
going abroad in  
full force, and  
nowhere is that  
truer than in  
Japan

Photo:CFP

Suntech's solar-paneled headquarters in Wuxi, outside of Shanghai: It is also the world's largest photovoltaic cell production facility

## Growing Pains

The problem that underpinned everything else was the financial state of MSK. “One of the biggest mistakes Chinese companies make when conducting overseas M&A is that they go for giants, especially giants in deep trouble,” says Prof. Teng Bingsheng, Associate Dean of CKGSB's MBA program and Associate Professor of Strategic Management. “Chinese firms don't have a strong track record [in turning around failing firms].” As a privately-held company, MSK had no experience doing accounting for investors. Suntech had no idea how troubled the company actually was.

One thing that became clear almost from the get-go was that Suntech hadn't done enough early-stage research. Around 80% of solar batteries in Japan are sold to individual buyers for home use. In most other major markets, the vast majority of sales are to solar farms. For Suntech, this meant its products

would now have to meet a whole new set of standards affecting everything from appearance to size. Suntech had to go through an entire product overhaul to appeal to this new market.

Further problems arose with MSK's labor unions. Suntech realized that while the R&D conducted in Japan was high quality and worth the expense, the manufacturing was far more expensive than in China. When Suntech decided to shut down one of MSK's factories and lay off the workers, it ignited a media firestorm and public outrage. In the end, the employees of the to-be-shuttered factory staged a coup. They exercised a right under Japanese law to buyout their factory, which they kept running in competition against Suntech.

Shi was apologetic, although intransigent. “No company wants to lay off workers, but we had to do it to keep the company alive,” he said to the *China Economic Report* at the time. “Japan's lifetime employment system is actually a hindrance to many companies' viability.”

Another major difficulty that Chinese

firms face when trying to tap the Japanese market is prying open tightly sealed sales and supply chains. According to a report by the Chinese Academy of Social Sciences, 70% of Japan's supply chain and logistics are controlled by an oligopoly of domestic conglomerates. MSK may have been a local company, but it was mainly a parts supplier. Sharp was responsible for getting its products to market—and it was going to help MSK now that it was owned by Suntech.

Here's where Suntech got creative. After failing to go through the traditional sales channels, the company struck deals with home appliance stores and other retailers who didn't normally sell solar batteries. This innovative way around the Japanese conglomerates has produced some success, but Suntech still has had trouble gaining a significant market share.

## Clash of Civilizations

The last of the big challenges Suntech had to overcome is by no means the least—culture. Although MSK had courted Suntech's purchase, the buyout was initially opposed by most of the shareholders. After several attempts to get more shareholders on board, MSK's CEO finally threatened to resign if the deal wasn't approved. The shareholders eventually acquiesced.

“This type of reaction is the by-product of being an island nation. The people are insular,” says Sarada Takashi, an analyst with Nomura Securities in Shanghai. “People see this as a threat to Japan, and the media often make matters worse.”

Despite the initial support of the CEO, he later became an obstacle to Suntech's reorganization plan. The CEO firmly opposed many parts of the plan, especially the layoffs (Suntech would eventually lay off 20% of MSK's Japanese employees). Shi was stuck. Unable to work around the Japanese CEO, Shi spent two years looking for a replacement. He finally brought on an executive from video game developer Sega who had considerable experience working at MNCs. More bottom line-minded in his management outlook, the new CEO was able to push through Suntech's plan and MSK returned to profitability.

Six years after the takeover, Suntech is now the world's leading PV manufacturer by installed capacity. This is in no small part due to its incorporation of MSK and the access it gained to Japan's market. Unlike many of the Western firms in the early 1990s, Suntech learned to adapt and innovate, rather than just give up. Obviously it wasn't easy, but on this matter Shi has one last piece of advice: “Success comes from perseverance. Buying a Japanese firm is very difficult. But if you give up because you're afraid of all of the challenges, you'll be missing a great opportunity.”

# China's Hottest Commodity

As the war for talent intensifies, Chinese firms seem to be winning for the first time ever

By Chris Hawke and Sam Waldo

**J**en Jiang, the second member of Halma's China team, was hired to head recruiting in 2006. At that time, the British hazard detection and safety technology conglomerate conducted its Chinese recruiting online through just three recruiting websites.

In the intervening years, Halma has experienced increasing difficulty in attracting and retaining qualified talent. "From 2006 to 2008, it was much easier to recruit entry-level employees or finance, marketing, and sales staff. From 2009 up to now, our HR team has spent more time on internet recruiting and got fewer CVs," says Jiang.

Turning to social networking sites like Sina Weibo and LinkedIn to draw more applications led to disappointing results.

Jiang and her team became more proactive, posting available positions on Tsinghua University's online career message board and engaging professional headhunting services.

Halma is not alone in its struggle to build a strong team in China. Hiring and retention have become difficult for multinational corporations (MNCs) in recent years.

Last year, only a quarter of graduating students listed MNCs as desirable employers. That figure was 50% in 2007 and 66% in 2004, according to surveys by recruiting firm ChinaHR, a company owned by Monster Worldwide.

Hiring is only half the battle—retention is another struggle. "It is not uncommon for MNCs to face 20% turnover or higher in China, a number that would raise major warning flags in most other markets," says Ben Cavender, Senior Analyst with China Market Research.

MNCs are not the only firms with high turnover, but they are the ones who are struggling more to attract potential employees. Alexandra Hendrickson, Executive Vice President of executive search firm DHR International, has both Chinese and international clients. Hendrickson uses 30% as a base turnover rate.

"If your turnover rate is at 30% or above, it's a total disaster whereas if you can get it below 10%, that is considered really good," Hendrickson says, though she knows rare companies that have achieved rates of 4% or 5%.







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Chinese enterprises are perceived to offer greater security and loyalty to their employees compared with MNCs

### A Turning Tide

China's brightest, whether fresh graduates from top universities or seasoned managers, used to flock to MNCs in droves, drawn by high salaries, opportunities to learn global best practices, and the possibility of overseas assignment.

China's state-owned enterprises (SOEs) and fledgling private companies looked either bloated or frail by comparison.

But China's enterprises have been learning, adapting and growing at rates that make most MNCs look anemic. For example, according to the Ministry of Finance, SOE profits grew by 37.9% in 2010 and another 12.8% in 2011.

Successful Chinese firms are now competitive for top talent too. “(This means) increased demand for skilled talent, while the local supply remains stable,” explains Michael Maeder, Account Manager with China-based recruiting firm Direct HR. MNCs no longer get the pick of the litter. The number of MNCs in China has increased as well, further exacerbating the supply shortage.

Though foreign workers used to be the hottest commodity, experienced locals, especially those with overseas working experience, are now the most sought after.

More and more companies are coming to China to set up shop. Yet selling in the local

Photo: gettyimages

market requires local expertise, and even experienced foreigners lack the knowhow of a PRC national.

These coveted few are in such demand that they are getting job offers every week, even daily, and routinely decline even lucrative offers, says Paul Loo, China Managing Director of executive search firm Profile Search and Selection.

A dominant short-term gain mentality has led many in China to hop from one job to the next following higher and higher offers, explains Cavender, leading to China's astronomical turnover rate.

### Second Fiddle No More

Chinese enterprises, both state-owned and private, are giving employees offers that MNCs have trouble matching.

A 2011 report, *Rise of the Chinese Enterprise as Employer of Choice* by executive search firm Korn/Ferry International, describes the unique appeal of Chinese firms.

For one, cash-rich Chinese firms can now offer salaries which are competitive with MNCs. Private Chinese firms also have the financial allure of a potential IPO, an enticing prospect that has made many millionaires overnight, says Korn/Ferry.

There is also the "sense of achievement in helping the Chinese enterprise go global", Korn/Ferry reports, something MNCs generally cannot offer.

Managers in China also feel that Chinese firms promote quickly. "(Local enterprises) are willing to pay for (outside) talent. So they offer senior, flexible titles to encourage executives to come on board since most MNCs cannot offer these," says a senior HR manager from an international beverage company surveyed by Korn/Ferry.

And even with the chance of failure at a small Chinese firm, executives surveyed by Korn/Ferry expressed that "Chinese enterprises are perceived to offer greater security and loyalty to their employees (compared with MNCs)".

Chinese firms are seen as giving employees more decision-making freedom, and this empowerment can be attractive. A manager at a global fashion retail company surveyed by Korn/Ferry described joining a small Chinese firm as "(akin to) starting your own company and satisfying a dream or ambition, but without having to sink in your own capital".

### For Self and Country

These reasons and more led Xiao Ming (name changed), an Ivy League-educated lawyer with humble roots in one of China's poorer provinces, to leave his dream job at a prestigious Wall Street firm after five years,



SOE's perceived stability and room for advancement have made them appealing to Chinese employees. At this job fair in Wuhan, one student had her arm dislocated and three climbed over porta-potties to get into a job fair for 25 major SOEs. Because of the crush of applicants, the fair had to be shut down early

return to China, and join an SOE in Beijing.

One motivating factor for Xiao Ming is the scale, novelty and complexity of the deals he now works on in China. Xiao Ming's Wall Street clients may have been large, but China's SOEs tend to be the leviathans—unsurpassed the world over in both size or growth.

Working at an SOE has thrust Xiao Ming to the highest reaches of his industry, giving him a chance to impact the entire country. "(SOEs) give us a lot of power and influence over what we do," he says.

But many who make the jump from MNC back to SOE struggle to fit in with the people-oriented culture of China's behemoth enterprises, notorious for Byzantine office politics.

"Are there successes? Sure. Are there failures? Yes as well," says Loo. "After three years, (many local Chinese) go back to multinational corporations."

Xiao Ming says that pay at SOEs still lags behind that of MNCs at the highest levels, though this gap is narrowing. But that is offset by the

special opportunities, sense of security and intangible benefits associated with SOE positions.

One such benefit is the sense that China's time is now. Fueling the Chinese economic miracle by helping a homegrown firm become a worldwide success can be appealing to locals. "China needs us—people like me—to implement its globalization strategy," says Xiao Ming, demonstrating a sense of pride and nationalism that MNCs would be hard-pressed to replicate in their employees.

### A Porous Glass Ceiling

Some MNCs have become their own worst enemies in employee retention by setting up unseen barriers beyond which Chinese employees fear they will not be promoted.

Alexandra Hendrickson gives an example of Fang, who worked at a large industrial employer for 11 years.

Fang's expatriate boss' tenure would last several more years, but the company had already told Fang that his supervisor's



position would be filled by another expat. Without the prospect of career advancement, the company lost an employee who had been with them for over a decade.

The mere idea of a glass ceiling is toxic for employee retention. This is one reason why MNCs have been taking visible steps to localize management.

The American Chamber of Commerce in Shanghai's 2011-2012 China Business Report found that 56% of the American companies polled have over 75% of senior management positions filled by Chinese nationals—a clear demonstration of just how thoroughly many foreign firms have localized their staff in China. Though it has not vanished, the glass ceiling for Chinese employees is certainly higher and more porous than it used to be.

The concept of the glass ceiling nonetheless persists in the minds of many Chinese employees. Situations like Fang's reinforce these perceptions and hinder any efforts by MNCs to foster company loyalty.

### Flies with Vinegar?

MNCs do a lot to push talent away. In 2011 Community Business, a Hong Kong-based NGO, published *Bringing out the Best in Asian Talent*, a survey which found some MNC traits that high-value Chinese employees find unappealing.

Sure enough, one turn off is the glass ceiling. Another is the complexity of English, the subtleties and idioms of which make it intimidating for even fluent non-native English speakers.

Some Chinese employees feel that this cultural barrier keeps them from networking successfully. "Only those who truly understand 'Western' culture are able to move up the corporate ladder," says the report.

A third negative trait is the "constant need to educate corporate headquarters staff about China, the values and the culture"—an onerous and unwanted responsibility for some Chinese employees.

### Try Honey

Competitive Chinese firms are here to stay, and MNCs have no means of returning to their monolithic dominance of the Chinese high-value labor market.

But there are a number of factors that MNCs can and must tinker with in order to improve their image as employers.

For one, MNCs should demonstrate a clear commitment to prioritizing work/life balance. Also, MNCs should counter poaching with salary flexibility.

Alexandra Hendrickson recalls advice she has given to clients in her Shanghai office for improving retention.

"At lower levels, create programs for employees—company picnics, employees' clubs, birthday celebrations, giving awards.

"At higher levels, (institute) training programs. Make Chinese employees feel they are being invested in, that the company cares about them. Training in the home country is a very, very powerful way to convey to an employee that they are valuable."

Most important of all is making career advancement opportunities clear. Hendrickson says, "The reason I see candidates in my office most often is that their employers do not articulate possibilities for employment in the company."

Korn/Ferry's advice to foreign firms is to "stretch your high-potential talent", taking a page from Chinese firms and giving challenging assignments to even employees who lack adequate experience.

Keep talent satisfied by "creating additional titles for use in China that are outside of the global ranking scale". An employee might leave for a competitor if offered a more prestigious title.

Korn/Ferry suggests MNCs demonstrate long-term commitment to the Chinese market in order to provide the sense of security readily available at state-owned juggernauts like electric company State Grid Corporation or telecom provider China Mobile.

Another strategy that could boost loyalty, according to Community Business, is providing more exposure to international best practices, an advantage that most MNCs have over Chinese firms.

Community Business also recommends localizing senior management and respecting the contributions of Chinese executives, thereby giving lower-level Chinese employees business role models and positions to aspire to.

MNCs can and must adapt if they are to regain their footing in the fight for China's top talent, integrating Chinese employees into their corporate families and replacing the pervasive glass ceiling mentality with clear, merit-based trajectories for advancement. ■

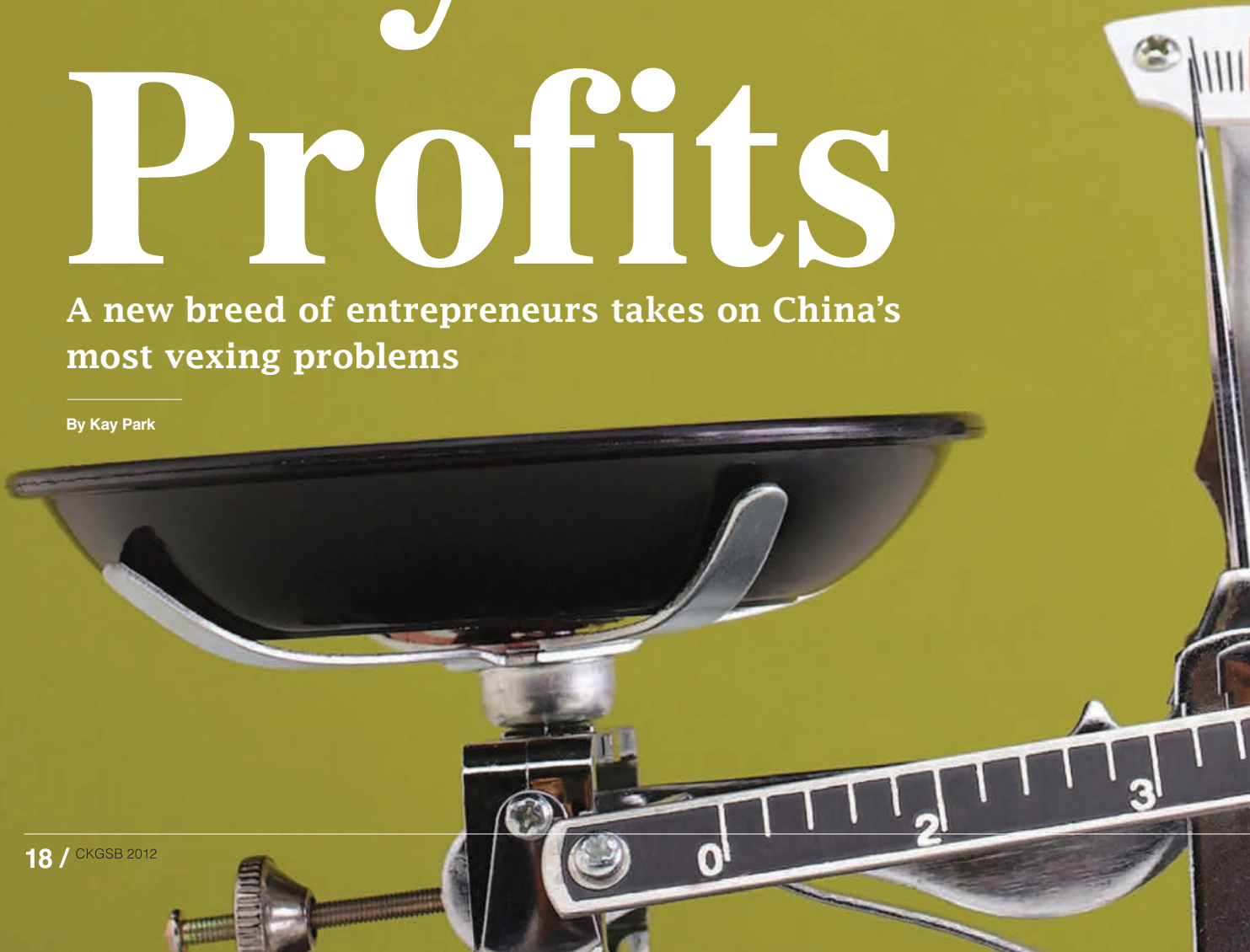
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SOEs give us a lot of power and influence over what we do, says Xiao Ming, a lawyer who left a blue-chip New York law firm for a Chinese state-owned enterprise

# Beyond Profits

A new breed of entrepreneurs takes on China's most vexing problems

By Kay Park





**A**mong the sand dunes of western Inner Mongolia, the futures of the encroaching desert, impoverished farmers and one enterprise are now intertwined with an unlikely product—fruit juice.

Sea buckthorn berries, a fluorescent orange fruit the size of a dime, grow on bushes about three to four feet high in the desert. Liu Zhifeng, founder and CEO of Spring Mountain, China's leading producer of sea buckthorn berry juice, has known the fruit since his childhood in Ordos, Inner Mongolia.

"I drank [the juice] when I was younger," says Liu. "But it wasn't widely available." In his early 30s, Liu has accomplished much, and he is eager to do more. The head of companies as varied as a weekly magazine and a hotel, Liu regularly takes the 7 a.m. flight from Beijing to Ordos and then the evening flight back. (One of Spring Mountain's major sales distribution offices is in Beijing.)

His first company was a small, single store selling elevator components. After nearly having to shut down his company, Liu ventured into different sectors and markets until finally making his first million installing elevators and central heating systems in the early 2000s. Liu began looking for another business to get into. He went into hotels and media. Yet he still wanted something bigger, something that went beyond the traditional models, something that could help society. Eventually, he thought of the juice he drank in his childhood. No company had begun large-scale production of sea buckthorn berry juice.

"I told my board that I wanted to start producing this juice and they were not excited about it," says Liu. He got his hands on some research—the juice is full of Vitamin C and Omega-3. The drink would be perfect for health food enthusiasts.

The health food market in China is becoming increasingly lucrative. Global market research firm Euromonitor International estimated that in 2009, sales of wellness foods and beverages in China touched \$1.5 billion, a 28% increase from five years earlier.

"Eventually I was able to convince [the board] that this drink had huge market potential, and they decided to go along with me," says Liu. He

raised funds and invested his own money, totaling RMB 800 million, and was off to the races—sort of. "The plant takes three years to bear fruit, so we had a long time to wait before we would see any of that investment back." Liu spent the three years acquiring the best juicing machinery, researching the health benefits of the juice, building sales channels and training farmers to ensure product quality. In 2011, the first year the bushes bore fruit, Liu's company boasted a sales revenue of RMB 200 million.

### Going the Extra Acre

If Spring Mountain were a normal beverage company, that would be the end of the story. But it's not. It's on the cutting edge of a business model that's relatively new to China—the social enterprise. Although he doesn't use the terminology, Liu thinks of himself as a social entrepreneur. "Through innovations in our product line, management and technology, we can promote societal progress and solve problems facing the country," he says. Liu is quick to add that this is not a charity: "Implementing a profitable business model is still the most important thing."

Western China's deserts are growing at alarming rates. Asia's largest desert, the Gobi, devours nearly 1,400 square miles of grassland a year. For decades, the Chinese government has led massive efforts to battle desertification, going so far as building a "green wall" of millions of trees to halt the deserts' advances. NGOs have attempted schemes of all kinds, sometimes even busing volunteers from Beijing to the desert regions to plant trees or cacti. These efforts have had a limited impact; but there are signs that the solution may come from people outside the government or NGOs. People like Liu.

Spring Mountain plants sea buckthorn bushes on 140,000 rented or purchased acres of desert in Inner Mongolia and Ningxia, two regions hit hard by desertification. The bushes require little water through the year and their roots burrow deep beneath the dunes—stopping erosion and slowing the march of the desert.

The land Spring Mountain uses was considered barren; the farmers and nomads who own it relied on other tracts of arable land for growing crops and grazing. But when Liu showed up, the useless sand dunes suddenly had value.

During the early phases of his company, Liu spent millions of RMB researching proper planting and maintenance methods for the sea

Farmers in Ordos, Inner Mongolia, plant sea buckthorn berry bushes. When properly planted and maintained, the bushes can prevent desertification



Photo:CFP

buckthorn bushes. He hired agriculture experts and cooperated with multiple universities. When the time came to leave the greenhouse and head for the fields, this investment paid off in spades.

Contract farmers go through a short training program that equips them with the technical knowhow to plant and nurture the bushes. As more techniques are developed, farmers are retrained to keep them up to speed on the latest methods. Spring Mountain buys the harvested berries, ships them to its factory in Ordos to be made into juice, and then distributes the juice through its sales network that stretches across China.

This model turns the 70% of farmers that lease their property to Spring Mountain into micro-entrepreneurs, who have more technical know-how and are empowered to make full use of their land. (The other 30% of farmers work on land owned by Spring Mountain.) Farmers in this region are among the poorest in China, averaging a cash income of between RMB 2,000 and RMB 7,000 per year. Spring Mountain pays over 100,000 farmers between RMB 700 and RMB 7,000 per year, giving them a revenue source in addition to what they earn from their other farmland.

## Rising Wave

Spring Mountain is just one of a growing number of social enterprises that are sprouting up across China.

Shokay International, a social enterprise that sells thread made from yak fur, was founded in 2006. The company contracts with nomads, mostly Tibetan, who shear and weave yak wool, which Shokay then buys and sells to clothing manufacturers. “Our first level impact is to generate more income for Tibetan herders by sourcing fiber directly from local communities,” says Shokay co-founder Carol Chyau. “Along the supply chain, we integrate hand spinners and hand knitters to provide more employment opportunities.”

Like Spring Mountain, Shokay is helping rural Chinese supplement their incomes by taking advantage of untapped resources. For most of the Tibetan herders they employ, yak fur didn’t play a role in making money; at most, they would use it for their own clothes. Thanks to Shokay’s training, however, the herders are now highly adept at weaving and making thread, thereby earning extra cash that they wouldn’t get otherwise.

While many social enterprises are focusing on providing income opportunities for rural dwellers, others are taking on environmental issues. Wang Zhaoming’s Mong Grass sells a hybrid of grass breeds in Inner Mongolia. An agriculture expert himself, Wang and his team of researchers has modified and cross-bred the Mongolian grass for years, strengthening its ability to resist drought. Sold at prices considerably lower than the imported varieties that were previously planted, Wang’s grass is currently used across China both to fight desertification and to reduce water usage in public green spaces.

These aren’t isolated cases. According to YouChange China Social Entrepreneur Foundation, China already has hundreds, possibly thousands, of firms that could be classified as social enterprises.



Farmers gather sea buckthorn berries for sale. By selling the berries to Spring Mountain, the farmers earn additional income

## Filling the Gaps

Clearly, the social enterprise is starting to take off, but why?

Experts point to a confluence of factors: everything from the Olympics to charity scandals. “The credibility of non-profit organizations has been challenged in China in recent years,” says Liao Jianwen, Professor of Managerial Practice, Strategy, Innovation and Entrepreneurship at CKGSB. “So people are less reluctant to make donations to those organizations.” The credibility crisis, according to Liao, has been fueled by scandals involving major charitable organizations including the China Red Cross. Because of this, he says, “in the social and environmental space, there’s room for business models—there is money to be made in solving social problems.”

Even before the credibility crisis, charitable giving wasn’t particularly high in China. In 2010, when Warren Buffet and Bill Gates visited China with hopes of encouraging the country’s billionaires to donate their wealth to charity, they were rebuffed. Many of China’s richest people even declined to have dinner with the American billionaires, fearing that they might be asked to make a charitable pledge on the spot. Given this climate, it’s not surprising that the 2011 World Giving Index, which extrapolated Gallup polling data to rank countries’ charitable giving, put China in the 140th spot, a far cry from the number one position held by the world’s other superpower, the United States.

Further, the charity model has limits, explains Liao. “If you’re a charity, you see a problem, raise money, and then try to solve the problem. After the money is gone, you have to go find more donors. Social enterprises are more sustainable.”

But it’s not just traditional charities that are struggling in China; many NGOs still haven’t found their footing. Yvonne Li, founder and CEO of Avantage Ventures, a company which funds social enterprises, says while that might be bad news for charities and NGOs, it might be good overall. “NGOs are now looking to change their model,” she says. “Many are seeking to turn into social enterprises to address cash flow

and sustainability issues. [This] is the reason why more and more people are getting involved in social enterprises.”

Many of these social enterprises were formed in and after 2008, widely considered a watershed year for the sector due to the Sichuan earthquake. “The earthquake gave people a foundation from which they were able to start to understand the role enterprises can play in addressing social issues,” says Ling Hui, program director at YouChange. “The Beijing Olympics cultivated a spirit of volunteerism that fed into greater interest in how to do good things for society sustainably.”

The shift in public attitudes toward charities and social responsibility is obviously benefitting these enterprises,

but there’s another factor that can’t be overlooked—the people at the grassroots level working for them. Cornell University Professor Stuart Hart has argued since the mid-1990s that social enterprises need to involve locals throughout the business. “[N]ative’ capabilities... enable a company to develop fully contextualized solutions to real problems in ways that respect local culture and natural diversity,” he wrote in the *Stanford Social Innovation Review* in 2005. These comments go a long way to explain why models like Shokay’s and Spring Mountain’s, which use extensively indigenous resources and skills, have been successful.

The late University of Michigan Business Professor C.K. Prahalad went a step further. In his 2004 bestseller, *The Fortune at the Bottom of the Pyramid*, he wrote that enterprises work best when the people involved “get recognition, respect, and fair treatment”. “Building self-esteem and entrepreneurial drive [of the low income groups] is probably the most enduring contribution that the private sector can make,” he wrote. By turning the herders of Tibet and the farmers of Inner Mongolia into businesspeople, Shokay and Spring Mountain are doing just that.

## Unsung Heroes

Social enterprises in China are making some solid headway, but they still have a long way to go.

“Our biggest challenge is educating consumers,” says Spring Mountain’s Liu. In other countries, social enterprises can capitalize on their societal benefits to promote their products. “That works with some small segments of Chinese society—the well-educated and the wealthy. But for the most part, advertising our social benefits doesn’t help us sell our products to the average Chinese consumer,” he says. Not to be deterred and always business savvy, Liu hired Zhang Hanyu, one of China’s biggest box office draws, to be the company’s brand ambassador, leveraging the actor’s credibility and popularity to boost consumers’ interest in the juice. Pictures of the superstar adorn almost all of Spring Mountain’s promotional materials.

But not all social enterprises can afford to spread the word and YouChange’s Ling sees this as a major problem. “The average Chinese



Social ventures in Western China, like Shokay International, target Tibetan herders, some of whom are among China’s poorest citizens, and have helped raise incomes while maintaining cultural practices and traditional lifestyles

person doesn’t know anything about social enterprises,” she says. “Most people think enterprises are supposed to make a profit, not help society—that’s for charities. It will still take time for this concept to become widespread and well-understood.”

Average Chinese citizens aren’t the only people who are unclear on what a social enterprise is. “It’s hard to give a definition to the term ‘social enterprise,’” says Ling. “That’s one of the several reasons why there isn’t sufficient policy support coming from the government—they don’t know what should qualify as social enterprise.”

Another aspect of the policy support issue is that working for the benefit of society is often seen as the exclusive province of the

government. “What would a social entrepreneur be in China?” asks Rick Aubry, professor of Social Entrepreneurship at Stanford Graduate School of Business. “The government sees part of its role to create social benefits through government activities themselves. They have said, ‘We will take care of the people, you succeed as a businessman to take care of the economic wealth of the country.’”


In the absence of government backing, social enterprises have been seeking support from other organizations, even other countries. Shokay, the yak fiber enterprise, got its startup capital by winning Harvard Business School’s prestigious social innovation competition. YouChange Foundation provides training sessions for social entrepreneurs. And a handful of funds like Avantage Ventures is investing exclusively in social enterprises.

## Scaling Up

Aubry adds that another major obstacle that social enterprises often face is scalability. “The challenge for the social enterprise is that it tends to be very local and micro in scale,” says Aubry, who has run a social enterprise in San Francisco for over two decades. “It is hard to create a national model where millions of people are affected rather than hundreds.”

Liu Zhifeng also had problems with scalability in the early days of Spring Mountain. “We originally had problems with the farmers,” he says. “They were often unwilling to work with us and were reluctant to rent out their land.” By giving training sessions and paying wages in advance, however, Spring Mountain was able to earn their trust, and now the company works with over 100,000 farmers. Further, Liu has been able to bridge growth problems because he’s been there before. Previously, he built a company from scratch into one with national reach. Now he’s even more ambitious.

“We’ve already received the organic certifications from the USFDA, Japan and the EU; and we’ve been negotiating with foreign exporters,” he says. “Our next step is the international market.”

If he succeeds, Spring Mountain won’t be shipping over just products—it’ll be exporting a different way of doing business. 



# Homegrown Fashion

**Fashion designer Mao Jihong on how one of China's leading luxury brands made its mark on the mainland**

By Matthew Jukes

**M**ao Jihong is the man who could build a bridge between China's fashion industry and the rest of the world. Standing astride the world's second-largest luxury market, Mao, the founder and president of Mixmind Art & Design Co., Ltd, and his then wife and fashion designer Ma Ke famously started out by selling handmade clothes at high prices opposite Guangzhou's landmark Garden Hotel. He wanted to avoid mass factory production, he said, because he believed it would decrease consumer faith in his products.

Today, 16 years later, Mao's efforts seem to have paid off. His company, set up in 1996, offers two fashion brands for women: Exception de Mixmind, the flagship ready-to-wear clothing line and the curiously named Wuyong (which means useless in Chinese), a haute couture collection which was founded in 2006.

Ma Ke has since stepped out of the corporate limelight to focus on Wuyong, which made a splash in the fashion world with its use of distinctly unfashionable materials. Models sashay down the ramp in chic clothes made out of recycled objects, leftover tarpaulin and sack-like cloth.

Meanwhile, mainstay brand Exception has built a significant presence of over 100 stores in the Eastern cities of Beijing and Shanghai as well as their home base, the growing metropolis of Guangzhou. Exception is touted as the Chinese fashion industry success story and has an estimated annual turnover of more than RMB 900 million a year. Mao claims that he's the biggest in the market. Industry



observers such as fashion media mogul Hung Huang have put the brand at the top of their watchlist for homegrown brands with the potential to make it big abroad.

When Mao launched the brand, Exception was almost the only Chinese designer brand in existence, and he began on pretty much a blank slate. “When we entered the market, we chose a very different direction,” Mao recalls. “The international brands started off by building a high-end line, and from the top down they built medium or low-end lines.” Italian fashion house Armani started out in the 1960s, influenced by the style of British nobility, and hoping to bring that to an already wealthy population. It was only after Armani became successful internationally that they expanded to product lines like A.X (Armani Exchange) and Armani Jeans that could appeal to the lower end of the market.

Mao had no such demographic to work with, and was forced to test the waters before he could sell to the upper echelons of Chinese society. “For us as a designer brand, we had to enter the market slowly and grow with our consumers. Since we started out, we have had to work hard to make our clothing a definitive brand name,” he says.

Today, Exception seems to have carved out a niche of his own. “We’ve got so many different types of Chinese brands; I think they’re all kind of their own thing. I think the only thing comparable in being design focused, would be the smaller independent labels,” says Nels Frye, editor-in-chief at *Lifestyle* magazine and founder of the Beijing Stylites website. “I mean how would you describe Dolce and Gabbana? It’s not exactly a luxury brand, but it’s certainly priced very high, and it’s more fashionable, more design-oriented. I think this label [Exception] is interesting because it’s very much its own voice.” Exception considers as competition well-known international brands and a host of young Chinese designer clothing brands that have followed in its footsteps.

So what really sets Exception apart? At the root of this is Exception’s product philosophy. “Our brand has always used cotton, linen, silk and wool as material, respecting nature and the environment,” says Mao. Mao understands the pulse of the Chinese consumer, and that gives him an added advantage. “Westerners use sight as their fashion sense, whereas Chinese tend to favor touch and texture as a measure of beauty. We’re exploring that measure, and that’s what builds loyalty and confidence among our consumers,” he says .

This philosophy—of touch and naturalism—is reflected in everything from the garden-esque shop interiors to Mao’s down-to-earth clothing. Despite having to supply to nearly 100 stores around the country, Mao hopes to retain this USP.

This philosophy seems to work for Mao. Says *Lifestyle*’s Frye, “I can imagine an older generation... would be inclined to buy something with more texture and more color and pattern.... It actually has a certain connection to what I would describe as a movement which has toured among the young people; a very simple rejection of all the brands and the ‘glitteriness’.”

Fangsuo Commune, Exception’s concept store in Guangzhou



A design from Exception’s Spring/Summer 2011 Line



## Cashing in on New Luxury

China's growing obsession with wealth and luxury has been well documented over the past decade. The need to appear wealthy is closely linked with the sociological concept of "face", and the amount of respect you are shown by individuals around you. In China, visible affluence can be key to everything from job interviews to successfully hailing a cab—and conspicuous consumption pays, especially when it comes to fashion.

A McKinsey report titled *Understanding China's Growing Love for Luxury* published in March last year, attributed the surge of luxury purchases to "luxury role models", the self-made entrepreneurs who have sprung up in wake of China's opening up and reform policy, and the luxury fanatics, whose sense of optimism correlates with China's growth in GDP figures. It is estimated that currently 300 million Chinese with a disposable income are driving the nation's spending. By 2030, that number is estimated to rise to 1.4 billion.

The knock-on effects have already been seen in the luxury market. A survey released by PricewaterhouseCoopers in December 2011 suggested that during the year luxury sales in the country reached \$15.5 billion, a growth of a whopping 30% over 2010. They are expected to almost double to \$27 billion by 2015, according to McKinsey.

Mindful of this audience, in 2005 Mao started a marketing campaign to create an idea he calls "new luxury", which is targeted at China's new generation of wealthy consumers. He believes that his customers care just as much about environmental issues as Western aesthetics when they are looking to spend.

"I have been questioning the 'luxury' concept since 2005. I hope that our generation can give birth to the concept of 'new luxury', which focuses on the ecology of a product," says Mao. "The establishment of a brand, at different levels, is in part related to the strength of a country and the quality of life that the people have. The value you have to add to that [to make it successful] has more to do with culture, and how you incorporate and deal with other world influences."

To establish this "different form of luxury", Mao paid close attention to the production process. Clothing is made from natural materials, the use of dyes and colorants has been minimized, and the manufacturing process is conducted mostly through traditional techniques like spinning weaving and sewing.

He clearly believes that this approach is important to his customer. Mao's eco-approach is not a new one. Luxury brands the world over have dabbled with it. Moët Hennessy Louis Vuitton (LVMH), for instance, bought a stake in organic clothing company Edun in 2009 and has since pledged a commitment to the environment. So how is Exception different? The answer is simple. Rather than latching on to the concept once the brand had already achieved international fame, Mao made it a focus from the very beginning, so it is a thread that runs through everything the company does.

"The humanistic perspective is closely related to oriental values, this idea of a unity between humans and nature. This is the aspect we need to develop if we want to find our position amongst the top luxury brands in the world," says Mao.

The fashion scene in China is becoming increasingly vibrant with young designers who have the education and freedom to experiment. It is hard to explain why Mao has become so successful despite sticking to "oriental" values.

Frye offers some clues. "If you look at the younger generation, you could say that they're influenced by China, they're working from an aesthetic which is responding to Chinese culture. But then this is the age old question: what is Chinese in aesthetic terms?" he says. "Where does the work of this brand fit into the idea of developing a modern Chinese aesthetic (rather than a traditional one). I think that's the question we (the fashion industry) are all engaged in."

Exception debuted on the international stage in 2008. After several showcases at major fashion shows, including the Paris Fashion Week in 2007, it looked like Mao and his partner Ma were ready to take the Chinese brand on the international market.

But they chose to grow steadily in the domestic market first. "In the years since, we have been penetrating the Chinese market slowly, but steadfastly. The competition is very fierce, and every brand is out to profit from China," says Mao. "Actually, it does not really matter where your battlefield is, but what mentality you take when you approach it. If you can build the internal creativity of your company, if you haven't purely followed, copied and imitated others, you have a global mentality that could succeed."

Internal creativity is something Mao takes very seriously. He ensures that the education of his employees takes precedence. "We push our staff to interact with different ideas all the time. Our stores hold monthly lectures by different writers, artists and people in the design industry," says Mao. By continually stimulating his staff, he hopes that they'll come up with new ideas to keep the designs fresh, as well as enjoy their working environment.

Mao is well aware that he has been lucky when it comes to homegrown competition. He was among the first to start out on the mainland, and many Chinese companies are still mired in the copycat mentality—imitating their more profitable competitors, rather than trying to best them. He knows that you can't win at that game. Mao believes that as long as he continues to pay attention to the cultural values of his home market, he'll continue to be successful.

"China exports a lot of products, but not many of them are made by Chinese brands," he adds. "In a country built on production, we need to be conscious of how our cultural values will influence the future of the industry."

Mao is optimistic about the future of the Chinese fashion industry. "The development of the fashion industry began in London, and then Paris, Italy, the US and Japan," he says. "Now it should be China's turn." ■

# Getting Ahead Of The Curve

## How Retailer Jingdong Mall Scored Big by Transitioning Online

In the world of online retailers, Liu Qiangdong's Jingdong Mall is a rare success story—a brick-and-mortar chain that made the transition to the internet. Earlier this year, CKGSB Associate Professor of Strategic Management Teng Bingsheng looked at what enabled Jingdong to hold its own in front of giants like China's leading electronics supplier, Gome and Jack Ma's Taobao. Here's what he found:

A Chinese proverb, "Crisis creates opportunities" rings true with entrepreneur Liu Qiangdong, whose powerful online mall, Jingdong Mall, also known as 360buy.com, had its roots in the 2003 SARS crisis.

Two years after graduating from Renmin University in 1996, Liu Qiangdong started his own company, Jingdong Mall, in Beijing. With RMB 12,000, Liu rented a booth, and started selling electronics in the massive Zhongguancun Electronics Market. By 2001, Liu's operation had become China's number one retailer of opto-magnetic products, and had gained dealership rights to four well-known electronic brands.

In 2001, his total revenue was RMB 60 million and Liu had 12 stores in Beijing, Shenzhen and Shenyang. His product range included speakers, drivers, CD burners, computer keyboards and many other peripheral IT products. "I sold almost everything except core computer components, as profits were relatively higher," explains Liu.

However, disaster struck when Liu was forced to close all 12 stores during the 2003 SARS epidemic. During the lock-down, he paid his staff and even gave them food supplies. Liu had them stay at home to avoid the infectious disease, while he sat alone in the empty office wondering about the company's future.

Facing large stocks in the warehouse, inspiration struck: "If the epidemic stops people from selling and buying things face to face, why not start trading on the internet?" Liu thought. He quickly put his inventory list on the largest online blog sites where customers could read product information and place orders. Buyers would pay in advance and receive their goods at home, delivered by Liu's company. A month later, Liu's online sales were not very encouraging: just 100 IT products were sold, and most went to his long-term customers rather than to new clients.

Fortunately, the SARS epidemic ended soon enough, and the brick-and-mortar Jingdong Mall reopened for business. The short-lived e-commerce experiment, however, left a strong impression on Liu.

He began gathering information on the internet, learning about e-commerce models employed by American companies such as Amazon.com. With the advantage of lower costs, higher efficiency, and better risk management, e-commerce seemed more attractive to him than managing a bunch of brick-and-mortar stores.

Liu decided to put his own e-commerce concept into action and it went live in January 2004. Managed by a team of four, the online business, 360buy.com, made RMB 10 million in revenue in 2004, a small addition to Liu's



12 stores that were bringing in 80-90% of total income.

### A Bold Plan

By 2004, business at both 360buy.com and the offline Jingdong Mall stores were thriving. But it raised a new question for Liu: how to integrate the two very different business models? Restrained by limited resources, Liu could not keep developing both models evenly at the same time. "Trying to do both might end up with me not managing either well," says Liu.

Therefore, he looked at the IT market and weighed the costs of traditional retail operations and sales channels, which to him seemed unmanageably high. In a management meeting at the end of 2004, Liu proposed a bold business plan. He would abandon the brick-and-mortar stores and focus entirely on the online business.

The first problem was convincing his management team. General IT purchase and sales manager Sun Jiaming, who had joined Jingdong Mall in 2001, says, "In view of the general business environment in China, e-commerce was just emerging. We knew very little about it despite being in the IT industry ourselves. At the time, 90% of our business was conducted through traditional offline stores. When the staff is asked to do something completely new, it's natural for them to hesitate, because no one could predict the future of e-commerce in China."

Fortunately, Liu anticipated resistance to his e-commerce plan. "Eighty percent of my people were worried; they thought I was taking a gamble with e-commerce. But with the resources we had, it was not possible to develop both the traditional offline business

Although the firm previously relied mainly on word-of-mouth and repeat customers, intensifying competition in the online sales market has encouraged Jingdong to beef up subway advertising targeted at white-collar commuters

and e-commerce at the same time. We simply had to concentrate on one area of expertise. This was the only way to make a breakthrough."

### Selling the Online Vision

To gain support from his staff, Liu talked up e-commerce on every occasion, whether at meetings or dinner engagements. After much heated discussion, Liu persuaded his employees, who were thinking about jumping ship, to trust him with the new online business model.

Liu closed Jingdong's 12 retail stores between January and June 2005, and focused on the company's website, 360buy.com. Since most of the company's profit had come from the offline stores until then, their closure resulted in major losses, and left many employees without jobs. Since Liu had promised not to dismiss anybody, he urgently needed to create new roles for them. With this in mind, a large warehouse was built in Shanghai in 2005, easing employment pressure at the company.

According to Liu, "I believed that we would overcome these teething problems. I was not worried, since I knew that we had more than RMB 10 million in cash to ride it out. Besides, our operational costs were low. We had our own offices, and we did not need to pay rent. I estimated that even if we didn't make a profit for three years, I would still be

2010 **10.2** billion  
15 million users

2009 **4** billion  
8 million users

2008 **1.32** billion  
1.2 million users

2007 **360** million  
300,000 users

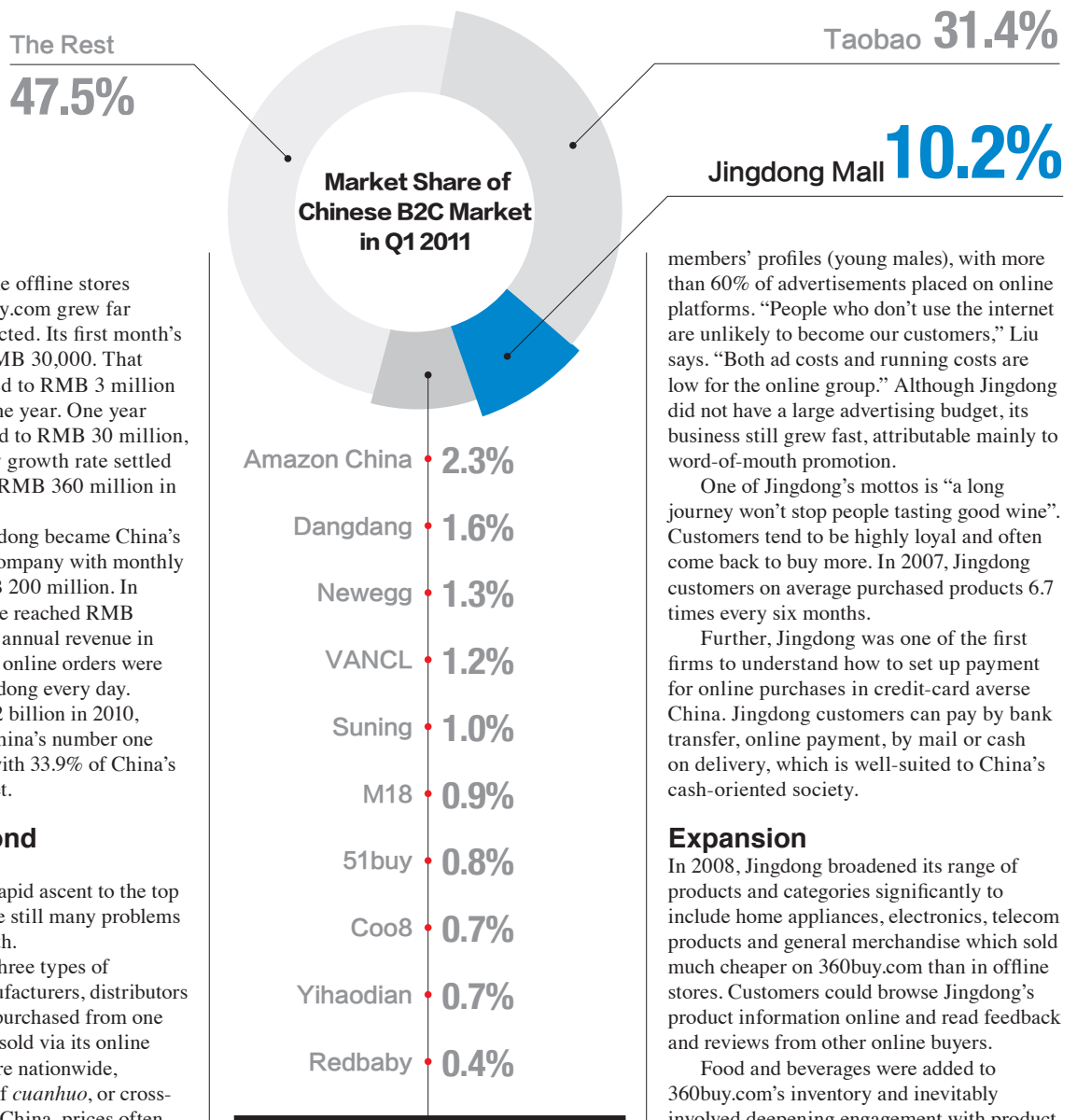
2006 **80** million

2005 **30** million

2004 **Jingdong Mall enters e-market**

## Meteoric Rise

*Jingdong Mall  
Sales Figures  
(All Figures in RMB)*



able to pay salaries.”

While shuttering the offline stores reduced revenue, 360buy.com grew far faster than anyone expected. Its first month’s revenue in 2004 was RMB 30,000. That paltry figure skyrocketed to RMB 3 million a month by the end of the year. One year later, sales had increased to RMB 30 million, after which the monthly growth rate settled at about 10%, reaching RMB 360 million in 2007.

In March 2009, Jingdong became China’s first B2C e-commerce company with monthly revenue exceeding RMB 200 million. In June, its monthly revenue reached RMB 300 million, equal to its annual revenue in 2007. More than 20,000 online orders were being processed by Jingdong every day. Sales reached RMB 10.2 billion in 2010, and Jingdong became China’s number one e-commerce company with 33.9% of China’s B2C e-commerce market.

### Innovating Beyond Challenges

Despite the company’s rapid ascent to the top of the market, there were still many problems Jingdong had to deal with.

First, Jingdong has three types of upstream partners: manufacturers, distributors and dealers. Goods are purchased from one of its partners, and then sold via its online store. Jingdong’s sales are nationwide, leading to the problem of *cuanhuo*, or cross-regional distribution. In China, prices often differ in different markets through regional distributors. Since the same products are sold in different regions at different prices, cross-regional sales by a regional distributor are often not allowed.

At the beginning, 90% of Jingdong’s suppliers viewed *cuanhuo* as a problem and would not permit the practice. Liu had a different opinion: “E-commerce should not be confined by when and where the trade is made. If I buy from manufacturers in Beijing but sell the products in Shenyang, in the traditional business sense, this is *cuanhuo*. However, in e-commerce, this concept does not and should not exist.”

Prior to e-commerce, Jingdong had accumulated six valuable years of dealership experience and established sales channels for many products. Jingdong used this experience

to break barriers and build additional channels and in March 2007, business started to pick up. HP took the initiative to contact Jingdong, followed by other major IT manufacturers such as Lenovo and Intel, which extended their support to the company.

In addition to breaking through the traditional sales channel resistance, Jingdong also foraged ahead with an innovative membership and advertising programs. Members were classified into eight levels according to purchase volume. With priority in buying goods, members also enjoyed discounted delivery costs and other benefits. The company’s registered members totaled 15 million in 2010.

Jingdong’s advertisements target its members and people likely to fit their

members’ profiles (young males), with more than 60% of advertisements placed on online platforms. “People who don’t use the internet are unlikely to become our customers,” Liu says. “Both ad costs and running costs are low for the online group.” Although Jingdong did not have a large advertising budget, its business still grew fast, attributable mainly to word-of-mouth promotion.

One of Jingdong’s mottos is “a long journey won’t stop people tasting good wine”. Customers tend to be highly loyal and often come back to buy more. In 2007, Jingdong customers on average purchased products 6.7 times every six months.

Further, Jingdong was one of the first firms to understand how to set up payment for online purchases in credit-card averse China. Jingdong customers can pay by bank transfer, online payment, by mail or cash on delivery, which is well-suited to China’s cash-oriented society.

### Expansion

In 2008, Jingdong broadened its range of products and categories significantly to include home appliances, electronics, telecom products and general merchandise which sold much cheaper on 360buy.com than in offline stores. Customers could browse Jingdong’s product information online and read feedback and reviews from other online buyers.

Food and beverages were added to 360buy.com’s inventory and inevitably involved deepening engagement with product supply chains, technology, payment and logistics. In addition, good human resource management became even more essential to success.

According to Jingdong’s vice president Yi Rangyue, “We have to find the right people before starting a new venture.”

Next to human resources in importance was capital. In January 2009, Jingdong received investments totaling \$21 million from Today Capital and Bull Capital Partners.

### Competition

But Jingdong’s rise did not come without competition and some controversy, particularly price undercutting criticisms from China’s two leading appliance and electronics giants, Gome and Suning, both of which established online malls while maintaining



Photo:CFP

their offline outlets as well.

And China's "eBay", Taobao, established Taobao Electronics Shopping Mall (Tmall) in January 2010 with 13 categories of home appliances and consumer electronics products being integral parts of Tmall. In 2010, Taobao's total revenue reached RMB 400 billion, and its registered customers numbered 370 million.

Taobao has long been accused of selling bad quality and counterfeit products. Therefore, when it decided to establish Tmall, it prioritized engaging with customer concerns by providing them with a safer shopping environment.

Unlike Jingdong, Tmall does not sell anything itself. It only acts as an online platform for other companies to sell their products. Sales, logistics, stock and after-sales are all taken care of by the sellers themselves.

Taobao only allows registered companies to become sellers on Tmall. Individuals are not eligible for Tmall stores. There are three types of registered shops: "flagship shops" for manufacturers to sell products directly, and two types of authorized dealers, ones that are authorized to sell more than one brand and ones that are not. Since Tmall does not get involved in the actual trades, it makes profit by charging fees from shops. These include a real-time technical support fee, annual technical support fee of RMB 6,000 and a commission fee of 2% of transaction values.

The biggest difference between Tmall and the rest of Taobao is Tmall's emphasis on the

"quality guarantee". Customers have a non-conditional refund within seven days, an anti-counterfeiting guarantee and a nationwide after-sales service. Because Taobao does not have its own logistics facilities, Tmall's logistics have to be outsourced, and complaints about delivery led Tmall to build its own delivery platform for shop owners. In several aspects of e-commerce, such as IT, channels, services, marketing, stocks and logistics, shop owners can put their goods in the Tmall warehouses. The logistics center prepares the goods, and a delivery company will then take care of the rest. Tmall's logistics platform was first built in Beijing, Shanghai and Shenzhen and then expanded to other cities.

### Funding for the Future

By the first quarter of 2011, China's online B2C business achieved total revenues of RMB 47.07 billion. Tmall's strategy had worked and it led with a 31.4% market share, and Jingdong had come second with a 10.2% market share.

But Jingdong Mall, as a big player in China's e-commerce, had never been short of attention from venture capitalists. In 2011, Jingdong received a \$1.5 billion capital injection from six funds including DST Russia and Tiger Fund, as well as individual investors including a number of celebrities.


This is the largest investment into any Chinese internet company to date and Jingdong has decided to use the money to improve its logistics facilities and delivery system. After Jingdong's own delivery team was established, the company has accelerated

### Jingdong Mall CEO Liu Qiangdong

the development of its logistics system to cover the entire country. Jingdong has three warehouses in Beijing, and can store products from more than 600 suppliers. In addition, an even bigger "Asian No. 1 Warehouse" is planned in Shanghai. Jingdong will invest RMB 700 million in a 150,000 m<sup>2</sup> warehouse. With logistics in first-tier cities established, Jingdong has begun deploying its logistics network across the country. Currently, 70% (in some first-tier cities even 100%) of total delivery is done by Jingdong's own delivery team.

The company's investment in logistics facilities has started to show direct customer benefits.

Jingdong now has a refund policy involving home collection of unwanted goods. A fast delivery program called "211 Express Delivery" was introduced, so that orders placed before 11:00 a.m. can be delivered the same day, and orders placed before 11 p.m. can be delivered by 3 p.m. the next day. A parcel online tracking system was also established. Liu stresses the importance of Jingdong's customer support system. "Customers care about three things: products, price and services. Added value is very important".

Facing fierce competition, Liu believes there are two key factors for success: cost and efficiency. "Competition in cost and efficiency has been fundamental to Jingdong's focus for the past 10 years," he says. 

# Confucius In The Boardroom

An Interview with Tu Weiming, CKGSB Honorary Professor of Chinese History and Philosophy of Confucian Studies



**P**rof. Tu Weiming is one of the world's leading experts on Confucianism. For more than 40 years, Tu has been researching and promoting a dialogue to explore the influence and relevance of Confucianism in business today. Through forums and ecumenical dialogues, Tu disseminates his findings and encourages the application of Confucian theory in business practice.

Formerly director of the Harvard-Yenching Institute, Tu has made it his life goal to show how Confucius is relevant to the modern world, including one field many people think the sage disdained—business.

Since the 2008 global financial crisis, the market economy has been derided as heartless, inhumane, or at best indifferent. Tu believes that Confucian virtues, such as tolerance, empathy and benevolence, are essential to the maintenance of the market economy and democracy.

His voice has not gone unheard. In 2001, Tu was invited by the United Nations to join the “Group of Eminent Persons” to facilitate a “Dialogue among Civilizations”.

To find out what is so appealing about “Confucius in business”, we sat down for a Q&A with Tu, who is Chairman of the CKGSB Committee on Humanities. Excerpts from an interview:

*Q: When did you first become interested in Confucianism humanism?*

**A:** I was first introduced to Confucianism as a high school student and became fascinated by it through extensive reading. I then decided quite quickly to make a career based on the school of thought of Confucius.

Through 40 years of research and study, I have learned a great deal and it helped that I was able to get different insights from a wide variety of philosophical and religious views. From my time spent in the United States, I gained valuable knowledge from Christian theologians, experts in the Islamic tradition, ancient Greek philosophy, Hinduism and early Buddhist concepts. Through this wide exposure to the world's great traditions and ideas, I became very interested in the dialogue among civilizations. With my focus on Confucianism, my goal was to be able to illustrate what it means to be Chinese and how this particular school of thought played a big part in shaping our culture and how it still plays a major role in our modern perspective. Features such as openness, self-reflection and pluralism, continue to make Confucianism relevant in today's world.

*Q: When did you realize the knowledge and ideas contained in Confucian humanism could be applicable to business practices today?*

**A:** I began realizing in the 1980s how dialogues based on Confucianism could be useful for discussing a whole range of issues, but the real breakthrough for me occurred in 2001 when I attended a meeting at the UN and became a member of the “Group of Eminent Persons”. Here, we discussed ways to facilitate a “Dialogue among Nations”.

During that meeting, I realized that the findings of the research I had been engaged in for years could be applied to government policies, both foreign and domestic, a whole range of social policies, and modern business practices used by today's entrepreneurs.

In 2006, while attending a meeting in [Eastern China's] Shandong Province where the majority of speakers were entrepreneurs, I gained a different perspective since my background is in the humanities. The discussion was based on the idea that the virtues of Confucian principles can best be illustrated when used in the real world by entrepreneurs and not by theorists such as academicians or politicians. Confucian principles cannot be effectively promoted by the academic world because academics are trapped in ivory towers. Politicians also fail to promote Confucianism because they have to operate within certain ideological constraints.

Entrepreneurs, on the other hand, often travel extensively giving them a real global perspective. Because of this, if they have a



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Principles such as self-examination, self-improvement, altruism, a sense of justice and compassion are invaluable traits for today's entrepreneurs to embody



commitment to sharing Confucian principles and demonstrating its real practicalities in today's business world, they will clearly have a greater potential for promoting these ideals.

I was not able to fully integrate Confucianism into business practice until I came to CKGSB, where I head a committee with the purpose to incorporate the humanistic perspective of Confucianism into the school's business curriculum.

**Q: Are there some basic tenets of Confucian humanism that contradict how business is conducted today?**

**A:** It is interesting to note that some basic tenets of Confucianism such as self-sacrifice and benevolence are considered negative personality traits for a person hoping to be successful in today's highly competitive business world. It has to be understood that Confucianism has been heavily scrutinized by writers and governments in China since the beginning of the 20th Century as a result of growing nationalism and pride. Confucian principles were no longer considered relevant to modern times and represented an obstacle for effectively learning and incorporating the ways of the West, especially with regards to doing business.

There really aren't any basic tenets of Confucian humanism that conflict with how business is conducted today; and whether we are talking about entrepreneurs from China, Singapore, Hong Kong, the US or anywhere in the world; principles such as self-examination, self-

improvement, altruism, a sense of justice and compassion are invaluable traits for today's entrepreneurs to embody.

**Q: How can upholding Confucian values help entrepreneurs compete on a global scale?**

**A:** Certain Confucian characteristics, such as developing the dignity of the person, a sense of independence and a desire to achieve excellence, are the foundation for a lifelong improvement of oneself. Forming positive and productive relationships is, of course, a major priority for entrepreneurs. In other words, profit is not the only motivation for a Confucian entrepreneur.

**Q: With the rapid rise of the Chinese economy do you foresee a greater impact of Confucian principles on the rest of the world?**

**A:** Yes, I absolutely do. For example, regarding the US, Confucian principles such as concern for the welfare of the entire society can be used to address the extreme disparity between the wealthy and impoverished. This disparity of wealth is only increasing as time goes on and the issue of economic rights and how to deal with the associated problems seen today should be considered through the perspective of Confucian humanism. Now that China is a market society, it can also gain from incorporating Confucianism as a way of ensuring economic justice. ■

# “China Needs to Reduce Some Distortions”

Nicholas R. Lardy, a renowned expert on the Chinese economy, discusses the need to rebalance the economy

By Neelima Mahajan and Carol Wang

**N**icholas Lardy, the Anthony M. Solomon Senior Fellow at the Washington D.C.-based Peterson Institute of International Economics, has been watching the Chinese economy for more than three decades now. His first book on China—*Economic Growth and Distribution in China*—was published in 1978. Over the years, Lardy has chronicled the rise of the Chinese economy through several books such as *The Future of China's Exchange Rate Policy*, *China's Rise: Challenges and Opportunities*, *Debating China's Exchange Rate Policy*, and *China: The Balance Sheet—What the World Needs to Know Now about the Emerging Superpower*. His latest book, *Sustaining China's Economic Growth after the Global Financial Crisis*, discusses China's response to the crisis and examines the imbalances in the economy. Lardy advocates rebalancing the Chinese economy through a slew of policy measures. During a recent visit to Beijing, Lardy took time out of hectic schedule to discuss his work with CKGSB's Neelima Mahajan and Carol Wang.



**Q:** How do you evaluate China's rapid rise? What would be the driving force for China's economic growth in next decade and beyond?

**A:** From the perspective of three decades and more of economic reform, I think China's growth has been extraordinarily strong, much faster than anyone would have anticipated during the late of 1970s. I do think, however, the driver of economic growth, the sources of growth will evolve going forward. China needs to shift away from relying too much on investment, to much more on private consumption expenditure to generate economic growth.

**Q:** Do you think China can sustain the growth patterns that it has enjoyed for the last several decades? If yes, why? If no, what are the factors that could stymie China's growth?

**A:** No, I think the economic model doesn't need to be changed. If it does change, I think the growth results going forward will be quite different from what we have seen in the past decades.

I think the ideal growth model for China in the next five to 10 years will be one in which the growth of private consumption expenditure will be greater than the growth of GDP. The growth of investment will still be positive but will be slower than the growth of GDP. You will have a rising consumption share and declining investment share of the GDP. I think there is potential to sustain rapid economic growth, but the structure of demand will be different. We will have less growth in heavy manufacturing, more growth in services, for example, in response to the rising consumption demand.

**Q:** If China were to sustain those levels of growth, what kind of policies would it have to implement? What do you think of China's progress in implementing such policies?

**A:** The thing really to focus on is what type of policy will lead this kind of rebalancing. In a word I would say that China needs to reduce some of the distortions that currently exist. Certain types of energy are significantly underpriced. We still don't have a completely market determined exchange rate. The interest rate structures are very heavily

managed by the central bank. I think China is basically a market economy and most goods and services are priced in the market, but certain critical factor inputs are not so well-priced. Capital is underpriced and the exchange rate is probably still a little bit undervalued. So I think we need a move towards market determination of those remaining factors—production and critical elements in economy.

The biggest shortcoming recently has been the failure to move toward more market-determined interests rates, particularly the deposit rate. This was the key part of the 11th Five-Year Plan that Premier Wen Jiabao mentioned in his speeches in the NPC in 2009. But here we are, three years later and nothing really has moved forward in terms of market-oriented interest rate reform.

**Q:** *Some people argue that China's economy is beginning to rebalance itself. You seem to disagree with this argument. Why?*

**A:** I certainly would agree that there has been a lot of rebalancing in terms of the external imbalances. China's current account surplus declined quite dramatically as the share of GDP since the peak in 2007. But I think in terms of the internal imbalances, it is very hard to sustain the argument that much progress has been made in recent years. The growth of incomes is still below the growth of GDP. Private consumption expenditure still seems to be languishing.

Some people think it is under measured, but I think if you do analysis of all the data that's available, it is hard to sustain the argument that consumption has had much of a rebound in terms of the share of GDP.

Some people like to rely on the retail sales data. That's very problematic because first of all, it only includes goods and has nothing about services which are very important in consumption. Secondly, sales retail data also includes wholesale data. As the economy becomes more privatized, there are lots of small businesses buying things they need from retail stores. So the retail sales data are flawed because they are based on the point of sale, not who is actually purchasing. There are lots of business transactions, government transactions, transactions of military units and social units going through retail sales. But it doesn't really reflect the strength of private consumption demand.

**Q:** *How do you evaluate the end of negative interest rates in China? How will it affect China's economic growth?*

**A:** The biggest effect that liberalizing the deposit rate would have is it would increase household incomes. Households have been subject to a very high hidden tax because the rate of return of deposits is negative. This has been widespread globally in the last couples of years. But in China the average deposit rate has been negative now since 2004, so it has been a very sustained problem. That makes household incomes and consumption lower than otherwise they would be.

It also led households to save a larger share of their disposable incomes. So the income growth is slower and the savings rate is going up. Both of these reduce consumption as a share of GDP. Gradual liberalization, particularly on the deposit side, will lead to more rapid of rise of income and reduction of saving rate, both of which tend to push consumption up.

**Q:** *Since the deposit rate is low, real estate investment is close to impossible, and the stock market risk is huge, which areas can the Chinese invest in?*

**A:** There are a lot of Chinese households still investing in real estate. The government has put up some obstacles in trying to curtail that for people who are buying property which is not used for private residences. Still Chinese are investing more of the GDP in residential property than any other economy that we have data for—over 9%. It has roughly doubled in last five years. It is near the peak for the US or Spain in 2007, way ahead of in India and Taiwan. China is an outlier in terms of the relatively high share of resources that are going into residential property investment.

In the case of China, it is a bad thing because it is partly the result of distortions in financial sector. The stock market is not very well managed and there seems there is no long-term investment option. The return has been higher in property than any other asset class, so more and more people have invested

in property. Wu Xiaoling, the former vice governor of the central bank, even recognized that the course the government is pursuing has the risk of creating asset bubbles. So when your financial return is low for savings, people look for real assets that are appreciating and they find them. They turn to concentrate in that asset class. I think that's what has happened with residential real estate. It is not that bad in short run, but it can create a bubble that is not sustainable. Property has become the main driver of economy growth in China. There are a number of reasons to believe that this is not likely to be the case indefinitely. So the proper thing for the government to do is develop policy that will lead to a gradual slowdown of real estate investment and somewhat offset incremental expenditure in other areas.

**Q:** *Do you think the Chinese economy is headed towards a soft-landing or a hard-landing?*

**A:** I am not sure I like the landing terminology because different people have different ideas about what it really means. But the risk for China is it could be a long slow landing in which you have a gradual slowdown in economic growth that might last for quite a long time. A hard landing to me implies a sharp downturn and possibly a rebound back. So you have a "V" shape decline and recovery. I think it is more likely if policy doesn't change, you could have a period of multiple years during which the economy declines. ■

“

China needs to shift away from relying so much on investment, to relying more on private consumption expenditure to generate economic growth



By Dr. Xiang Bing

*Dean of Cheung Kong  
Graduate School of  
Business*

# It's Time for a New Era of Business-Government Relations

# W

ith the onset of the financial crisis, the Washington Consensus has been effectively obliterated. The talk of the “end of history” has ceased. In the aftermath of this systemic meltdown, we need a new paradigm, a new framework for the way governments and businesses work together. China’s model, while not perfect, should be examined as an alternative to the failed Washington Consensus.

One of the first comparative advantages of the China model is its elite governance. The best and the brightest in China are drawn to government work, possibly for two reasons: China has a long tradition of sending its best students to government posts, and the potential power and influence one can wield as a government official in China is considerably greater than in Western countries.

Another strength of the China model is how government officials are promoted—they all are required to start at the bottom and work their way up. This gives officials both grassroots foundational experience with the potential to later have opportunities for high-level experience. The US, on the other hand, can produce “Reagan-style leaders,” i.e., an actor becomes president without having any grassroots-level experience. This is impossible in China.

Perhaps China’s greatest advantage, however, is the centralization of power. When a massive infrastructure project needs to be completed, the central government can muster the resources to complete the task. If an earthquake or other natural disaster devastates a region, the government can quickly respond and rebuild.

But while it is obvious that there are things to be learned from China’s advantages, there are also shortfalls that ought not to be ignored.

For example, according to the World Bank, 1% of China’s population controls some 41% of the country’s wealth. China’s wealth redistribution mechanisms are clearly flawed, yet they are protected by powerful interests. That is why, while incorporating the obvious advantages of the model, we are in need of a system overhaul.

I believe the basis for this new system should be one of harmonious development and growth, while keeping in check “corporate-government conspiracies”. Collusions between state and enterprise can be devastating to a country as it puts the value of profit-seeking above that of the societal good.

The challenges for the government under this new rubric are as follows: First, how to establish an outside check on government power that does not discourage political participation by the most talented members of society. Second, how to reduce the government’s role in resource distribution while still providing the conditions for social and class mobility. In this way, the “Chinese Dream” can become a reality like the American dream. Third, the government needs to establish a more inclusive system that provides basic needs like retirement funds, healthcare and education. Fourth, the government needs to seek social harmony without eliminating the conditions that create groundbreaking innovation. Japan, for example, has the lowest Gini Index of any developed nation. You could say Japan is ultra-harmonious. Yet the rigidity of the system that allows this harmony also stymies innovation and creativity. It is hard to see them producing a Google or Facebook.

Enterprises must also play their part in forming a healthy corporate-government relationship. They must go beyond creating wealth and focus more on how to build great organizations while also contributing to the growth of the middle class. Entrepreneurs and businesspeople need to ask themselves deeper questions. Don’t just wonder, “How do we do business well?” but also “Why do we do business?” If entrepreneurs are only concerned with making money or becoming famous, all types of corporate misconduct will be widespread. In addition to the damage these actions have on our own country, it is important to realize that the perception of Chinese business ethics problems globally fans the flames of the “China threat theory”.

In order to maintain harmonious and sustainable development, humankind needs to redefine its relationship with nature. From the ancient Greeks to the Christians, Western philosophy has revolved around humanity—people were at its core and held the highest position. This concept has been one of the key reasons people have been the root cause of global climate change and environmental degradation.

The Chinese idea of “human and nature as one” could be used to reorient our value system vis-à-vis the environment. Therefore, I believe that as one of the major challenges facing us today, we need to meet climate change head on by completely realigning our values. We should adopt the notion of “human and nature as one” as part of our universal values.

This can only be done through a new alliance between corporations and governments—one that is based on jointly working to address major problems we are facing. This way, Chinese philosophy can make a great contribution to the world and usher in a new era of corporate-government relations.



By Gan Jie

Professor of Finance at  
Cheung Kong Graduate School  
of Business

# Inside the Shanghai Stock Exchange's Lost Decade

Despite pervasive arguments to the contrary, the Shanghai Stock Exchange has had a rough 10 years. But there are still ways for investors to make money

**A**t the end of 2011, the Shanghai Stock Exchange closed at 2199, just one point below its 2001 peak. It didn't take long for the pundits to pounce. They labeled it "Ten Years of Zero," proclaiming that investors hadn't made a penny on the Shanghai market over the previous decade.

The China Securities Regulatory Commission (CSRC) reacted defensively. In an interview with the *People's Daily*, Guo Shuqing, Chairman of the CSRC, said that the "Ten Years of Zero" was all a big misunderstanding—investors were comparing apples to oranges and they actually had made money. Guo gave three reasons for why investor complaints were unwarranted: "Firstly, the index, which represents the stock market at a certain point, and investor returns, which represent the turnover during the period, are not comparable."

This argument fails because if it were correct, how could we calculate returns? If we buy a stock at RMB 10 and sell it at RMB 20, the return will be calculated by comparing the prices. The return is always about comparing prices, therefore this argument is not compelling.

"According to calculations on an absolute comparable basis, the stock index rose 28% during the previous 10 years, or 2.5% each year. Taking dividends and other factors into consideration, return on investment reached 40%, 3.4% each year." There is some logic to this argument, but does the "absolute comparable basis" necessarily reflect investment return? The absolute comparable basis here means we should compare all traded stocks in 2001, and not those listed afterwards. On this basis, many poor performing

stocks would not be included.

"Thirdly because the index at two different time points cannot be compared, valuations for its listed companies are completely different." This is a valid argument, but it doesn't address the question: did the stock market result in 10 years of zero growth? The valuation standard at most reflects possible returns in the future, but it cannot increase past returns. In fact, it is future returns under the current system that investors are worried about.

## Figuring Out Investors' Returns

While Guo's arguments do not effectively prove his point, other figures show that he may be right. For example, the Shenzhen Market Index was 3,100 in 2001 and stood at above 10,000 at the end of 2011, yielding an annualized return of 12%.

The above discussions about index returns, however, all miss the main point. The large discrepancy between individual investor returns and the market index return has long puzzled me. There is a "70-20-10 rule" in the Chinese stock market, wherein 70% of investors lose money, 20% break even, and only 10% earn money. This pattern has been confirmed by various surveys. A Chinese investor who breaks even should consider himself lucky.

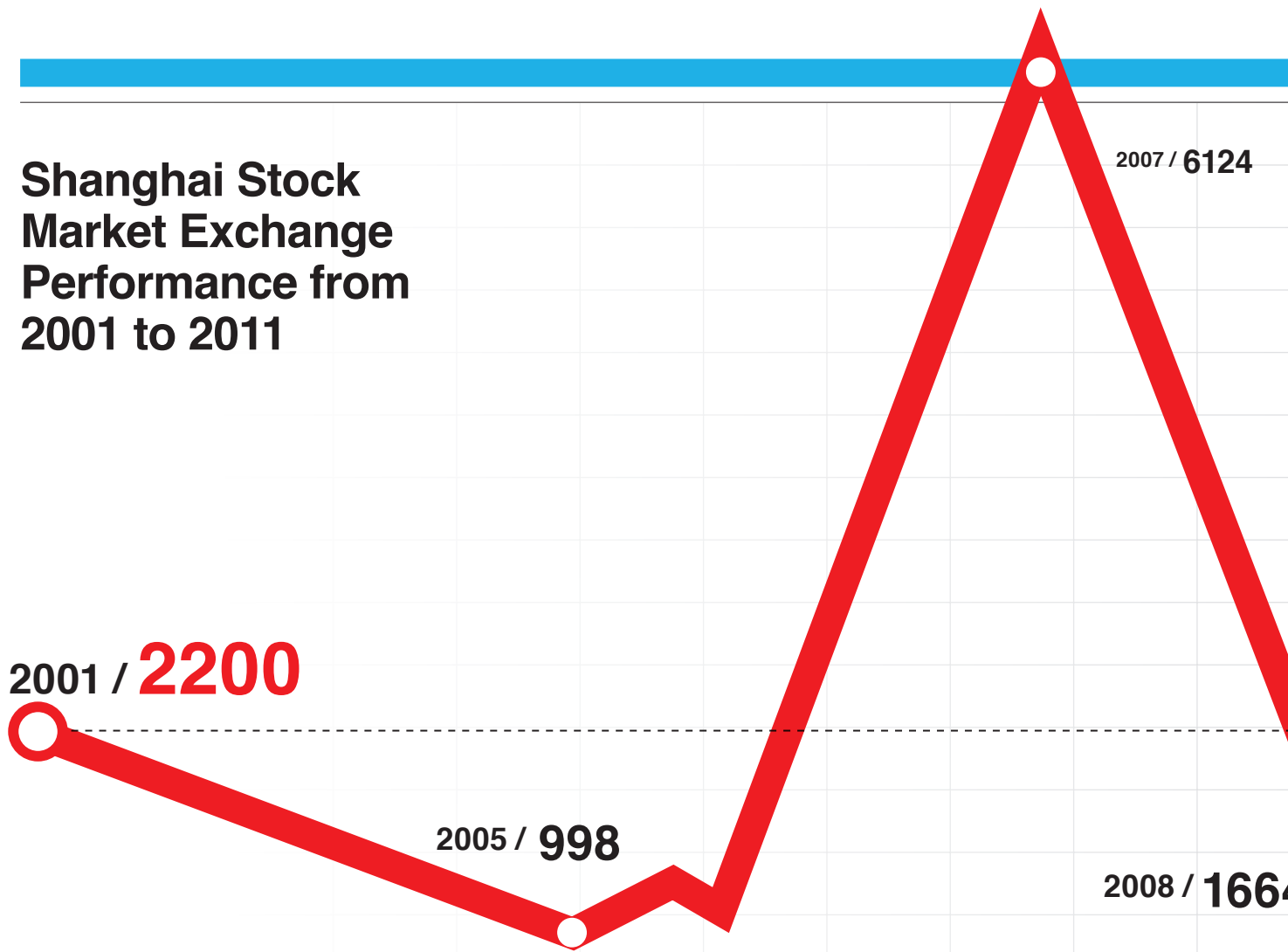
On the other hand, despite the "Ten Years of Zero", the Shanghai Composite Index did rise from 100 points in 1991 to 2,810 points in 2010, showing an average annualized return of 18%. In 2011, the index rose another 100 points to 2,199 points, and the annualized return dropped to 16%.

Compared with Warren Buffett's long-term return of 20% (from 1964 to 2009), the 16% return of the Shanghai Composite Index seems pretty good. It is also on par with the two best-performing mutual funds in the US, Fidelity Magellan (16%) and Templeton Growth (13%).

So how do we reconcile these strong market index returns with dismal returns for individual investors? I explain this disparity in a recent working paper, the main thrust of which can be illustrated through a simple numerical example. Let us imagine a company named Value Game Co. At the time of its IPO, Value Game Co.'s stock price is \$1 and it has 100 million shares; its market cap is \$100 million. Suppose the company's stock price increases hundredfold to \$100 per share, bringing its market cap to \$10 billion. The company has now created a value of \$9.9 billion for secondary market investors.

The company then issues 100 million shares of new equity at the current stock price, increasing its market cap to \$20 billion. Suppose the stock market and Value Game Co.'s stock both tank suddenly. Value Game Co. is now trading at \$50 per share, having lost \$10 billion in

# Shanghai Stock Market Exchange Performance from 2001 to 2011



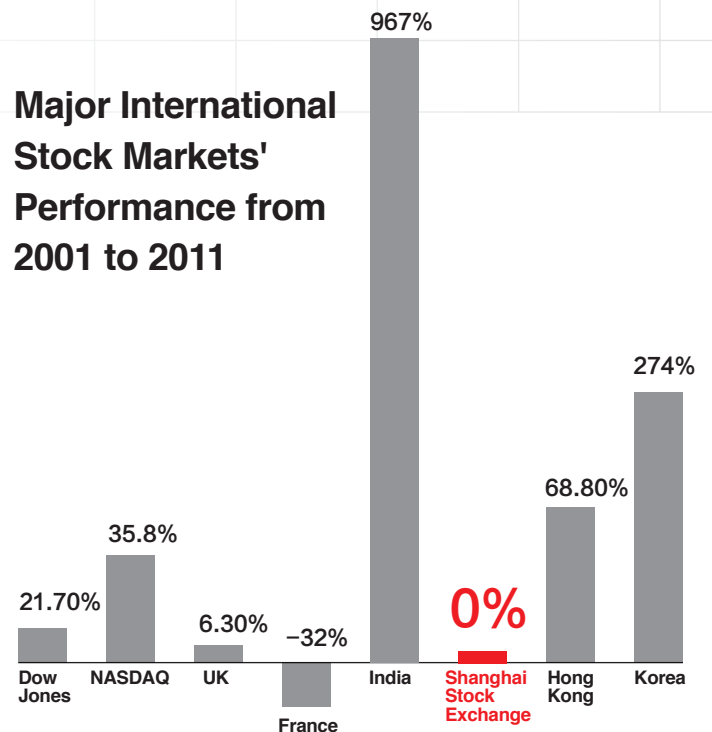
market value. How much value all told has the company now created for investors? The answer is \$9.9 billion minus \$10 billion, or a loss of \$100 million. Even though this company's stock is 50 times higher than it was at the time of IPO, it has still lost \$100 million for its stockholders.

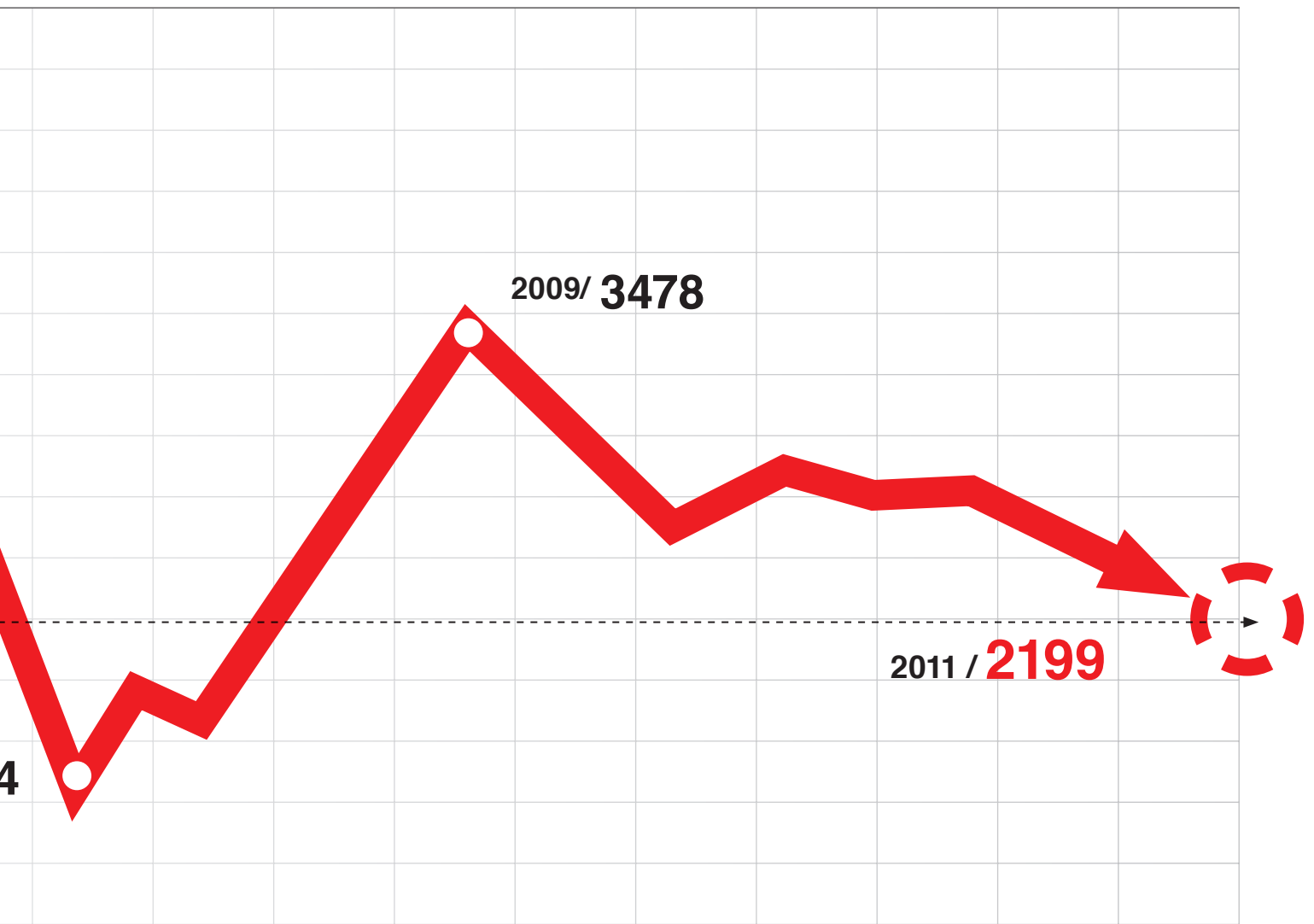
One might think this example too extreme, but it really is not. Chinese firm Vanke, the largest real estate developer in the world, is a good example. Not including its IPO first day return (close to 1500%), Vanke's stock went up close to fifty-fold from 1991 to the end of 2011. In 2006, Vanke issued RMB 5.6 billion worth of equity; in 2007, at the peak of the previous bubble, Vanke raised RMB 21 billion. But by the end of 2010, Vanke's market value had decreased by 60% from its peak in 2007. This means a loss of RMB 12.5 billion over these few years, a drop equal to Vanke's total market value at the end of 2005.

These examples highlight the key difference between the often-quoted simple return and the actual return for investors. The simple return is the return that the investor would get if he bought stock on day one and held it continuously. The investor's actual return, however, depends on when stock is purchased. Given market volatility and other variables, the simple return alone is a poor method for calculating investor returns.

If we view China's stock market as one big company, buy whatever shares it issues at various times, and hold those shares till the end, our actual return is in relation to all of the individual dollar investments

## Major International Stock Markets' Performance from 2001 to 2011





that we have made over time. This figure is also known as the dollar-weighted return. Practically speaking, this can also be known as the internal rate of return (IRR) of all our cash outflows for stock purchases and cash inflows when stocks are liquidated. From 1991 to 2010, investors in the Shanghai Stock Exchange saw a dollar-weighted return of 6%; at the end of 2011, this figure was -4%. A negative IRR over a given time period implies that investors are not earning money. These figures for investor returns are in stark contrast to the index returns of 18% for 1991-2010 and 16% for 1991-2011.

### Are Banks Better?

Two other investment strategies also beg mention. Again, for these scenarios consider the entire stock market to be one large company. One strategy is to buy all the shares this big company issues and hold them. The other strategy is to put the same amount of money into a bank deposit account and assume, conservatively, that you will earn a one-year deposit rate. How much wealth would you accumulate by following these two strategies?


If you were to follow these two strategies simultaneously from 1991 until 2010, the value of your stock account would be 1.1 times that of your bank account, a small difference. But keep in mind that risk is much higher for your stock market account—if you extrapolated the strategy out another year until the end of 2011, then your stock account

would be worth only around 80% the value of your bank account. The bank route is surely the safer of the two.

But does this mean that we should give up on the stock market altogether? I do not believe so, because these trends are actually predictable and could be used to yield solid investment strategies.

For example, companies that issue a high volume of shares tend to have low returns. Additionally, every time a company collects 10% of its capital, its returns in two years will decrease by 1.5%. Investors could make a long-term trading strategy based on these patterns.

### Moving Forward

The case of the Shanghai bourse is distressing but not hopeless. There are two areas that need to be addressed. One is investor protection—there need to be stronger institutions to protect small investors' collective interests. As of now, class action lawsuits are not allowed in China. If they were, then companies would think twice before issuing equity at peak stock prices. The other issue is insider trading regulation and stock price manipulation. As long as the pricing power of the stock market remains in the hands of high-level investors, there will be no efficiency. Only with these and similar basic institutions in place can one hope for market-based reforms such as short-selling mechanisms and IPO pricing to be effective. We can avoid “Ten More Years of Zero” only by fixing these problems. 

# INSIDE CKGSB

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# The Five Fires Of Michael Yu

By Neil Selby

**M**ichael Yu is 49, bespectacled, casually dressed and in very good shape. He is one of the richest men in China and one of the thousand richest people in the world. This morning he is addressing a multinational class of CKGSB MBA students in English. He is plainly enjoying himself tremendously, sharing his principles and philosophy of life.

Michael, or Minhong as he is known in China, is talking about 2012. Next year, he says, he will celebrate the 20th anniversary of his company, New Oriental, in the People's Hall in China. Observing him, I can see that he can visualize the ceremony and the participation of the 13,500 English teachers that he employs. Watching his gestures, I can see the influences on his life that have brought him to be here: his mother; his father; his teachers. Following his movements, I can make out five fires that seem to drive him: courage; purpose; ambition; creativity; humility.

Deep within him are the influences of his mother and father. They have shaped who he is. Although illiterate, his mother prized education above all else. After he had failed the university exams twice, his mother forced him to try again – at which point he succeeded in gaining entry to Peking University to study English. “Her words were like spells,” he says, “They persuaded me to study to become a teacher.” His father, a peasant and carpenter in Jiangsu Province, taught him the lesson that has most affected his perspective on life. Unable to buy bricks, one day his father collected waste rubble and stones. Out of the unpromising fragments, he created a small pen for the family’s animals. “I learnt from my father that with persistence and a map in your head you can always turn rubble into a building,” he says.

Having the courage to overcome adversity is a key message of Michael Yu. On the frontispiece of his book to inspire entrepreneurialism—which he gives to every student - he has embellished the words of Martin Luther King: “Hew a stone of hope out of a mountain of despair and you can make your life a splendid one.” He speaks of how, having gained entry to Peking University, he was placed in a class for sub-standard students because he couldn’t speak standard Chinese. He recalls how he lost a year of his studies to pneumonia. He mentions how he was looked down on because he was poor and because, unlike most of his class mates, he failed to win a scholarship to go to an American University. It is a situation which, ironically, led to his subsequent success.

In an attempt to raise money to study abroad, he speaks of how he taught fellow students to pass the required TOEFL exams only to be disciplined publicly by Peking University and expelled in



Photo:CFP



I started this business to make a living. But as the company grows, responsibility grows

disgrace. He tells how he negotiated with Oriental University to teach English but was refused certification because he was not considered sufficiently qualified. He recounts how he gave free lectures to establish a reputation to convince the authorities to let him teach.

He pauses for a moment and demonstrates a new fire – that of purpose. He loves what he does. Through his unremitting passion for teaching, he proved to the authorities that his methods were successful. Of course now he helps millions of people from ages four to 90 to enjoy a better life, to have a better future and to engage with a wider world through education. New Oriental's educational programs, services and products include English and other foreign language training, overseas and domestic test preparation courses, all-subjects after-school tutoring, primary and secondary school education, educational content and software as well as online education. He believes the purpose of New Oriental is far more worthwhile than just making money. "If I wanted to make money, I'd go into real estate," he says. "I have the contacts. I know the officials. But with New Oriental I have a far better reputation and a far better influence on society. With 54 branches in 48 cities, 6 industrial institutions, 47 book stores and 500 learning centres, New Oriental enhances the lives of 12 million people."

As he speaks, the fire of ambition takes over. He recollects the words of the teacher who, alongside his mother, encouraged him to sit for the college exam: "I need you to take this exam. I need you to fight for a different life, even though you may fail. You may go back to work as a farmer, you may go back to feeling tired in the field with a hoe in your hand, looking up to the clouds and sighing, but you will have tried."

Now looking upwards, fixing his gaze above the heads of the MBA students, he speaks of his 10-year dream. "Education will be the major growth area of domestic consumption over the next 10 years. I know this to be true. New Oriental will be in schools, on the internet and on mobile phones. It will be everywhere and highly profitable. The government used to believe that children's education could not be profitable. I have shown that children's education can make a good and healthy profit. New Oriental will lead profitable growth in both adult and children's education in all tiers of China's many cities. And while first tier cities may grow by an average 25% given the fierce competition, lower tier cities will grow by upwards of 60%. Our business will boom. And after New Oriental becomes a model for private education in China, the 10-year goal is that it become the best in the world."

Michael's creativity is the fire that has fuelled the remarkable culture of New Oriental. From the first lesson he gave in 1991 in

rented space in a shabby primary school in Zhongguancun, Michael Yu was experimenting with humorous, interactive approaches to learning. "Creativity is one of the core characteristics that define the New Oriental Way", he says, "I am unrelenting in asking our people at every level to demonstrate not only results, but also to show that they continue to have new ideas and ultimately test their ideas in the marketplace. I am unrelenting in asking them to show passion, create an engaging learning environment and inspire. I recognize that true innovation is contextual. The people of Sichuan are worlds apart from those in Guangdong, people from Shanghai think about things differently from people in Jilin or Liaoning. So I always give autonomy to our school heads to develop classes and curricula that best suit the local context."

As the talk to the CKGSB MBAs draws to its conclusion, I notice a change in Michael's posture. He arches forward, stoops a little, draws his palms together and reminds the class of the importance of humility. 'I would not call myself a success', he says. "You can never call a living man a success. A career is like a journey. It means walking from one oasis to another. It requires camel-like perseverance and a good sense of direction."

He reminds the class of the responsibility of his position. "I started this business to make a living. But as the company grows, responsibility grows. For me, social responsibility means serving the students with all my heart. We are committed to training a new generation of business and community leaders, empowering students to achieve their potential, build self-confidence and develop a global vision encompassing both traditional Chinese values and modern thinking."

He pauses. All of a sudden, he appears vulnerable.

Michael Yu has more wealth and fame than most in the world and certainly more than he could ever have dreamt of as the son of a poor farmer in Jiangsu province. He is a judge on China's equivalent of 'Dragon's Den', president and founder of the highly influential Chinese Entrepreneurs' Society and a member of the Chinese People's Political Consultative Council. He dreams of creating a 'Harvard of the East' for the poor who would otherwise never make it to college.

He talks of Martin Luther King. He knows his 1963 speech off by heart though he was scarcely born at the time. He encourages the class to dream. He insists they should dream. He thinks of how his mother and teacher dreamt of a better future and how his father, ever practical, made usefulness out of scattered waste fragments.

"Because if you live your life without a dream", he says, "it's just a heap of days".

*Neil Selby is Director of Executive Education at CKGSB.*

# Building Bridges

The All-Party Parliamentary Group aims to strengthen ties and bridge knowledge gaps between the East and West



Lord Green of Hurstpierpoint, UK Minister of State for Trade and Investment, at the All-Party Parliamentary Group for East Asian Business ceremonial launch



Lord Wei, Chairman of the APPG, discusses UK East-Asia relations at the APPG launch ceremony in February in London

The newly-formed All-Party Parliamentary Group (APPG) for East Asian Business was launched in February in London's Houses of Parliament by international leaders from government, industry and academia. The purpose of the group is to facilitate the development of relations between businesses in East Asia and the United Kingdom. It does this by bringing together members of the UK House of Commons and House of Lords with executive leaders, entrepreneurs and related interest groups from both regions to share knowledge and perspectives.

CKGSB is acting as the Secretariat to the APPG for East Asian Business. The school's main campus in Beijing and European headquarters in London will provide administrative support and advice to the officers of the group as they develop its program of activities.

In order to deliver on its mission of developing relationships between businesses in East Asia and the United Kingdom, the APPG will present a series of seminars and events, inbound and outbound trade delegations and observational reports.

The APPG's officers and supporters, along with CKGSB, hope that by promoting the sharing of knowledge between the countries of East Asia and the United Kingdom on issues pertinent to business and trade, the APPG will make a positive contribution to those respective communities.

"Right now, if you ask a British person or European, 'name me someone that represents America,' they can say Steve Jobs or Bill Gates," noted Lord Wei, chairman of the APPG, at the launch event. "They can't do the same for Asia. And that's a real shame, because we're going to be doing so much together. And I think through the stories that we hear, we can build trust and understanding."

Speaking at the launch, CKGSB's Founding Dean Xiang Bing emphasized mutual learning and developing new models for sustainability. He concluded his remarks by noting that the APPG for East Asian business "can serve as an important platform for learning and for sharing best practices, knowledge and wisdom (between the UK and East Asia)."

"If we open ourselves up to new thinking, new ideas and new models," said Xiang, "I am sure that we can do much together for economic prosperity, social betterment and the common good."

### 2012 Bo'ao Forum for Asia

CKGSB was honored to act as a knowledge facilitator at the 2012 Bo'ao Forum for Asia's CEO Brainstorming Session, the premier business and economic conference in Asia. Dean Xiang Bing moderated a discussion on 'Asia in the Changing World: Moving Toward Sound and Sustainable Development', which was chaired by former US Secretary of the Treasury Henry Paulson.

*Former US Secretary of the Treasury Henry Paulson and CKGSB Founding Dean Xiang Bing at the CEO Brainstorming Session held on April 3 at the Bo'ao Forum for Asia Annual Conference 2012*



*CKGSB continues to expand its global reach through thought leadership platforms across the globe. So far in 2012, CKGSB faculty and partners have held forums in China, Japan, South-east Asia, the UK and the US, with an international roster of events planned in the lead up to our 10th Anniversary celebrations in November*



### 'Principles of Entrepreneurialism' with Sir Tom Hunter

On April 24, CKGSB hosted an intimate gathering with Sir Tom Hunter, son of a village grocer, who became Scotland's first homegrown billionaire. In the interactive lecture, 'Principles of Entrepreneurialism', the retail tycoon and philanthropist traced his career starting from humble roots to becoming Britain's most prolific philanthropist. Sir Tom Hunter and CKGSB have created the CKGSB Hunter Scholar's Programme to foster the leadership potential of up-and-coming social entrepreneurs (Read 'Business Leaders go Back to the Classroom' on page 44).

*CKGSB students, alumni and friends discuss social entrepreneurship with Sir Tom Hunter*



*Ambassador Wu Jianmin discusses the growing importance of Chinese soft power at the CKGSB 2012 Annual Forum in Sanya, Hainan*

### CKGSB 2012 Annual Forum in Sanya, Hainan

The CKGSB Annual Forum connects leading scholars, government officials and businesspeople—including more than 1,200 CKGSB students and alumni—for discussion on critical issues facing Chinese companies. Held in the city of Sanya on Hainan Island, it is one of China's premier business meetings.



### China-ASEAN Business Forum

The CKGSB China-ASEAN Business Forum, held on April 12 in Jakarta, Indonesia, included two panel discussions featuring high-level Chinese and Indonesian businesspeople. The theme of the first discussion was 'Investing in Stronger Ties: The Investment Environment between China and ASEAN'. The Jakarta forum is the first of many China-ASEAN Business Forums that CKGSB plans to hold across South-east Asia. Each forum will be held with the goal of advancing the school's mission of building new bridges for business cooperation and cultural understanding among high level global leaders from business, government and academia.

*CKGSB Visiting Professor  
Dr. Leslie Young at the China-ASEAN Business Forum*



*The forum included an in-depth panel discussion of China's economic development*

### CKGSB 2012 Nanjing Forum

The CKGSB Nanjing Forum, held in April 2012 brought together over than 400 government and business leaders from China's Yangtze River Delta. Participants explored opportunities for development through an in-depth discussion of how to respond to new economic challenges. The forum which was jointly held by CKGSB, SASAC Jiangsu Province, Jiangsu Province Federation of Industry and Commerce, the Youth Federation of Jiangsu Province and Jiangsu Province Radio and Television (Group), provided an unique opportunity for networking and knowledge sharing amongst the region's leading entrepreneurs.

### CKGSB China-Japan CEO Forum

CKGSB partnered with Nikkei Business Publications (Nikkei BP) to co-organize the 3rd CKGSB China-Japan CEO Forum on March 8 in Tokyo, Japan. The full-day forum—which brought together top executives, government leaders and scholars from China and Japan—centered on building bridges for sustainable growth between the two nations.

*CKGSB Visiting Associate  
Professor of Marketing Zhu Rui*



# What Did They Say?

On March 8, business leaders from China and Japan converged in Tokyo for the China-Japan CEO Forum, jointly hosted by CKGSB and Nikkei BP. They discussed the challenges and need for innovation that globalizing firms face in a changing economy



## Zhu (Juliet) Rui

CKGSB Visiting Associate Professor of Marketing

### On China's brand management conundrum

"The challenge for Chinese companies is brand awareness. 'Made in China' will always damage a product's image—especially with regard to luxury goods. It is not a problem that is unique to China; many brands from underdeveloped countries face this issue. For example, the best quality chocolate in the world is made in Venezuela but compared to Belgian chocolate brand Godiva, the price point of most products is relatively low."

## Daisuke Tanita

Former president, TANITA Co., TANITA Research Center

### On emerging opportunities for Sino-Japanese cooperation

"Japan is arguably the most developed Asian country yet all Asian businesses are still exploring new business models. In Japan, single or divorced baby boomers are not willing to be taken care of by their children and instead, prefer to live independently and move to luxury eldercare facilities. This booming industry is highly profitable. China also has an aging population, which represents a new opportunity for Sino-Japanese collaboration. By sharing resources and access to a wider market, firms could expand across both countries to offer a mutually beneficial solution to rising demand for better elder care facilities."

## Hiroshi Mikitani

CEO, RAKUTEN Co.

### On China's e-Commerce industry

"E-Commerce in China is too hot, and a bubble is developing. Many players borrow large sums of equity from venture capitalists to start new businesses. They have too many competitors, however, which is why they pay huge PR costs and many companies have to undercut their own profits to survive. This is unsustainable in the long term.

In the near future, large numbers of e-Commerce companies will go bankrupt. Even large companies collect private loans worth billions of RMB. If they cannot list on the stock exchange, they cannot remain liquid."

## Yasufumi Kanamaru

President and GM, Future Architect

### On the key to success in e-Commerce

"The e-Commerce industry is in a technological race to the top. As China's GDP increases at seemingly exponential rates, individuals' disposable incomes also increase. Chinese consumers are exploring new avenues for spending and the e-Commerce industry is booming. The key to success will be attracting the best human resources from across the globe."

## Koji Rishima

Chairman, Yaskawa Electric Co.

### On the importance of adaptability and a global outlook to a firm's longevity

"Yaskawa Electric will celebrate its centenary in 2015, it's rare to have a manufacturing company with such a long history, surviving two World Wars, two global Oil Crises and the devastating 2011 tsunami. How has the company endured all this? Through constantly adapting and evolving the business's management and organizational structure to overcome new challenges and economic development.

Another reason is the company's emphasis on seeking overseas business opportunities. Prior to my appointment as president of Yaskawa Electric in 2004, overseas sales accounted for only 37% of total sales revenue. Since then that amount has grown to over 50%. Of course, overseas markets hold significant risks, but by diversifying investments across the US, Europe and ASEAN markets, we have managed to hedge these risks effectively."

## Fan Min

CEO, C-Trip

### On the need for freedom and flexibility in Asian tourism industries

"In China, the middle class is expanding and the average income has increased. Now more than ever there is a huge demand for travel. When I was young, the only Asians who frequently travelled internationally were affluent Japanese tourists and business people. Chinese people now have an equal opportunity to travel. The average middle-class consumer demands flexibility and creativity on their vacations and is not interested in rigid package tours. Tour operators across Asia must be able to cater to the individual's needs."

# Practical Knowledge For The Real World

CKGSB launches Knowledge Center to bring business leaders, decision-makers and academics practical knowledge on China and emerging markets

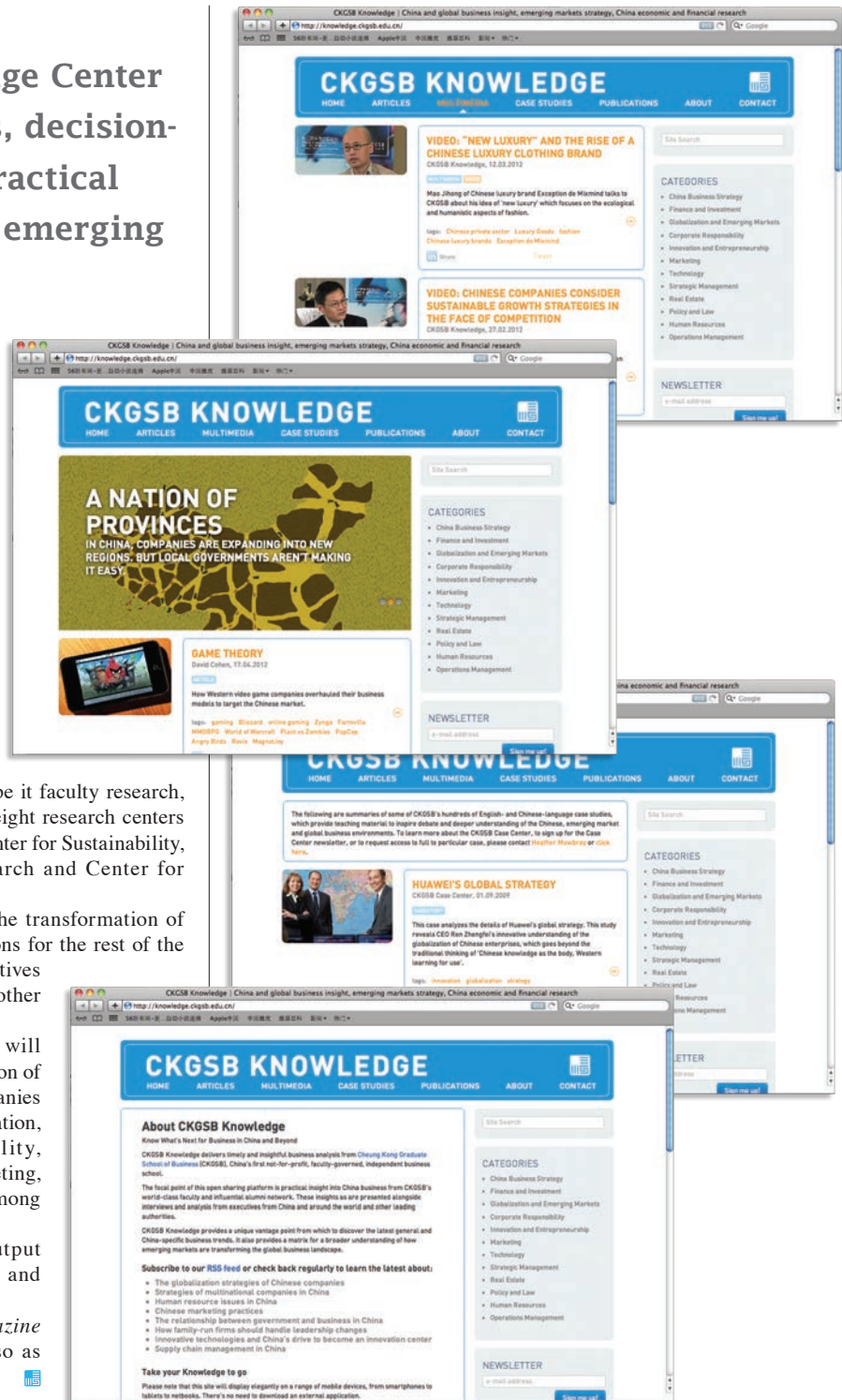
In February this year, CKGSB set up a new department called Knowledge Center to take its thought leadership to the next level. The main idea behind CKGSB Knowledge Center is to give business leaders, decision-makers and academics real-world insights on China and emerging markets. Instead of just looking at events in China from the inside, CKGSB Knowledge Center will also offer an outside-in perspective by leveraging global experts and analysis.

The Knowledge Center will draw insights from CKGSB's considerable research strengths, be it faculty research, or the output of the Case Study Center and the eight research centers such as the Center for Globalization Research, Center for Sustainability, Center for Multinational Corporations Research and Center for Financial Research.

CKGSB Knowledge Center will chronicle the transformation of the Chinese economy and examine its implications for the rest of the world. It will give readers analysis and perspectives on business and economic trends in China and other emerging markets.

Some of the themes the Knowledge Center will focus on include the Chinese economy, globalization of emerging market companies, multinational companies and their strategies in emerging economies, innovation, sustainability, corporate social responsibility, entrepreneurship, finance and investment, marketing, human resource management and leadership, among others.

Highlights of the Knowledge Center's output will be available on the new CKGSB research and knowledge website CKGSB Knowledge (<http://knowledge.ckgsb.edu.cn/>), *CKGSB Magazine* and its Chinese language counterpart, and also as research reports.



# Business Leaders Go Back To The Classroom

Sir Tom Hunter seeks to expand his understanding of China through interactions with Chinese entrepreneurs and business leaders

A unique collaboration will see 45 leading Chinese entrepreneurs and business leaders visit the UK in November 2012 to take part in an educational programme which dovetails into a parallel programme for 30 European counterparts. This combination is designed to improve understanding and build opportunities to engage with the world's fastest-growing economy.

This three-and-a-half day programme, which will take place in Cambridge and London in November 2012, will see an elite cohort of Chinese and European entrepreneurs go back to the classroom to discuss the implications of China's globalisation, as well as to learn from each other how best to successfully do business in their respective regions.

Particular emphasis will be placed on opportunities within China and topics covered will include creating successful strategies, identifying the growth opportunities and regions of the future, accessing peers, adapting to China's rising cost base, the mass-market approach to new technologies and accelerating innovation. Chinese business leaders will, in turn, learn about Western approaches to creating and managing brands, latest thinking in marketing and communications and how European businesses leverage CRM and customer servicing for business advantage.

15 European business leaders have already signed up to course, including leading Scottish entrepreneur, Sir Tom Hunter.

During his recent visit to CKGSB, he said, "No business can afford to ignore China and the opportunities it presents or under-estimate the importance of its business sector to the current and future global economy. China's growth potential is phenomenal and the West needs to learn from China's economic development, flexibility, adaptability and vision. Strategies that were relevant just five years ago are now out-of-date due to a number of socio-demographic and economic reasons.

"There is no better way to understand what is required to be a success in China than by interacting with those Chinese entrepreneurs and business leaders who are already among the most dynamic within the country. This programme is a unique opportunity for business leaders from across the globe to get together to learn and share experiences."

As well as attending the China Programme event, Sir Tom has also partnered with CKGSB to launch the CKGSB Hunter Scholars programme. The scheme offers five full fee scholarships to up-and-coming entrepreneurs to attend the CKGSB Cambridge Global Strategy: China programme in November, and then go on to study a full MBA at CKGSB, Beijing.

CKGSB Professor Leslie Young said, "The China programme offers entrepreneurs the broad context of China's development opportunity and enables them to formulate real personalised business

strategies relevant to the dynamic Chinese market – and make the contacts necessary to realise them."

Professor Peter Williamson from Cambridge Judge Business School said, "It's almost impossible not to be excited by the potential of the Chinese market. But it is also easy to have spirited discussions about strategies that are little more than pipedreams. To have the option to actually win in China requires us to be able to build our knowledge and capabilities on the ground in China – and fast."



Sir Tom Hunter at the CKGSB Distinguished Speakers Series 'Principles of Entrepreneurialism' event, April 24, Beijing



# A Global Education

Executive-level insights into the world's changing business landscape

**C**CKGSB global executive education programs connect on-the-ground China knowledge with executives who are leading their companies in a dynamic global economy. The open enrollment and customized programs combine theory and real-life business cases – blending instruction on best practices in management and leadership with timely insights on collaboration and competition in global markets. In 2012, CKGSB will launch a suite of innovative executive education programs which answer a growing demand for knowledge of how to integrate China into a global business strategy in the context of ASEAN, BRIC and developed economies. These programs include:

## Global Business Strategy: China (GBSC)

With Columbia Business School

Delivered in New York over a period of four days in partnership with Columbia Business School, the North American version of the GBSC program offers critical insights for North America-based international business leaders seeking to enter or expand their business in the Chinese market and gain new perspectives on the implications of China's globalization. Program participants will have the opportunity to attend the annual CKGSB China-US CEO Forum in New York and interact with elite Chinese business leaders from CKGSB's China CEO Program.

## Global Business Strategy: China (GBSC)

With Cambridge Judge Business School Executive Education


Delivered at the University of Cambridge campus over a period of three days in partnership with Cambridge Judge Business School Executive Education, the UK version of the GBSC programme offers critical insights for an elite cohort of European entrepreneurs seeking to enter or expand their business in the Chinese market. Participants will gain new perspectives on the global and particularly European implications of China's globalisation, along with strategies necessary for success in the world's largest growth market. Participants are invited to attend the annual CKGSB China-UK CEO Forum in London and interact with elite Chinese business leaders from CKGSB's China CEO Program.

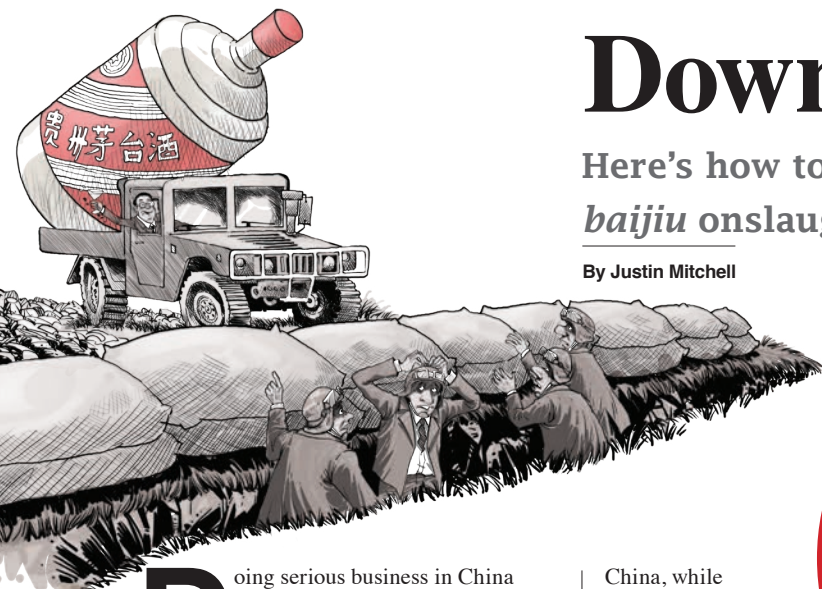
## BRICs on BRICs

Delivered across a period of 20 days in four different modules in Brazil, Russia, India and China, the 'BRICs on BRICs' program equips global executives with the knowledge, skills and insight they need to successfully invest in and operate in the BRIC nations. Modules take place at the campuses of CKGSB, Brazil's Fundação Dom Cabral (FDC), the Moscow School of Management SKOLKOVO and the Indian Institute of Management Ahmedabad, and include lectures from those schools' respective faculty members.



## ASEAN Global Leadership Program—China

Delivered in China, the 'AGLP—China' program was jointly initiated by CKGSB and the Human Resources Development Fund (HRDF) of the Malaysian Ministry of Human Resources. It offers critical insights for South-east Asian business leaders seeking to remake their strategies to reflect China's rising importance in the ASEAN bloc and in global business. It consists of China-oriented classes and company visits that provide a close-up view of China's business landscape, as well as networking and learning opportunities with Chinese peer executives. 



# Downtime Blues

## Here's how to hold your own against the *baijiu* onslaught

By Justin Mitchell

**D**oing serious business in China often means serious drinking. The drink of choice, *baijiu*, at a potent 100-120 proof, is distilled from sorghum and packs a powerful kick. Literally translated as ‘white liquor’, many foreigners struggle with the China’s favorite alcohol.

Old China hands, however, praise its taste and the significant role it plays in lubricating the social spirit of business deals and family celebrations. Luo Yong, president of Wanguo Education, one of China’s largest and most successful education firms, first sampled premium *baijiu* brand Maotai, in the 1980s and was instantly hooked.

“I was immediately conquered by the flavor,” says Luo. “It has a special bouquet but no alcohol fumes. You will never get a headache from drinking Maotai, though you may be a little bit fuzzy-headed the next day.”

He also praises its traditional use as a social ice-breaker. “Strangers always put on a mask when they meet for the first time. Liquor helps to bring them closer. Persuading a stranger to drink is actually a way of strengthening interpersonal communications and mutual trust by removing those masks,” he adds.

Li Guangdou, a Beijing-based expert on liquor brand development, agrees. He suggests that *baijiu* is “a liquor of etiquette.”

“People at banquets use *baijiu* to test one’s ability and sincerity. If you don’t drink when asked at a dinner table, Chinese people may think you look down upon them and they lose face,” he says.

For unwary foreign visitors, giving the host a chance to save face can also mean losing their own lunch. Matthew Silverman, an American petroleum geologist and his team suffered *baijiu* exposure for the first time on a business trip. He and his consulting group were flown from Beijing to Harbin, Northern

China, while conducting an oil-field development feasibility study and were inducted into the fold with a traditional Chinese banquet.

“They were surprised to learn that our chief engineer was a woman. Instead of going after the [male] head of our team with *baijiu* at the banquet, they targeted her,” says Silverman. “She’s a good sport, so she took them on, but was outnumbered. We left the banquet and she threw up in the lobby of the hotel on the way to the elevator.”

But despite a nauseating start to the trip, Silverman says his chief engineer had the last laugh.

“She was up bright and early the next morning, while many of her Chinese counterparts were clearly hung-over. She ran rings around them in the technical evaluations and blew them all away at a karaoke bar later in the trip.”

Paul Nash, a Toronto-based investment analyst who previously taught in China, says his experience has taught him to carefully gauge his *baijiu* buddies before imbibing too much.

“I’ve never quite acquired a taste for *baijiu*, which to my palate tastes like a blend of paint thinner and diesel fuel,” says Nash. “I have learned, though, that you have to be mindful of your drinking partners. Typically, you don’t have to worry too much in a formal business setting with mature partners because they should, very subtly, ensure you don’t exceed your tolerance limit, which they naturally assume is much lower than theirs.”

That attention is not afforded guests in all situations however, and if there’s a celebration

¥1,456,000

In 2010, a 1958 bottle of China’s leading *baijiu* brand Maotai sold for nearly RMB 1.5 million at an auction, making it the world’s most expensive bottle of alcohol

to be had, it’s best to be on guard. Nash recalls teaching at a business college in Shijiazhuang, Hebei province, and being invited to a wedding banquet by a student.

As the only foreigner in the room and the first foreign acquaintance for some, Nash found himself surrounded by eager young men with glasses full of spirits looking for a chance to toast this rare new creature. The father of the bride had to put an end to the over enthusiastic toasting.

“But it was too late. I could barely stand and the room was spinning in a way it never had with Scotch whisky or other spirits,” says Nash. “I was violently sick that night and badly hung over the next day.”

But liquor brand development expert Li, who has hopes that *baijiu*’s popularity will flow overseas, says that there is an escape route that can save both your host’s face and your own stomach. Learn how to say no and resist having a drink.

“In that case, you have to be really strong and not take a single sip. You can’t toast one cup and refuse when another person proposes a toast later, because the second person would think that you are looking down on him,” says Li, who thinks that foreigners should show no fear of refusing. “You can always explain to your hosts that you don’t drink due to religious or health reasons. Chinese people won’t belittle you for not drinking.”

Ultimately, Li says, foreigners who attend a Chinese banquet have to make a choice; face the *baijiu* head on and “do as the Romans do” or stick to your guns and resist the temptation of taking a sip. Otherwise, he says, you might make a cultural faux pas—and you won’t be sober enough to realize it.

# MBA



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## Selected Global Executive Programs

### Open Enrollment Programs:

#### -Global Business Strategy: China

In the UK in partnership with Cambridge Judge Business School Executive Education  
In New York in partnership with Columbia Business School

#### -ASEAN Global Leadership Program: China

For business leaders from Southeast Asia

#### -The CKGSB China Country Manager Program

For China heads of global companies

### Sample Custom Programs:

-China briefings for board members of global companies

-China business immersion programs for doing business in China and with China

## Selected 2012 Global Events

### China-ASEAN Business Forum

-April 12, Jakarta

### China-France Business Forum

-June 26, Paris

### China-US CEO Forum

-August 10, New York

### China-UK CEO Forum

-November 16, London

## For more information:

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