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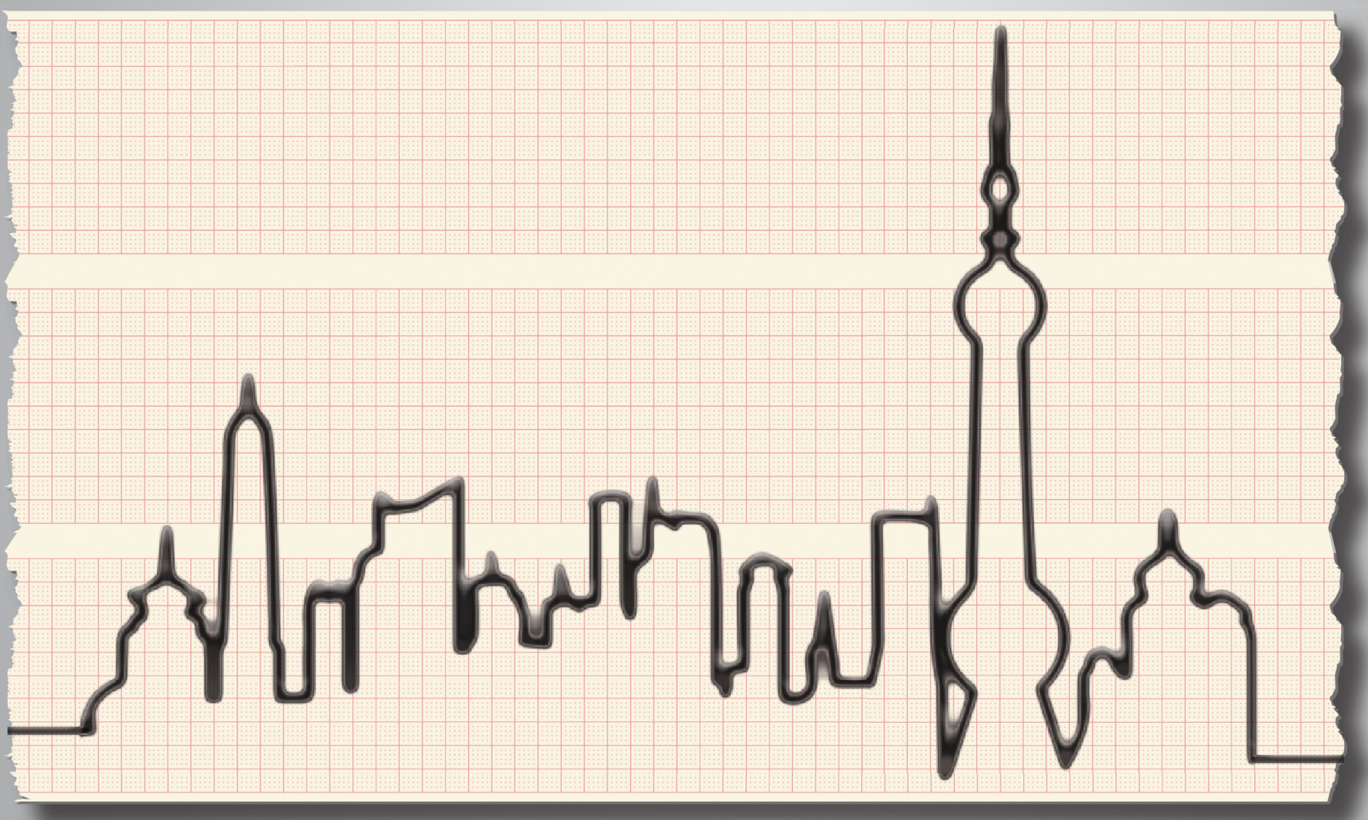

China's Urban Pulse

The new urbanization plan and what it means for the country's future

- China's slowing property market casts a shadow over developers
- Can Huawei erase the memory of public blunders and expand its global presence?
- Stephen Roach says the US-China codependency threatens the global economy

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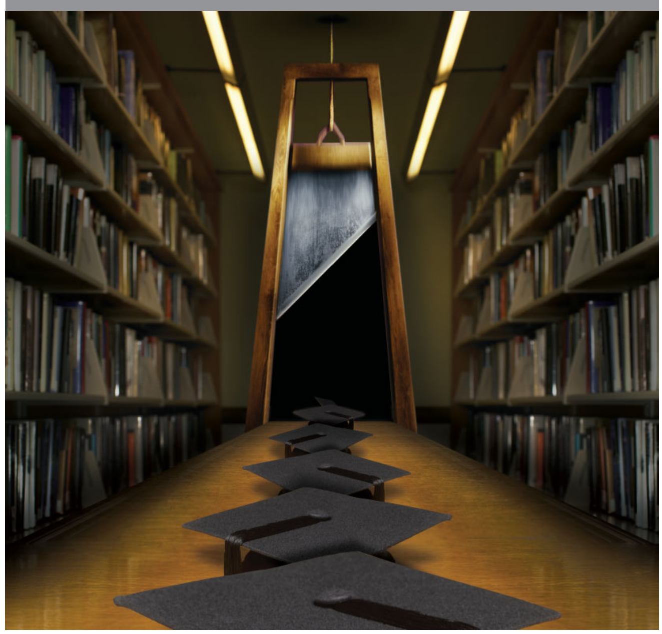

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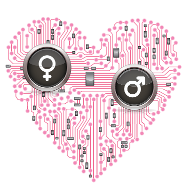


China's Urban Future

Pudong, overlooking The Bund across the Huangpu River in Shanghai, may be one of the best symbols of China's dramatic urbanization in the past 30 years. When I visited Pudong for the first time in my life in the early 1990s, the entire area was a farmland. Today instead of vegetable fields, you see tall skyscrapers and China's busiest financial district—all on the same soil I had stepped on 30 years ago.

To put things in perspective let me throw some figures at you. In 1950 only 13% of China's population lived in cities. In 2012, for the first time in history China's urban population exceeded China's rural population with 51.27%, or 680 million, living in cities. Today various studies say that by 2035, 70% of China's population will live in cities. That will be bigger than the population of all the European Union countries combined or more than three times of the entire population of the US.

As China changes from its export and investment-driven development model (which has been running out of steam in the past few years as the developed economies are saving more and buying less), the new Chinese leadership believes that consumption will be the new driver of economic growth in China and urbanization will help drive up the purchasing power of household consumers. To help the process of urbanization, this year, the government has put *hukou*, China's urban residence permit system, into the spotlight. With that, it seems there will be an increased emphasis on integrating rural migrants better into cities. There are also other issues that merit a close examination: such as China's capacity to meet the technical challenges of such dramatic change head on. Also, what will happen to the environment? We look at all those issues in our cover story on page 22.

Elsewhere in this issue, we chronicle the rise of Huawei. In its early life, Huawei successfully kicked out dominant foreign telecom giants out of China by adapting Chairman Mao's military strategy of "surrounding the cities (where the enemies are strong) from the countryside (where the land is vast and the enemies are weak)". When Huawei went global, it encountered difficulties in markets such as the US, and started getting a stronghold in the emerging markets as well as smaller developed markets like New Zealand and Finland. Will this help Huawei become a successful 'emerging giant'—a fast rising multinational company from an emerging economy in the global market? For answers, turn to our story on page 39 where we take a hard look at Huawei's globalization strategy.

Stephen Roach is like a household name in the world's finance and economics communities. In our interviews section, we bring you an interesting—and hard-hitting—interview with the former Morgan Stanley Asia Chairman. Without mincing any words, Roach reveals why the US-China co-dependency is unhealthy and can cause further imbalances in the global economy (page 57).

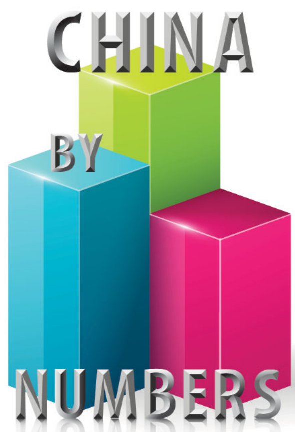
We also bring you an interview with Chris Stibbs, the new CEO of The Economist. Readers of this magazine might recall our earlier interview with Andrew Rashbass, former CEO of the The Economist, who explained why the magazine had continued to grow despite the downturn in print media. Stibbs, who took over from Rashbass last year, talks about his philosophy for the group and how he plans to keep it on the growth path. That's on page 50.

As always, we look forward to your feedback and suggestions. Please email us at *ckgsb.knowledge@ckgsb.edu.cn.*

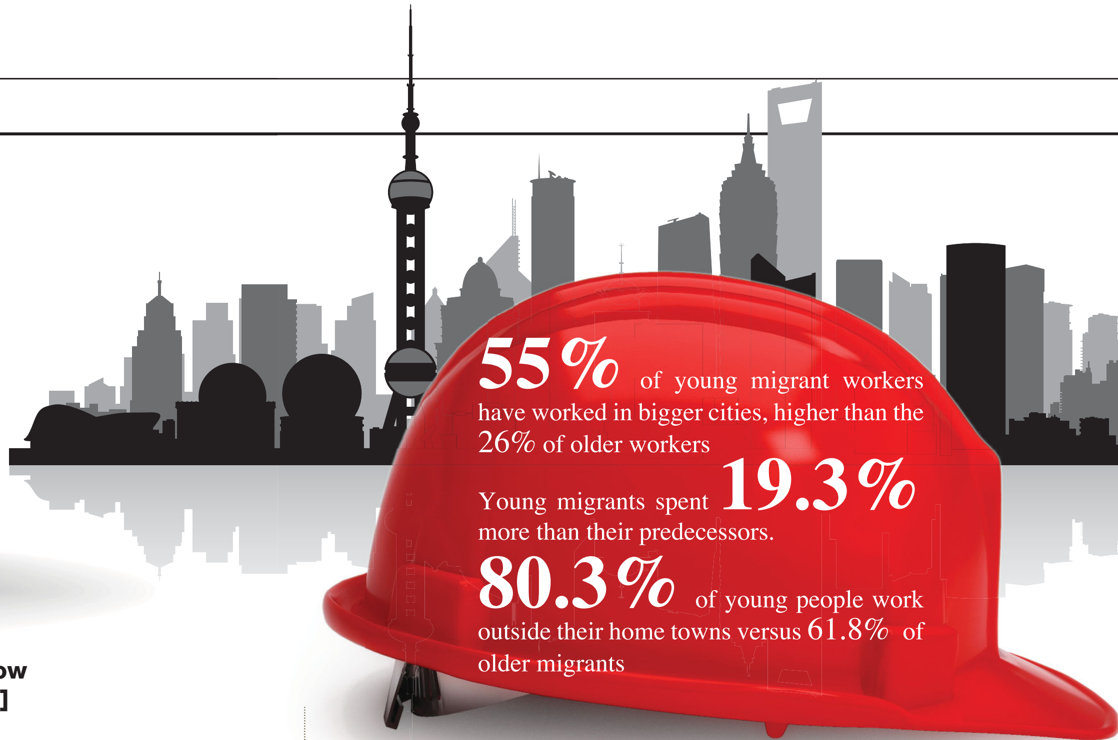
Yours Sincerely,

Zhou Li
Assistant Dean, CKGSB

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



The stats you need to know
[from April and May 2014]

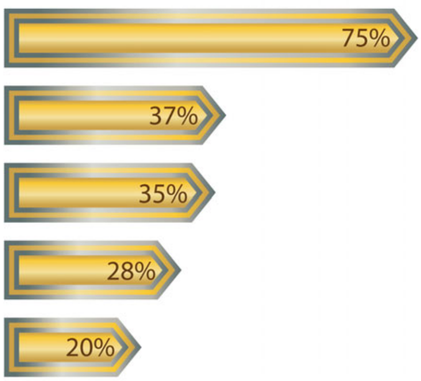


Country Mouse turns City Mouse

Source: National Bureau of Statistics

China's voracious appetite

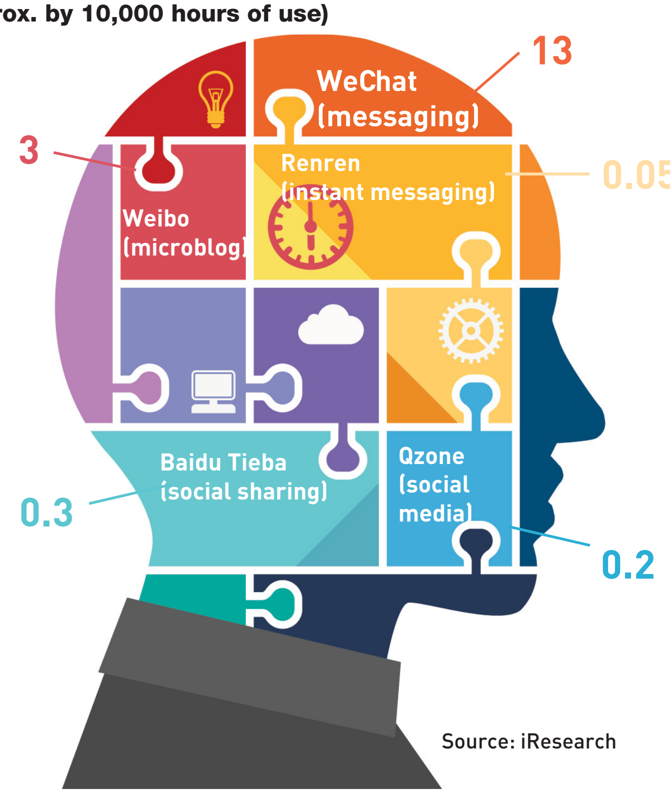
China's Imports of Commodities (% of Global Total)



Source: Capital Economics

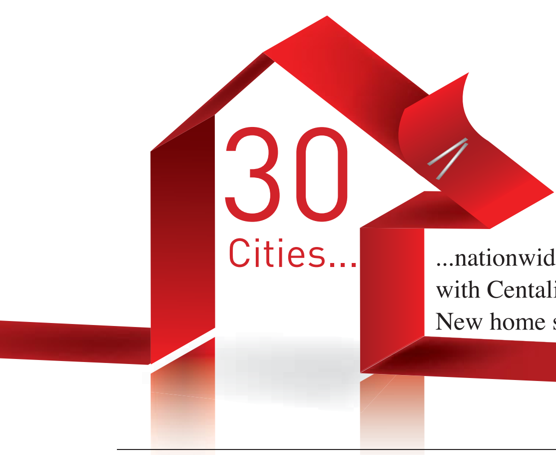
The most addictive apps in China

(approx. by 10,000 hours of use)

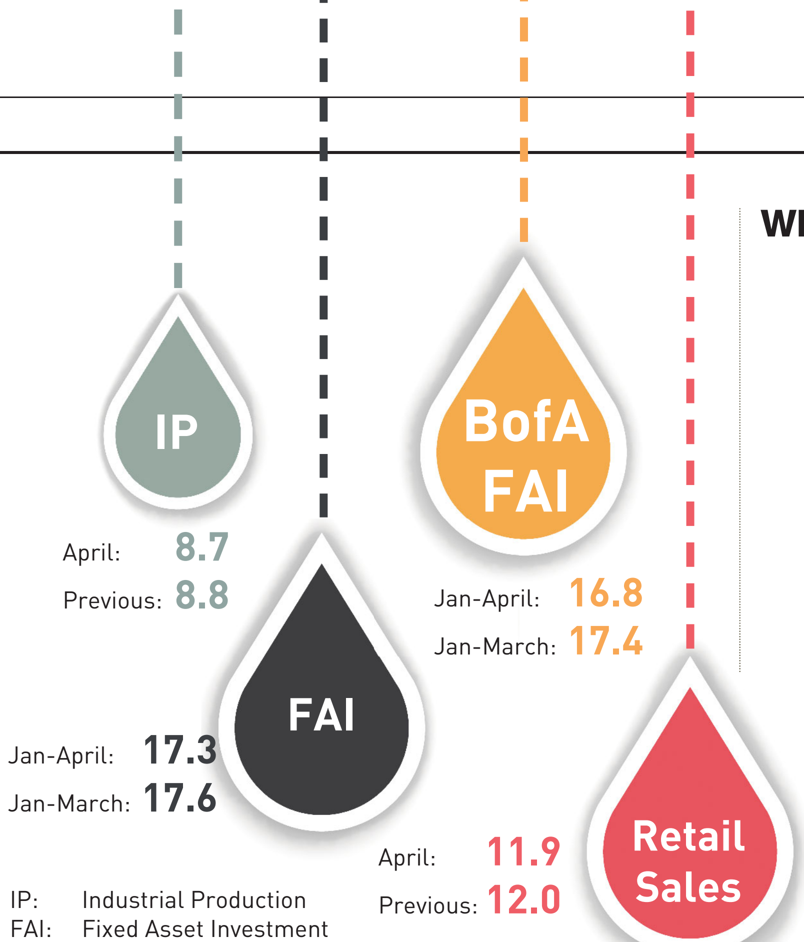


Source: iResearch

Time for an intervention



...nationwide are expected to loosen controls as the market cools - Zhang Dawei, Chief Analyst with Centaline.
New home sales grew -15.4% in terms of value, worse than March's -10.6%.



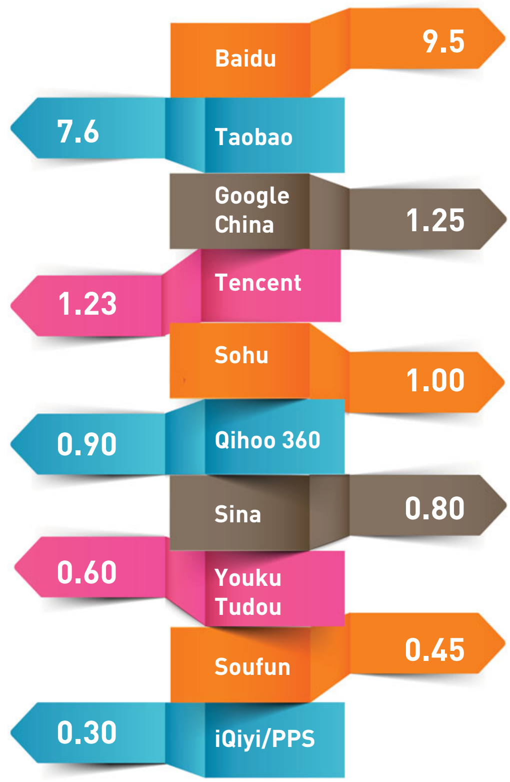
IP: Industrial Production
FAI: Fixed Asset Investment
Note: All figures were released by NBS except for Bank of America Merrill Lynch FAI*

Source: National Bureau of Statistics (NBS)

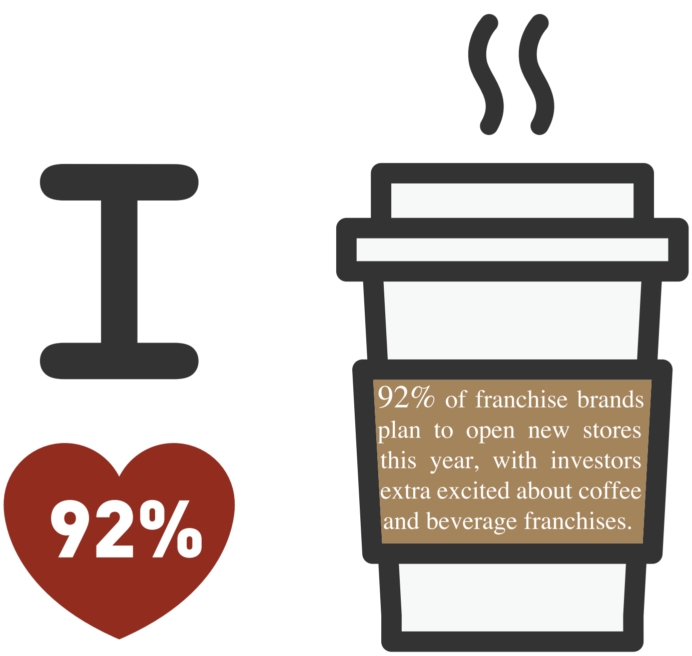
China's economy's got the shakes...

Who's rolling in China ad money?

(RMB Billion)



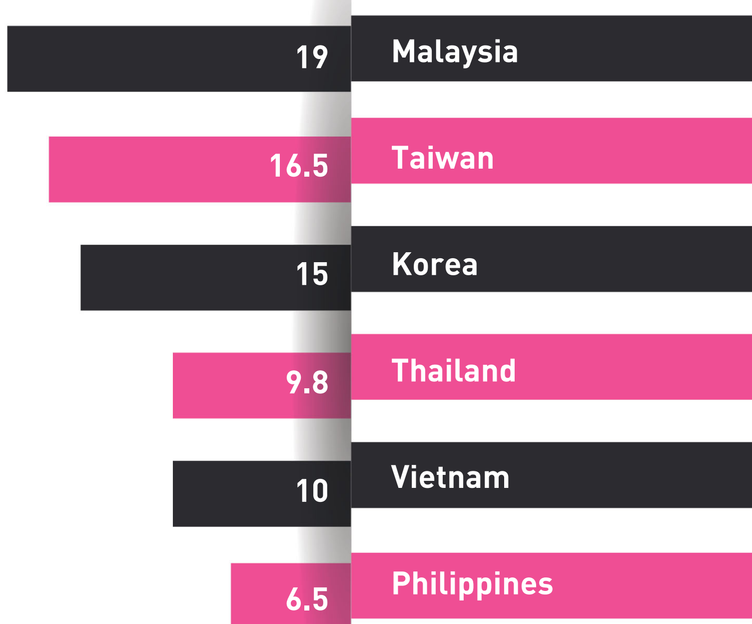
Caffeine Fix



Source: The China Chain Store and Franchise Association

Whose exports does China like best?

Gross export exposure to China (% of GDP, 2013)



Source: National Bureau of Statistics

Holiday Diary

Euromonitor released a May forecast of 16% growth in China's outbound market for 2014 after seeing expenditure reach a record level of $120 billion in 2013. CKGSB Knowledge shows where the travelers are going and what they're encountering when they land.

Hong Kong
Visitors: 34,914,505 (2012) 40,745,227 (2013)
Growth: 16.7%
Developments: Chinese visitors to Hong Kong hit a milestone in the summer of 2013, reaching a total of 4 million border crossings in a single month!

Macau
Visitors: 17,188,383 (2012) 18,632,207 (2013)
Growth: 8.40%
Developments: Mainland Chinese visitors' market share of the total number of visitors to Macau reached 65% in August, hitting a new record.

Thailand
Visitors: 4,000,997 (2012)
4,705,173 (2013)
Growth: 17.6%
Developments: A February 2014 poll from Chiang Mai University found that 80% of Chiang Mai residents were not happy with the massive influx of Chinese tourists thanks to the popularity of "Lost in Thailand".

Taiwan
Visitors: 2,586,327 (2012)
2,874,702 (2013)
Growth: 11.15%
Developments: Mainland visitor numbers to Taiwan are slowly bouncing back from changes to restrictions on tour groups in early 2013, which caused a momentary lapse in volume.

Singapore
Visitors: 2,033,918 (2012)
2,269,853 (2013)
Growth: 11.60%
Developments: Even while Chinese visitor numbers dropped thanks to more stringent group tour restrictions, Chinese are still the top-spending tourist demographic in Singapore, shelling out $2.98 billion.

Source: Embassies, China Outbound Market Intelligence

US

Visitors: 1,474,715 (2012) 1,808,000 (2013)
Growth: 22.60%
Developments: 2013 saw the in-vogue 'investor visas' more than double from 2012, with Chinese investor visa recipients accounting for 80% of all such visas issued

Vietnam

Visitors: 817,042 (2012)
1,907,794 (2013)
Growth: 133.50%
Developments: Beijing's deployment of an oil rig in disputed waters in May this year set off a wave of anti-Chinese riots in Vietnam, causing Chinese tourists to flee home or to neighboring countries. This is likely to impact tourist numbers.

Malaysia

Visitors: 1,559,123 (2012) 1,791,432 (2013)
Growth: 14.90%
Developments: The mysterious disappearance of flight MH370 scared off Chinese tourists to Malaysia surrounding the May holidays in 2014, but officials are optimistic that skittish tourists will return in full force sooner than later.

Japan

Visitors: 1,425,637 (2012)
1,314,437 (2013)
Growth: -7.80%
Developments: Territorial disputes could be behind Japan's negative growth in Chinese visitors, but numbers for 2012 were outstanding, a 130% increase over the previous year.

South Korea

Visitors: 726,924 (2012)
1,046,771 (2013)
Growth: 44.00%
Developments: K-pop is attracting China's more youthful tourists, and the country is also gaining on the losses of its neighbor, Japan.

Degree to Nowhere

Official unemployment figures from China may not be showing us the reality of joblessness for recent graduates and migrant workers

By Xin En Lee

Recent graduate James Du has been searching for a job for four months in Beijing to no avail. The holder of a master's degree in finance from Moscow University of Industry and Finance rationalizes: "I've only applied to large companies and I prefer jobs which are intellectually stimulating. As my parents have already spent so much money on my education, I'd prefer a job with a certain salary as well, [and] the job should have a certain status."

James is amongst an estimated 7 million Chinese university graduates who have quickly become the most work-strapped demographic in the country. The situation presumably worried Chinese leader Xi Jinping enough for him to drop by a Tianjin jobs fair to reassure local graduates on his commitment to employment just days after his inauguration.

Explaining the Disconnect

High unemployment has long been a preoccupation of Chinese leaders, with former president Hu Jintao famously telling his counterpart George W Bush that 'employment' was the issue which kept him awake at night.

Xi proclaimed at the jobs fair that employment remained his paramount concern, perhaps surmising the dangers of a disenfranchised middle class who'd just been sold the idea of the 'China Dream'.

Despite policymakers' proclamations, China's recent 2013 jobs data seemingly present little cause for concern. China's Ministry of Human Resources and Social Security (MOHRSS) reported that the unemployment rate was an average of 4.1% in 2013, well within the government's target of 4.6%.

However, most experts do not consider the statistics credible for a multitude of reasons. Firstly, the statistic has remained between 4% and 4.3% for most of the past decade even during major layoffs, such as during the global financial crisis in 2009 when tens of millions of workers in China's factories for export lost their jobs. In comparison, the unemployment rate in the US reached a peak of 10% in October 2008, but has dropped to 6.3% in April this year, its lowest rate in six years.

Secondly, unemployment rates released by different research groups do not match up. In 2012, researchers from Texas A&M University worked with China's Southwestern University of Finance and Economics to survey 8,000 Chinese households. It discovered that China's urban unemployment rate was 8.05%, almost twice the official estimate. In 2008, the Chinese Academy of Social Sciences published an unemployment rate of 9.4% while the official rate was 4.2%.

Thirdly, China's authorities count only those urban workers that register for unemployment benefits. For the estimated 260 million, or 20% of the working population, that are migrant workers lacking the all-important housing registration, or *hukou*, in their destination cities, this methodology is quite problematic. Without registration they cannot apply for unemployment benefits, casting even more doubt on the statistic.

Bewilderingly, the government also stopped announcing the number of jobless workers in cities, which they had previously announced until 2012. The numbers had stood at 9.18 million at the end of June 2012 and 9.17 million at the end of 2012. The sudden drop in transparency is yet another ill omen for employment figures.

Tim Pingle, a lecturer at the School of Oriental and African Studies who does research on China's labor relations, further pointed out the statistics hid large regional variations in labor markets and workers in the informal economy.

"Large numbers of people working in the informal economy are hidden from the statistics. Although the numbers are not as large as those in countries like India, some recent estimates have said that China's informal economy is much larger than thought," says Pingle.

The most recent survey conducted in 2008 by the Institute of Population and Labor Economics estimated that between 19.9% and 37.2% of households were in informal unemployment, according to different definitions. Informal unemployment is defined in several ways, but mainly as 'not having a formal labor contract' and 'not having social insurance.'

Finally, activists and academics highlight that the low unemployment rate hides the phenomenon of using agency labor. In the reform of state-owned enterprises (SOEs) in the early 2000s, many workers were cajoled into becoming 'agency labor', which meant that they were not directly employed by the enterprise but by an employment agency created by the enterprise as a cost-cutting measure. Typically, agency workers receive lower pay and fewer benefits than regular staff in the same position. In 2011, the All-China Federation of Trade Unions reported that there were more than 60 million agency workers, also known as dispatched employees, mostly in SOEs and government entities. Last year, the MOHRSS proposed revising labor contract laws to protect agency workers, which were supposed to take effect in July last year, with a grace period of two years. These measures include providing clearer definitions of employee positions, and capping the number of agency workers in a company to 10% of the company's total employees.

"It affects a majority of companies, because many companies and multinationals have been using dispatched employees in a wide range of positions for a long time," says James Hu, a partner at Chinese law firm Fangda Partners.

But Communications Director of China Labor Bulletin Geoffrey Crothall is skeptical of the law's enforcement capacity.

"It is unlikely that the local labor departments will investigate every single agency worker placement to ensure that their terms of employment are in line with the regulation. It would also be a very complicated and time consuming task to calculate that a company has exceeded the 10% cap on agency workers," he adds.

"It will be up to the workers themselves to implement the law through lawsuits, but we have seen that courts are reluctant to take these cases because of their lack of clear guidelines." Crothall concludes.

Divining the Jobs Market

A key piece of information used by researchers is the employment component of two manufacturing purchasing managers' indices, one of which is compiled by HSBC Markit and the other by the official China Federation of Logistics and Planning. The latest figures, which are published monthly, showed that although the manufacturing sector, which is China's largest industry, declined at a slower pace in April compared to March, companies cut staff for the sixth consecutive month.

But we may not need to panic yet.

Mark Williams, Chief Asia Economist of Capital Economics, says that GDP growth has now been below 8% for nine successive quarters with little evidence of difficulty appearing in the labor market.

"China's GDP growth has slowed but parts of the economy which are labor-intensive, such as in construction, have experienced strong growth, so the job market has remained tight," Williams says.

"The government can boost spending on infrastructure, but it will be drawing gainfully employed workers from elsewhere."

Williams also highlights that China's labor market was resilient last year, creating a record high of 13.1 million new urban jobs despite the stagnating GDP. Shen Minggao, head of China Research at Citigroup, also shares similarly optimistic sentiments. "There is little slack in the job market. Together with the peaking of working age population and expansion of the service industry, large-scale unemployment is unlikely," he says.

What then, underpinned Xi's visit to the graduate fair in Tianjin? China's first domestic research study, 'China Household Finance Survey', conducted by Texas A&M University and China's Southwestern University of Finance and Economics found that while 16.4% of university graduates between the ages of 21 and 25 were unemployed, only 4.2% of those in the same age bracket who had dropped out before middle school were unemployed.

Last year, Xinhua reported that university graduates faced the toughest labor market in years, with an estimated 7 million graduates looking for jobs.

"The education system and universities are run in a way similar to that of SOEs. In SOEs, the workers produce based on plans instead of market demand. In state-owned universities, students are trained in disciplines which the labor market has no interest in, and are merely there as 'jobs' for university professors," says Di Dongsheng, a professor at Renmin University.

"I can see that university students these days are all spoiled to a certain extent by not just their families, but also the entire society. It is seemingly better for them to be unemployed than to take a job below 'their stations'," he says.

Gan Li, a professor at Texas A&M University who spearheaded the research on Chinese unemployment, says that a unique aspect of China's labor mismatch is the lack of mobility for the younger generation. "Rising housing and rental prices make it difficult for young people to go to where the jobs are."

No Quick Fix

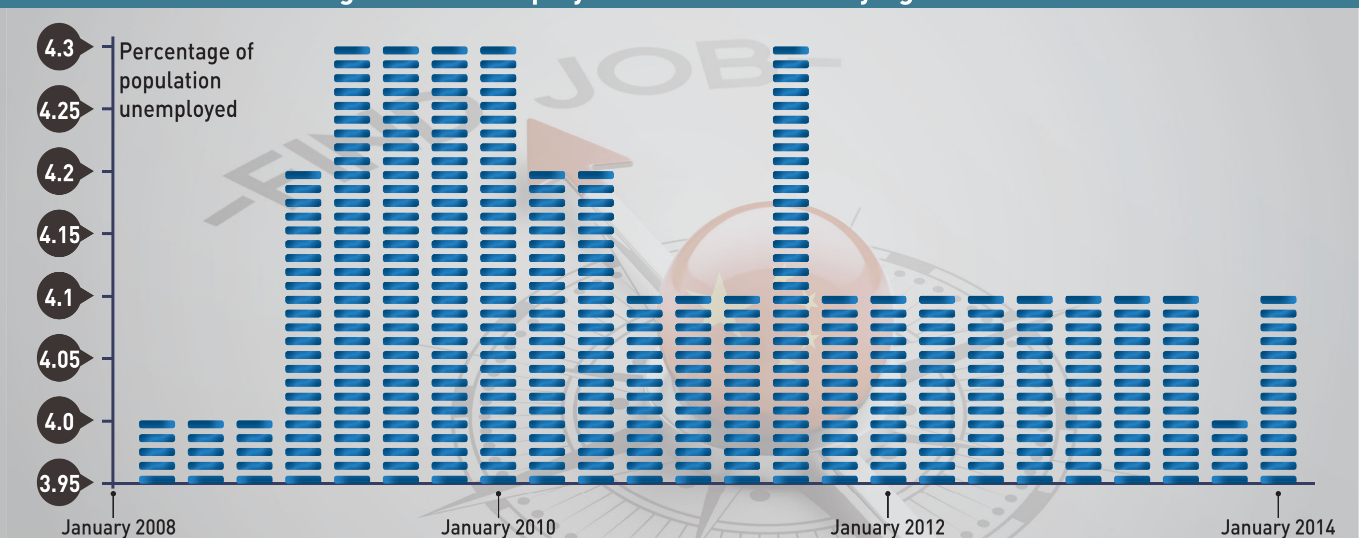
Premier Li Keqiang called for more employment channels during an executive meeting of the state council in May last year. He also encouraged college graduates to start their own businesses.

Taking his cue, China's Ministry of Human Resources and Social Security published a report in February this year on the impact of e-commerce on employment, highlighting that young graduates made up the majority of internet entrepreneurs.

Meanwhile, Beijing has encouraged entrepreneurship amongst the young by

Steady As She Goes

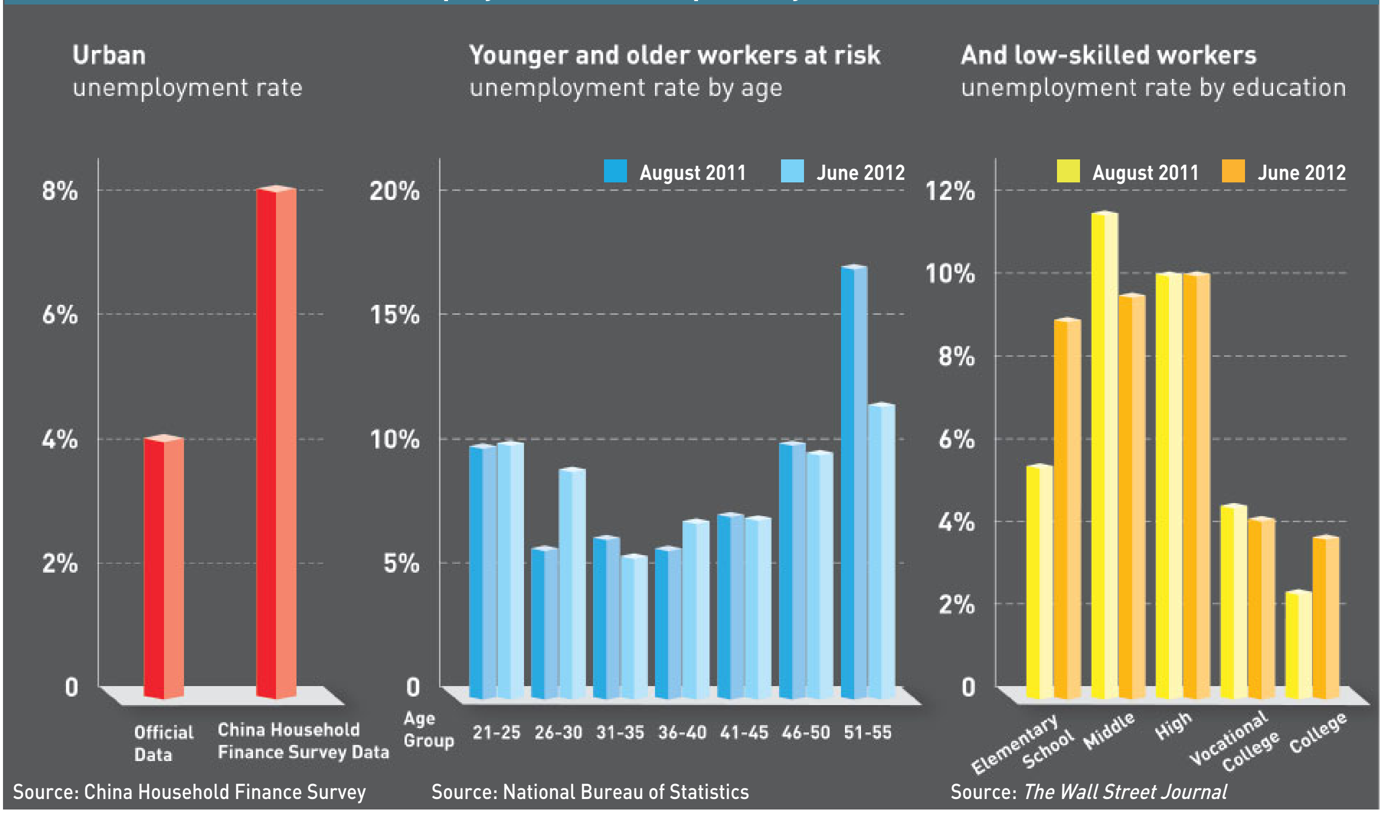
Official figures of unemployment in China. Steady figures since 2011



Source: www.tradingeconomics.com, China's Ministry of Human Resources and Social Security

Differences of Degree

China's real unemployment rate computed by various entities (June 2012)



offering subsidized apartments and research money, while top universities in the capital such as Tsinghua University have created incubator programs to help graduate entrepreneurs get funding. Last year, the Guangdong provincial government also announced that college graduates who set up their own businesses in the province will be exempt from administration fees and given low-interest loans.

But small and medium enterprises remain the main source of jobs. The National Bureau of Statistics (NBS) estimates that they provide more than 80% of jobs in China. Ding Shuang, an economist at Citigroup, is skeptical. "I don't think government measures will have much of an impact on employment anytime soon," he says. Small and medium-sized enterprises (SMEs) are still facing difficulty in getting access to credit, discouraging the hiring of new staff.

The Ministry of Finance responded by announcing in April this year that RMB 3 million per project would be given to technological SMEs to subsidize their research and development expenses. The ministry has said that it would improve the efficiency in how funds are allocated to such enterprises.

In contrast to 2008, when thanks to the financial crisis 20 million Chinese lost their jobs and compelled the government to introduce a massive RMB 4 trillion stimulus package, it appears that this administration will not take similar measures. In April this year, Li Keqiang definitively ruled out short-term stimulus measures despite reports of China's slowest growth rate last quarter since 2012. The country's GDP grew 7.4%, narrowly missing the official target of 7.5%.

Renmin Univertisy's Di says abstaining from short-term fixes is best—resolving labor mismatch will be slow and painful.

"We need to reform universities and reduce intakes of universities with the highest unemployment rates of students. Secondly, we have to upgrade the Chinese economy at the cost of GDP growth, which means we will have [to] sacrifice some manufacturing jobs," he says.

But future estimates suggest a tapering off of high unemployment rates in two demographic groups—those in their 50s approaching retirement, and college graduates between the ages of 21 and 25.

"These elderly workers in their 50s are now close to their retirement age. Rather than job hunting, they will collect their retirement benefits and alleviate the unemployment rate further," he says.

"[And] laborious jobs are actually becoming better-paying. [So] over time, [graduate] expectations will become better adjusted to reality, so I don't foresee a jobs crisis."

But if James Du's job wish list is any indication of recent-graduate expectations—"intellectually stimulating", "certain job salary", "certain status"—reality is a way off yet.

If You Build It...

...will they come? China's slowing property market casts a shadow over developers

By Christopher Beddor

On a spring afternoon in Beijing, Zhou Fang is busy hawking apartments in a new residential complex along the city's third-ring road. He doesn't appear to be having much luck.

The buildings opened a couple months before and have plenty of amenities, including a community gym with a swimming pool, shops and a large underground parking ramp. While the apartments are not "luxury", they are certainly designed to attract upper middle-class residents.

Zhou's real estate agency does not allow him to offer discounts on these apartments even as the market slows. He says that "nearly everyone" in the area has heard of the developers offering "substantial" discounts on new properties further out in the suburbs, and now prospective buyers have been asking him for price cuts too.

Such discounts, which began in Hangzhou and Changzhou earlier this year, are just one sign of trouble brewing in China's property sector. These were brought to the fore in March, when reports surfaced that developer Zhejiang Xingrun Real Estate was poised to default with around RMB 3.5 billion ($560 million) in debt.

While Xingrun is not large enough to seriously disrupt the market, it has highlighted the dangers that developers face as property prices cool. Both Chinese and foreign media have warned of an impending wave of developer defaults this year.

In reality, the outlook is mixed. Smaller developers are more exposed to market swings than their larger rivals, and are facing ever-tighter liquidity conditions. A period of accelerated consolidation seems likely—though just what shape it takes will depends on how both developers and policymakers respond.

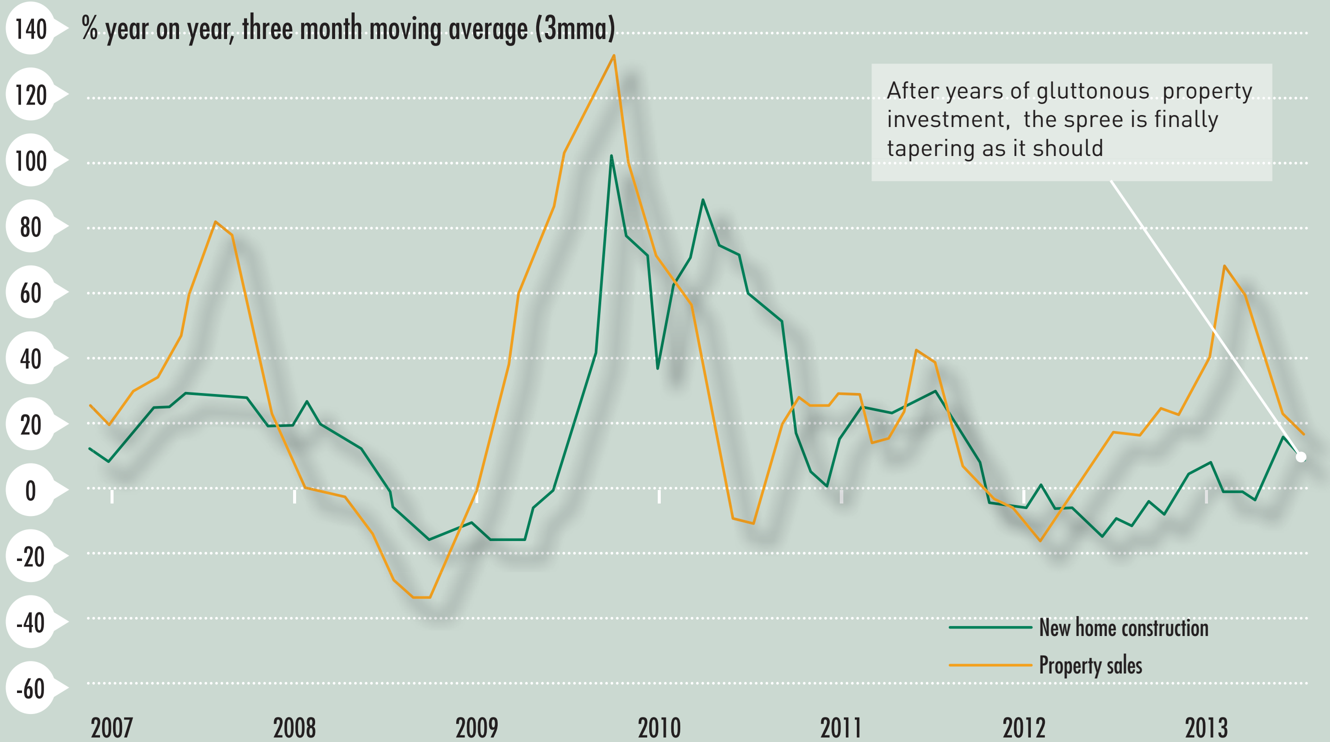
"You see the results of the Chinese developers listed in Hong Kong, and they tend to be doing pretty well. But at the same time, you've got smaller developers defaulting on bonds or cutting prices," says Sam Crispin, a longtime China property analyst based in Shanghai. "That suggests there's a real issue here."

Where'd the Buyers Go?

China has almost 90,000 registered developers, according to the latest data from the National Bureau of Statistics (NBS) released in 2012. But this year the National Australia Bank released a report in March putting the number of developers at approximately 60,000, and even among these the overwhelming majority are small companies. China's 10 biggest developers—including firms such as China Vanke, Dalian Wanda, Poly Real Estate, Greenland, and China Overseas Land and Investment—made up just 13.3% of total property sales last year and 8.4% of floor space sold, ac-

Binger's Remorse

Property sales and housing construction from 2007-2013



Source: SG Cross Asset Research/Economics cording to China Real Estate Information Corporation.

Smaller developers were at the heart of the homebuilding boom from 2008 to 2011, when Beijing and local governments launched a series of stimulus measures designed to combat the global economic slowdown. Since the boom began, home prices have regularly risen at double-digit rates, far outpacing GDP growth.

In an effort to restrain prices, the central government has implemented increasingly tough home-buying restrictions, especially in first-tier cities. These rules include higher down payment requirements, limits on the total number of home purchases, stiffer mortgage rates and so forth.

While these measures initially did not seem to have much impact, home price growth has cooled noticeably in recent months. Prices rose by 7.7% in March, down from 8.7% in February and 9.6% in January, according to the NBS. The volume of residential floor space sold fell by 5.7% in the first quarter, and the value of homes sold declined 7.7%.

"The question is: where have all the buyers gone?" says Crispin. "Because there's seemingly not as many buyers out there in some places as there used to be."

Touching the Peak

Developers have taken note of slowing demand: new construction fell by 25% in the first quarter, according to the NBS.

At least part of this downturn is structural. Home completions decreased by 0.5% last year, the first decline since 1995. The fall marks a turning point and suggests that "China has permanently passed the peak rate of annual completions," argued Rosealea Yao, a property analyst at Gave-Kal Dragonomics, in a note to investors.

So analysts are now focusing on overbuilding in lower-tier cities. Around 67% of residential construction was in smaller cities last year, according to Nomura.

"There's real concern about the sustainability of some of the lower-tier cities," says James Macdonald, Head of China Research at Savills. "There seems to be a short-term, and possibly a mid-term, disconnect between supply and demand."

> "These developers are much better than they were
>
> James Shepherd
> Head of Research, Greater China
> Cushman & Wakefield

According to NBS figures, prices in second- and third-tier cities have been growing much more slowly than in first-tier cities. But the problem may be even more acute because many smaller cities are not covered by official data.

By using proxies such as steel and cement consumption, Yao and her colleagues found that homebuilding in 218 prefecture-level cities grew much faster than larger cities, especially in the years after 2008. Moreover, they found that while urbanization drew around 12 million people per year to these smaller cities between 2000 and 2008, that figure has since slowed to around 4 million. Migrants are moving to first-tier cities instead, despite the overcrowding in those places.

The upshot is that homebuilding in lower-tier cities accelerated even as population growth slowed, suggesting potential overbuilding. This is cause for concern for small developers in particular, because many—such as Xingrun—concentrate on a single region or city.

They also face eye-watering financing rates. Small developers pay around 20% interest on bank loans, compared to 6-9% for big developers, according to Standard & Poor's. Shadow bank lending rates are about 15-20%. Even a modest price slowdown could push developers into default.

Moreover, tighter credit conditions are unlikely to ease soon. Franco Leung, a Hong Kong-based property analyst at Moody's, says he is seeing Chinese banks become much more selective. Many now have lists of "preferred" borrowers that include big developers.

"What it means is that the lending criteria to those [firms with] weaker credit will become more difficult," he says.

By contrast, large developers are generally well-placed to ride out a slowdown. They are more diversified than their smaller competitors, and are widely seen as more prudent when it comes to buying land and designing new developments. Furthermore, large developers have much better access to liquidity should a crunch arise this year, says Leung. They can tap Chinese bank loans, as well as capital markets both in China and abroad. Several also have large stocks of housing inventory scheduled to go on the market, which should further line their coffers.

Divided We Stand

In theory, the combination of robust large developers and struggling smaller players should lead to M&A deals and consolidation. But the picture is complicated because developers have been getting smarter in terms of their management and structure.

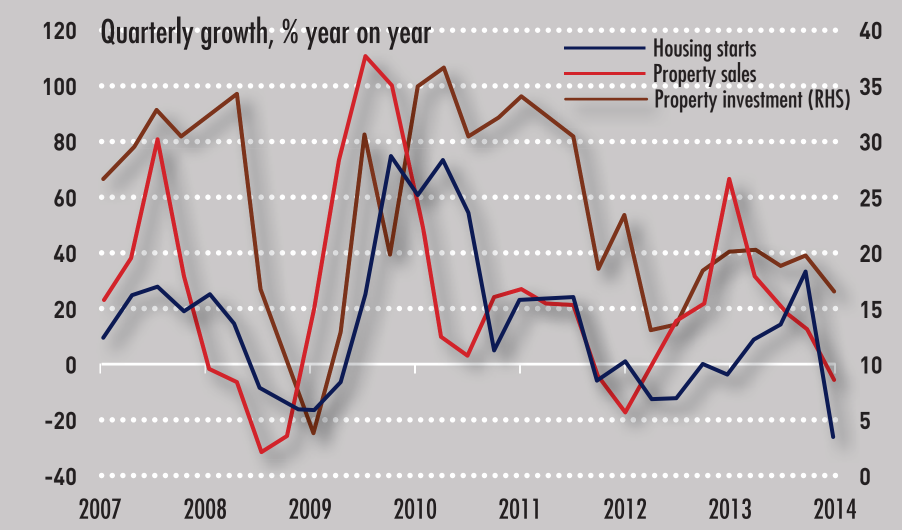
"I've noticed over the years a number of Chinese developers really evolving and starting to structure their businesses in a way that helps them deal with financial downturns or downturns in the real estate market," says James Shepherd, Head of Research for Greater China at Cushman and Wakefield. "These developers are much better than they ever were in the past."

He notes that developers used to own a number of project sites under one holding company, now many have restructured their businesses to create a development company for each piece of land they own.

This structure makes sense due to Chinese regulations designed to discourage "land banking", or the practice of developers snapping up available land, only to sit and wait for prices to appreciate before selling it to another buyer. Government rules thus require developers to start construction

Housing Market Condemned?

Alarmingly sharp deceleration in housing activities



Source: NBS, CEIC, SG Cross Asset Research/Economics

on their land holdings within a year, which stops them from "flipping" properties, making individual plots hard to sell.

However, by creating a subsidiary company for each piece of land, developers can skirt the rules by selling the firm owning the land, rather than the land itself. In theory, local governments could still intervene to curtail these transactions. But Shepherd says during tough times they tend to turn a blind eye to the practice.

This structure also solves another problem: reluctance of big developers to acquire smallers rival and assume all projects.

"In the past it was very difficult to sell a small- to medium-sized developer [with] different locations, because you'd be getting a mixed bag of sites," says Shepherd. "China's a huge place, and they have logistics infrastructure and a workforce ready to work only in certain locations."

For that reason, classic M&A deals are not likely going forward, says Shepherd. Consolidation will be silent and out of public view as big developers snap up individual projects from shrinking competitors.

Falling in Line

That type of consolidation is exactly what policymakers in Beijing are hoping to see, says Macdonald of Savills. A property industry with fewer players might be easier to regulate and optimize.

To that end, by allowing Xingrun to effectively default, officials sent a "shot across the bow of the real estate and financial markets," says Macdonald. "They said: 'Look, we will not backstop everything'."

Yet the government is not to be underestimated in the property industry's outlook, not least because local officials are loath to see slowdown and consolidation. Property construction provides a big source of employment, and land sales generate about 55% of revenues for local governments. Local officials are protecting their turfs by pushing against central government property restrictions where market have slowed.

"The central government isn't necessarily going to loosen restrictions on the property market, but some of the local authorities may," says Macdonald. He adds that many of the looser restrictions will be in lower-tier cities, where the disconnect between supply and demand is most severe and where prices have sagged.

Regulators in Beijing have so far not pushed back against local officials who are softening the rules, resulting in a de facto loosening of restrictions in certain cities. "It's not something that's been shouted from the top of the roofs in Beijing, but it's something that is being allowed at the moment," says Macdonald.

Yet the government's heft can be felt in other ways as well. In April, for instance, a leaked recording of remarks made by Mao Daqing, Vice Chairman of China Vanke, suggested that the government's anti-corruption campaign was seriously impacting property demand. (The company says the recording was taken out of context.)

Many developers are keeping an eye on the planned national property registration system in particular. The platform, which will allow authorities to track the home purchases of any individual and their family members, is due to be in place by 2018.

"It's a very powerful tool," says Crispin. In theory, it could allow watchdogs to sniff out when an official or wealthy individual owns a piece of property far more valuable than what their official salary could afford.

Yet similar systems are already in place, suggesting the announcement is more about signaling to property owners to clean up their act. "This must be a warning," says Crispin. "'You've got three or four years before this system is in place—so do something about it.'" Crispin thinks the effect will be softer prices in the market for the next three to five years.

If that scenario does play out, it is likely to accelerate the trend among developers to focus more on mass-market homes—small and mid-sized homes aimed at middle-class consumers. These projects are less profitable than the luxury condos, says Leung of Moody's. But developers have already been increasing their proportion because the luxury market is faltering.

In any case, developers will probably continue to focus on mass-market homes because Beijing wants them to, argues Crispin. If they wish to avoid Xingrun's fate, falling into line with government policy may prove equally important.

"I think there's a realization from developers that if they are aligned with government policy, then they will get more support from the state, including state-owned banks, land auctions, and so on," says Crispin. "And if they don't, then sorry, it's bye-bye."

Image Source: Rovio

Max Zhang has 16 games on her smartphone and usually plays 2-3 hours per night. The 26-year-old Shanghainese teaching assistant prefers casual games for their simplicity. "I don't want to use my head after a long work day," she says, adding that she regularly changes the games on her phone because they become passé quickly.

Zhang also plays exclusively on her mobile. "I've never played on a desktop computer," she says.

Millions of Chinese like Max are gaming exclusively on their phones as smartphone penetration rates soar and connectivity improves in the world's largest internet market. Lucrative opportunities abound for game developers, operators and distribution platforms, but so do risks

The numbers augur promise for investors. In 2013, China became the fastest growing mobile gaming market in the world, expanding at a 156% clip to reach $2.2 billion as it added 75.9 million new gamers,according to a report released in March at the China Mobile Gaming Conference in Beijing.

That explosive growth has heralded a flurry of mergers and acquisitions in China's mobile gaming sector, with market leader Tencent—China's largest internet company—spending billions of dollars as it shores up its position.

Tencent's shopping spree is just one indication that competition for China's fickle consumers is intensifying, with a game's lifecycle lasting just six months to a year. With more than 200 Android app stores, China's mobile gaming market is highly fragmented, complicating distribution, while rampant IP piracy remains a concern for Western game companies. Those able to overcome distribution and piracy travails still need a viable free-to-play business model to monetize, which by definition is difficult at best. Chinese consumers strongly favor games that are free to play and offer in-app purchases integral to the gaming experience.

While China already has 215 million mobile gamers, they comprise just over one-third of its 618 million netizens, leaving enough market share to inspire bold moves and vicious competition to make the next viral game.

Smartphones of the People

2013 saw smartphone shipments rise 86.3% year-on-year and 3G subscribers increase 78.8%, according to Nomura Research. Nomura predicts China's mobile games market will grow at an annual rate of 59% from 2014 to 2018, surpassing the PC client-based market, which is expected to reach $23.4 billion in 2018 according to a 2014 Niko Partners report.

Inexpensive Android phones are opening up access to a new gaming audience in lower-tier cities, says Ibrahim Dai, TalkingData's head of global business development. "The phones are cheap but device functionality is high, which means all the latest games work as well on a 1,000-yuan Xiaomi as [on] a Samsung Galaxy [which costs upwards of RMB 4,000]," he says. These mid-to-low end smartphones have brought mobile gaming to millions of users who otherwise would not have had it due to socioeconomic barriers, Dai adds.

Second and third-tier Chinese cities offer the greatest potential for mobile gaming, says Frank Yu, a veteran of China's gaming industry and CEO of the Gamify Your Life consultancy in Beijing. "They [residents of those cities] are in the middle of nowhere and bored," he says. "But they are always on their smartphones and games are the number 1 thing people download onto their mobile devices." A smart tip for developers, both domestic and foreign.

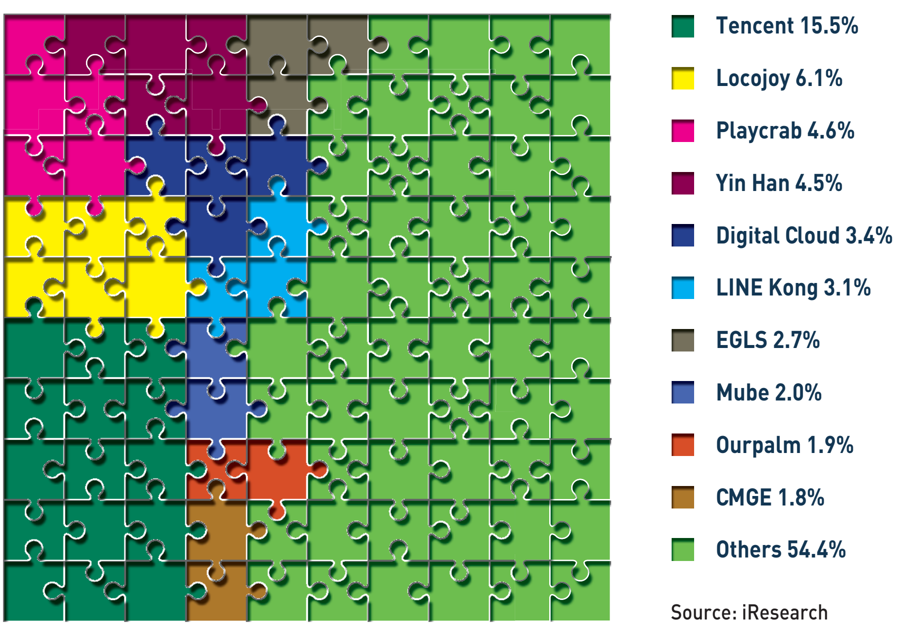
Beijing's Invisible Hand

Beijing has been ambivalent about foreign influence in its gaming market since the beginning. It banned console sales in 2000, claiming that playing video games could harm the mental health of Chinese youth. After gaming moved exclusively online in the wake of that ban, the Ministry of Culture set up a committee in 2004 to screen foreign online video games for objectionable content. In October 2013, Beijing lifted the console ban in Shanghai's Waigaoqiao Free Trade Zone, permitting foreign game companies to manufacture and sell games in China provided they establish a domestic operation in the zone. But that amnesty is expected to have little effect given the market's migration to mobile.

Competition in the early days of Chinese online gaming was so heated that de-

Playing to Win

Market share of mobile game developers by revenue in Q3 2013



Source: iResearch

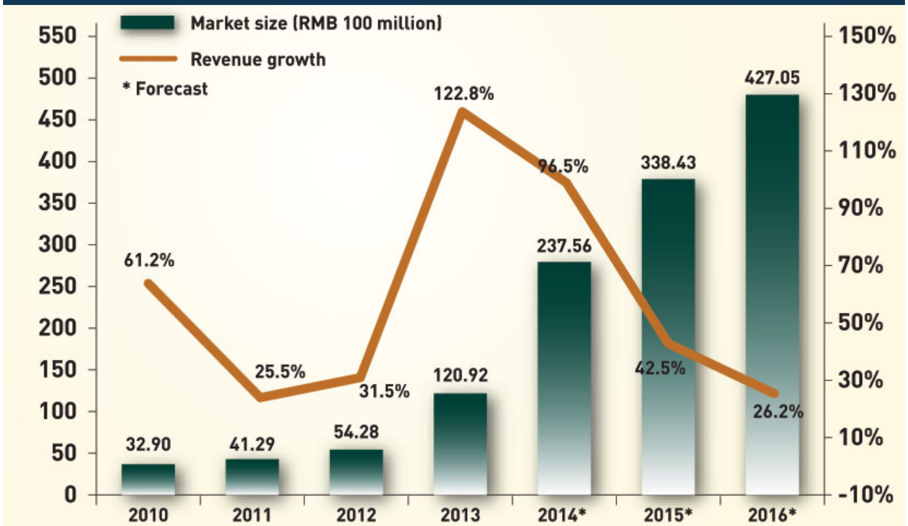
velopers adopted a free-to-play model, in which they earned revenue from value-added services like the sale of virtual items instead of selling the games themselves, says Dai of TalkingData. With a low barrier to entry, freemium monetized well, says Yu. “Players end up paying more for all those little in-app purchases than buying a game outright, but they have no choice if they want to keep playing.” An early freemium successes in China was US-based Blizzard Entertainment’s *World of Warcraft*, a multi-player online role-playing game.

Beijing again intervened in the gaming market after Google pulled out of China in 2010 by stunting the domestic functionality of the Google Play app store. It is nearly impossible to install the Google Play store or any Google Services on China-based mobile phones, because their operating systems have been programmed to prevent it, says Chris Mills, President of Hitcents, a technology consultancy.

With Google sidelined, hundreds of local app stores stepped in to fill the void, presenting a major challenge for foreign game developers accustomed to Google Play and Amazon in the Android app market, says Maxim De Wit, who directs the international division of the Global Mobile Game Confederation (GMGC) in Beijing. “Distribution is essential to the success of a good game. You need to make sure app stores are pushing your game, pushing downloads.”

The Games Just Get Better

Projected revenues of China’s mobile games market (2010-2016)



Source: Enfodesk

China Mobile Gaming 101

Chinese player preferences, which differ considerably from their Western counterparts, are a good place to start. “Chinese players’ interest curve is not gradual,” says Eric Tan, the China Country Manager of the French game developer Gameloft. “In the first 10 seconds, you need to draw them in.” In the case of its most successful game in China, *Despicable Me*, Gameloft made it easier than in the West, providing a tutorial for how to defeat the Level 1 adversary or “boss”, he adds.

Hardcore Chinese gamers, whose in-app purchases drive revenue for game developers in China, prefer action role-playing games (RPG) with fantasy elements and a Chinese cultural theme. RPGs monetize well because the games are designed to make in-app purchases urgent, for instance a player cannot advance to the next level of a game without buying a certain weapon. The RPGs *I Am MT Online, Clash of Clans, Da Zhang Men* and *Dragonbane* were among China’s best-selling mobile games in 2013, according to AppAnnie.

In-app purchases allow Chinese gamers to show off their virtual high-end equipment, said Xiao Jian, the CEO of China Mobile Game Corporation, in an April speech to employees published in a press release. Xiao couched such purchases in the context of Chinese aspirations for status, just like driving a luxury car, or wearing a high end watch.

Advertising is less important as a source of revenue than virtual items. “It’s a very small piece of our revenue pie,” Tan says, adding that players are loath to multitask when they are absorbed in a game, especially since mobile screens are smaller than computer monitors. Max Zhang, the Shanghainese gamer, says she ignores the “annoying” ads that appear while she is playing

Meanwhile, working with a Chinese game publisher, which selects local distribution channels for foreign partners, can make distribution smoother, says Yu. “A publisher can give you more market share, but they may have their own agenda, to make their channels happy at the expense of the game developer.” That may involve distributing games in app stores where publishers have close relationships rather than those that are best for attracting a game’s target user, he adds.

Rovio, maker of the *Angry Birds* mobile game, ran into trouble with its publisher when they cloned the game without permission and began selling it in Chinese app stores—a common problem foreign developers encounter. Eventually, Rovio enlisted the mediating services of the GMGC to persuade its publisher to remove unlicensed versions of the game from app stores.

It is also in the interest of app stores to have original versions of a game. Pirates don’t have access to the source code, so a pirated version is usually missing parts of the game that need to be purchased, says De Wit.

Even so, for Rovio, piracy was not all bad. CEO Peter Vesterbacka has spoken publicly on a number of occasions of how piracy helped *Angry Birds* branding by making it a household name among Chinese consumers.

Lackluster innovation from Chinese game developers gives foreign developers an edge, says Yu of Gamify Your Life. "Many Chinese games are a copy of a copy of a copy," he says. "Chinese gamers know *shanzhai* [a Chinese colloquial term that means 'fake'] when they see it."

Yet, despite the advantages foreign game developers have in the China gaming market, none of them have been as successful as Shenzhen-based Tencent, China's largest publicly-traded internet company with a market capitalization of $139 billion and ranked fourth globally in the sector after Google, Amazon, and Facebook.

Distribution Control

Tencent has emerged as the dominant player in the mobile gaming market on the back of a powerful ecosystem that includes a large online-games business and the popular QQ and WeChat messaging apps that act as distribution channels for its games. So far, it has released 12 mobile games through those channels, six of which have more than 10 million users.

In the mobile gaming market, "market power belongs to companies that control the distribution channels—and Tencent controls them," says Zhang Kaifu, an assistant professor of marketing at the Cheung Kong Graduate School of Business. "Distribution is more important than quality." Zhang further explains that Tencent has used its might to rig distribution such that many smartphone makers pre-install their games on their phones.

To monetize its user base, Tencent targets China's huge "casual gamer" segment rather than high-spending, "hardcore" RPG gamers, Zhang says. That strategy is working. Together, QQ and WeChat generated gaming sales of RMB 600 million in the three quarters leading up to December 31, 2013. The fifth top-grossing game in 2013 in China app stores—and the only non RPG—was a casual action game made by Tencent called *TianTian Ku Pao*, which means *Cool Running Every Day*. Overall, total online and mobile games revenue increased 34% last year from 2012, reaching a record RMB 31.97 billion.

At the same time, Tencent's acquisitions include a 2012, purchase of a majority stake in US online games developer Riot Games—maker of *League of Legends*, one of the most played games in the world—for nearly $400 million. It followed this with an investment in US game and technology developer Epic Games, taking a 40% stake for $330 million. More recently, in March, Tencent spent $500 million for a 28% stake in CJ Games Corp, the biggest game publisher in Korea by downloads and revenue, according to AppAnnie.

Shopping Spree

M&A activity surged in China's mobile gaming industry in 2013, with investors lured by gaming's proven monetization capacity and high net margins, typically 20-40% according to the *Asian Venture Capital Journal*. From January to October 2013, nearly 57% of the 22 acquisitions valued at RMB 16.89 billion made by China A share companies were related to mobile gaming, according to iResearch, a Beijing-based technology consultancy.

The M&A surge has accelerated in 2014. Xiaomi Ventures invested $20 million in Westhouse, a mobile gaming business, in February, taking a 4.7% stake. In April, Shenzhen-based ZQGame said in a statement it plans to acquire assets of three internet content and online game providers for RMB 1.75 billion ($281.69 million).

Meanwhile, Alibaba is reportedly planning to launch its own mobile gaming product to keep up with arch rival Tencent as it did last year in the social media sector by taking a stake in SinaWeibo.

With competition so fierce at home, more Chinese firms are expanding into foreign mobile gaming markets. Online games developed by Chinese firms generated revenue of $1.82 billion overseas in 2013, up 219.3% from 2012, according to a recent report issued by the Publishers Association of China, with most of the growth attributed to mobile games.

Waves of the Future

Asia is the largest market for Chinese games. In Taiwan, at least five out of the 10 most popular mobile games are from mainland China. Chinese RPGs are also popular in South Korea and dominate the mobile gaming market in Vietnam. "Chinese cultural storylines can be more easily exported to East and Southeast Asia," says Yu of Gamify Your Life, adding that in Southeast Asia's emerging markets, the freemium model works as well as in China. But Chinese developers still need to heed some important differences in gamer habits, such as a preference for games with a slower click rate, said China Mobile Games and Entertainment CEO Xiao Jian in a speech to employees last month.

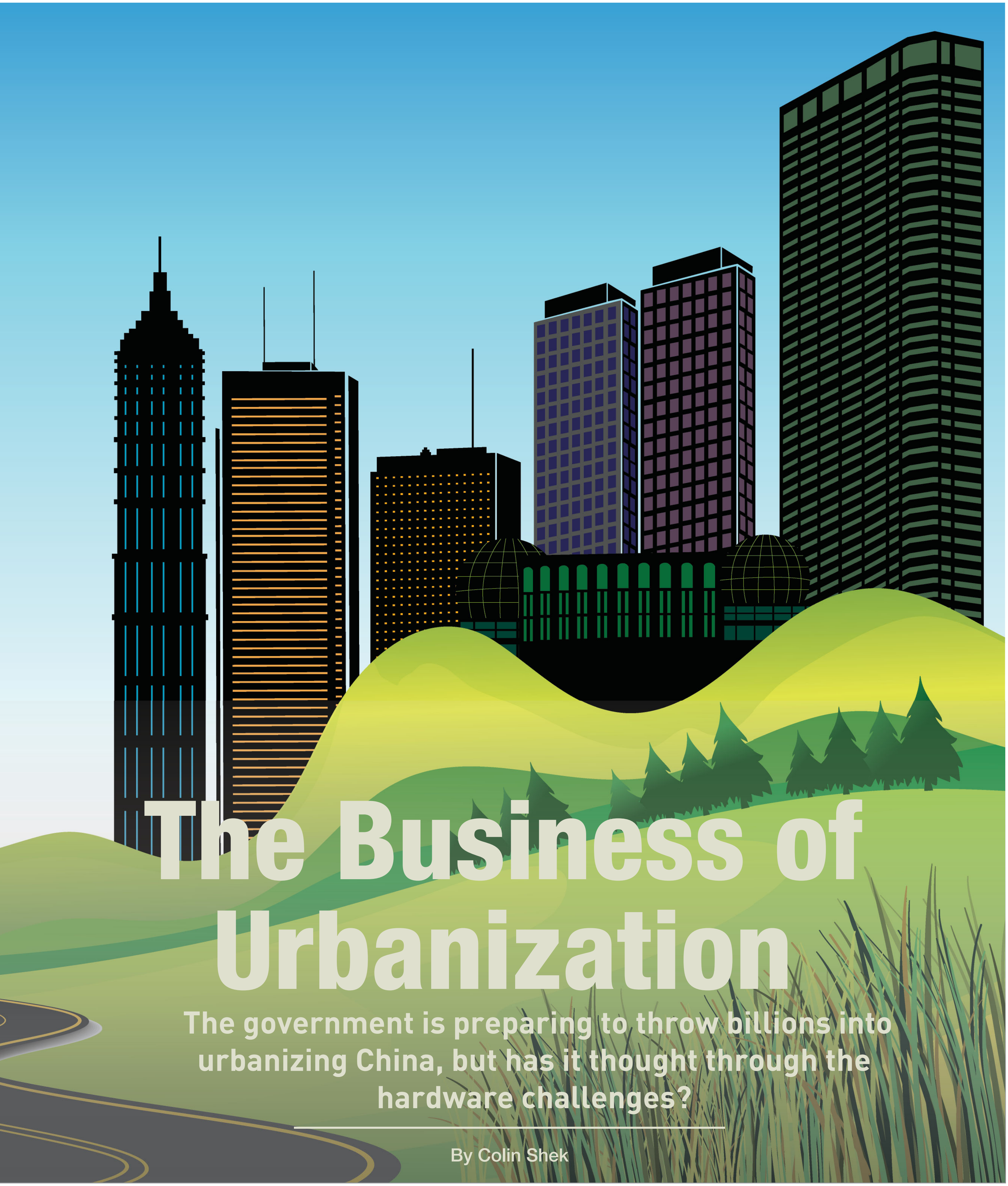
The US and European markets pose a greater challenge. They are attractive to Chinese developers because they boast a high payment ratio and loyal gamers. Yet the quality of most Chinese games is not up to market standards in the West, says Yu.

"They are very good at telling Western developers to localize, but they struggle to localize [in Western markets] themselves," says Tan of Gameloft.

In China, even as gaming companies remain an investor favorite, it may be too early to say they are consolidating. "It was like this a few years ago in the US, but when Zynga [a social gaming company whose stock lost 75% of its value in 2012 after a 2011 IPO] crashed, that killed investor enthusiasm in the sector," De Wit says.

The one aspect of China's mobile gaming market that seems certain is Tencent's control of it. None of the Shenzhen-based internet giant's rivals combines its depth in online gaming, superior distribution channels, huge user base and vast capital. In Tan's view, Tencent will harness those resources to promote its own games and those for which it negotiates exclusive distribution rights in China, gaining ever greater market share. For that reason, Tencent is partnering with the UK's King Digital Entertainment to release a Chinese version of the hit game *Candy Crush Saga* in China this year. *Candy Crush* was 2013's most downloaded free mobile game app.

"Tencent may end up with a market monopoly," Tan says. For that very reason, all developers, foreign and domestic, best root for Tencent's success. Tencent is driving mobile game popularity in China more forcefully than any other competitor, so for now, the market continues to grow in some part because Tencent commands it.



The Business of Urbanization

The government is preparing to throw billions into urbanizing China, but has it thought through the hardware challenges?

By Colin Shek

Perhaps the most striking way to take in China's startling urbanization is to sit in front of a computer and click through to Google's Earth Engine.

A search for Shanghai on the website brings up time-lapsed images of the city from orbit. In 1984, when the series began, Shanghai was a grey smudge in the middle of verdant countryside alongside a brown streak—the Yangtze River.

Press play and that smudge spreads like an ink stain, with downtown Shanghai becoming darker and the etched lines of Pudong International Airport easily visible. By 2012, the grey patchwork has sprawled out in every direction to leave just fragments of greenery. By 2015, Shanghai will reportedly host the second-tallest building in the world, with construction of the steel titan continuing at a feverish pace in the city's financial district.

Shanghai's mushrooming growth is part of the largest urbanization story in human history. The process is transforming China, and in some ways, has only just begun. By 2030, China's cities will be home to roughly one billion people—three times the current population of the US.

When China began its reform and opening processes in the late 1970s, the country was an overwhelmingly rural one. Back then, with more than 80% living in the countryside, it was the backwaters that supplied most of China's leaders, who sprung from peasant backgrounds.

Since then China has been transformed. From the 1970s up until the end of 2011, when half of China's population lived in cities, around 500 million people have added to China's urban population in the last three years—and the process continues to happen at a terrific rate.

Beijing regards urbanization as the next step in sustaining China's economic miracle. The push from farm to city will serve as the biggest lever for the country's economic growth, helping to modernize and transform the country from an investment-driven economy to one that is consumer-driven, according to top government leaders and independent economists.

China's urbanization drive to date has wrought severe social and environmental problems though, and a new approach is needed. Industries that are key to the process, such as construction, have thus far tooled themselves to deliver quantity over quality, raising the question: Can China actually build the 'new China'?

The Master Plan

Answering this fundamental question in the affirmative, Beijing mapped out the next phase of that shift from countryside to city in March of this year. China's long-awaited urbanization plan running from this year through to 2020 is not lacking in ambition or superlatives. The eye-catching headline is that the government aims to raise the rate of urbanization in the world's most populated country by roughly a percentage point every year, from 52.5% at present to approximately 60% inside seven years.

The bolder portion of the plan will confer former rural residents who are currently living in cities the same benefits and rights that urban dwellers enjoy.

By granting urban residency permits, which are China's internal passports and better known as *hukou*. This move could transform the lives of up to 160 million migrants, as it will enable them to access basic services and social welfare. In doing so, authorities anticipate the *hukou* urbanization rate will surge from just over 35% in 2012 to 45% in 2020—a faster increase than the previous decade. To cater to this huge influx of up to 260 million people, planning officials have envisaged 21 mega regions nationwide to harbor the urban population.

The previous phases of the urban operating model had emphasized the 'hardware' of city building—roads, railways, airports, and so on. This approach led local officials to fixate on the size of the city—as this sets the boundaries on urban versus rural population—without thoughtful consideration and planning to ensure effective land usage. Senior officials discussing urbanization in the past typically took it as carte blanche for "another round of infrastructure spending, more steel, more cement, more building, more money, and more investment", says Qinwei Wang, Chief China Economist for Capital Economics in London.

That fixation came at the expense of 'soft' infrastructure—services to assist the urbanizing population, such as schools and hospitals. That is set to change under the plan. Planning authorities this time have vowed to focus on the people populating those urban areas for the next phase, otherwise known as 'a new type of urbanization'.

"What is new urbanization? How does it differ to China's last periods of urbanization where they brought 500 million citizens from countryside to cities? I think that had been an era of focus on hardware—transport infrastructure, getting roads, buildings, bridges, and so on—correctly invested into, and now it shifts toward… how to put more livability around China's urbanization," says David Frey, Partner at KPMG's Global China Practice and country head of the consultancy's Cities Global Center of Excellence.

"China would fail in its urbanization if it simply displaced people from rural to urban," says Frey. Recognizing such, Beijing intends to build more extensive urban public transport systems—especially in large cities—and a national rail and road network to connect smaller cities and townships. It also aims to increase water and waste treatment ratios—particularly outside of large cities—while expanding broadband internet coverage, increasing the use of cleaner-burning natural gas in place of dirty coal in cities, and more district heating in the north to replace household coal-fired boilers.

A 'people-centric' urbanization also means theoretically greater spending on social welfare, hopefully to boost consumption of services.

Bottom-up + Top-down

The plan sticks with China's model of top-down oversight that encouraged bottom-up migration. Migrants moved of their own accord, seeking a better life in cities that were in desperate need of workers as they modernized, similar to how urbanization proceeded elsewhere. There had been a huge impediment to the flow of people from the countryside into cities due to the restrictive *hukou* system, and until Deng Xiaoping came onto the scene, there were tight restrictions on labor mobility.

At the same time, the role of the state

runs deep in urbanization, in contrast with how the process has been largely organic elsewhere. The country's rapid phase of urbanization, especially in the last 20 years, has been driven by strong government initiative at the central and local levels. "In other places, urbanization just happens," says Frey. "It's an economic phenomenon that is a result, not a plan." City governments welcomed the influx of workers, as they had decided the maintenance of economic growth in their administrations hinged on rapid urbanization—in other words, a building binge on infrastructure.

China's command over the urbanization process stands in stark comparison with the efforts of the world's second-largest emerging economy. As recently as 1987, India was more urban than China—as a quarter of the population lived in cities, compared with China's 24% according to data from the World Bank. But China's pace of urbanization overtook India's toward the end of the 1990s and raced ahead. More than half of Chinese citizens were urbanized in 2012, compared with less than a third in India. Experts with McKinsey have attributed the overtaking to Beijing's carefully shaped approach to urban transformation, while New Delhi has been less hands-on.

"If you were to check with urban planners in any economy today, they would tell you that, in fact, the best urbanization—the most optimized urbanization—actually does occur with more planning," says Frey. Planning that involves much weighing of what to mimic and what not to mimic in other nations' urbanization models.

"In China, when it's foreign expertise they need the most, they're not afraid to rush up and get in," says Kent Zaitlik, Business Development Director of sustainable sourcing and solutions company BEE in Shanghai. "That's at the helm of what makes China so great, that they're able to incorporate various learnings from around the world, and then incorporate those insights and techniques into whatever strategy they want to achieve."

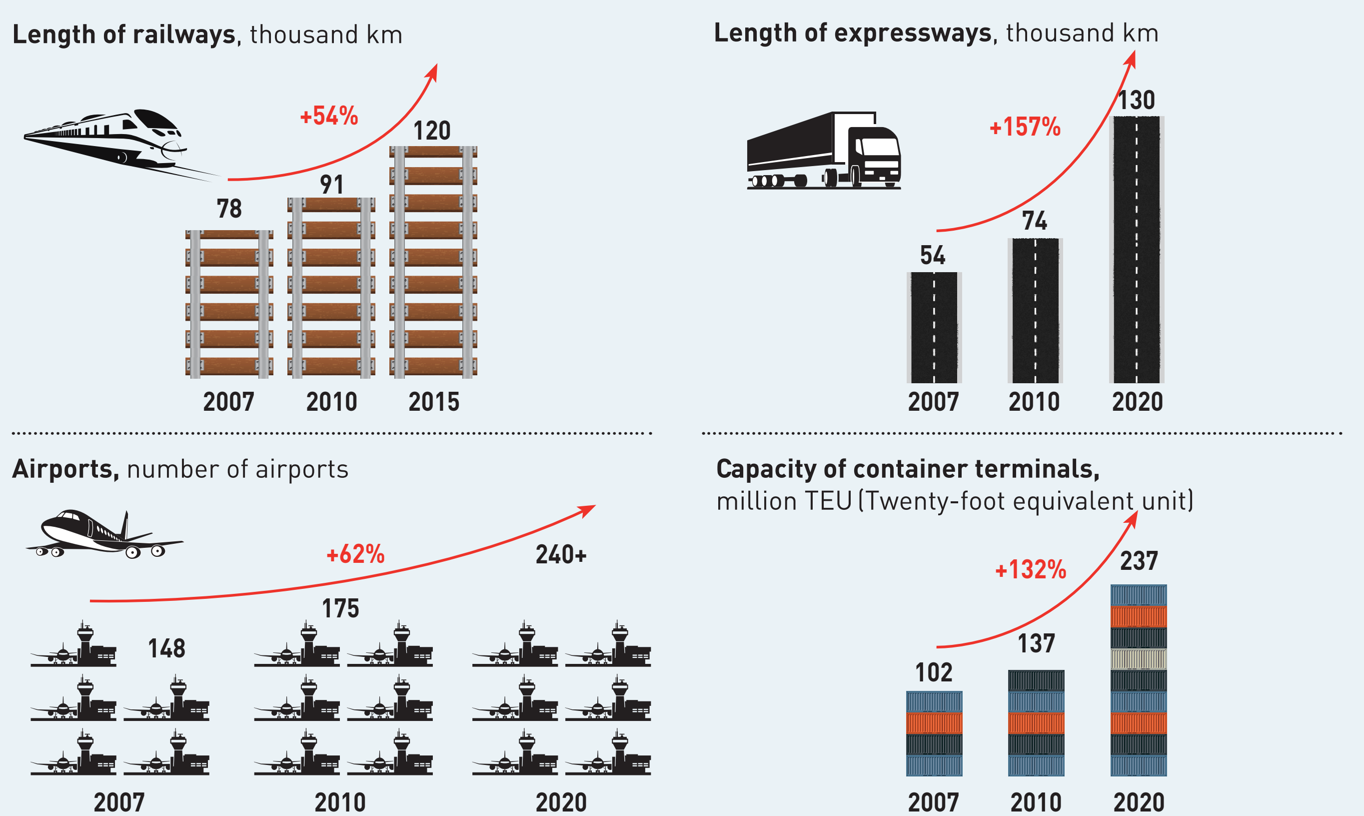
The top-down approach has arguably been vindicated in the relative absence of illegal slums and informal settlements in urban China, unlike other countries that have recently undergone some form of urbanization, such as India, Brazil and Mexico.

"China does not want the type of urbanization like in Latin America, where people moved to urban areas with no jobs and became unemployed and a burden to society," says Wang from Capital Economics.

Although China's urbanization has been impressive, it has impressed because of the unprecedented geographical scale

Building China

China plans to invest aggressively across key infrastructure sectors to support and stimulate future growth



Source: McKinsey

on which it is occurring. Not everything has gone according to plan and evidence of China's unbalanced urbanization has manifested in other ways. "The flaws in the previous model, in which urban construction mostly relied on land sales and fiscal revenue, have emerged in recent years, and the model is unsustainable," warned Finance Vice Minister Wang Bao'an on the unveiling of the new plan in mid-March.

Spatial urbanization has happened at a much faster pace than the rate of urban population growth—which since the late 1970s has been slower than other countries—encouraged by local governments that seized rural land and sold it to developers to build residential properties, office buildings and industrial parks. Consequently increase in urban land under construction expanded quicker than urban growth, at around 90% versus 52% from 1990-2000, and 83% over 45% in the next decade, according to data from the Ministry of Housing and Rural Development (MOHURD). Between 2000 and 2010, the ratio of urbanization of land to urbanization of population was 1.85, far above the international standard of 1.12 and leading to urban sprawl and the phenomenon of ghost towns.

Building a New China

China's new style of urbanization envisages half of the new buildings put up by the year 2020 to be 'green', compared with just 2% in 2012. It also takes aim at the hot-button issue of chronic smog hanging over Chinese cities, calling for more than 60% of cities to have air quality that meets national standards (particulate matter 2.5 rating between 35 and 75 depending on the location) by 2020, whereas environmental official announced in March that only three of 74 surveyed cities that met with national standards.

The sweeping scale of that mandate evokes skepticism regarding China's technical capacity to actually carry it out.

"My main concern is with their engineering capacity, with being able to implement some of the things they want to implement," says Zaitlik from BEE. "I don't think they really have a firm grasp of some of the engineering feats that need to be taken into account to incorporate some of the green technologies they want to use."

For instance, Zaitlik pointed to heating, ventilation and air-conditioning (HVAC) design as a particular challenge. "Design of a HVAC system is what's most important" to green building development, says Zaitlik, as it determines energy efficiency, indoor air quality and comfort. The multinational firms that BEE works with typically have the skill set to design sophisticated HVAC systems, but for Chinese firms, "it's a different story because their engineering team probably does not have the capability to incorporate some of those technologies from abroad," he says. "That is a different kind of thinking that China will almost need a crash course in. That's what's difficult."

Frey from KPMG concurs. "That's not something you just flip a switch on," he says. What Frey expects to happen is progressive and talented individuals seizing the initiative in certain cities, with their efforts eventually gaining traction and then replicated across the country over time.

He also points out that developed economies, in their own transformational programs, have also struggled with fostering green development. "No country, no area, no region really has a lock on what that path is, [but] what China has shown is that when it sets its mind to something, it's pretty good at figuring out how to execute."

But the industry is plagued with short-termism and is beholden to maximizing profits and lowering building costs—with little consideration for the building's lifecycle, the environment or the health of the occupants. "They've been building like this for years and it's all about having results, about who brings up the building [the quickest] wins," says Zaitlik.

He adds that one of the key reasons why the entire lifecycle of a building is not given proper attention in China is because developers run the show.

"Developers don't really care about the whole life of the building. They just want to get in and get out, as soon as possible. There're no rules or regulations, or incentives for them really to actually try to go forth and make sure that this building is energy efficient."

Part of the solution may lie in China's green building certification, the Green Building Design Label, also known as Three Star. Pushed out by the Ministry of Construction in 2006, it is similar but newer than its Western counterpart Leadership in Energy and Environmental Design (LEED) and consists of a set of evaluation standards for rating green building sustainability. MOHURD doles out financial subsidies under the scheme on a-per square meter basis, with up to RMB 250 available. Zaitlik says that if adhered to it could grow green constructions quickly, but clearly defining green is crucial.

"If they don't really... solidify what the meaning of green is, and also have a rigorous process in place to actually show the efficacy of what they're developing, then it will be a lot of lost money and not much to gain further down the road."

Frey argues that developers will ultimately have to act out of sheer necessity, noting some developers are already awarded projects based on their ability to differentiate with a set of eco-standards.

Some of China's largest developers are already well down this path, snapping up eco-conscious expertise and knowhow as they look toward the future, according to Frey. Smaller developers are also getting involved by tapping consultancies and institutions like the China Greentech Initiative—a collaboration of greentech firms, government agencies and non-profit organizations that promote greentech solutions.

The Environmental Brink

In addition to the negative environmental impact of urbanization, social problems in addition are nothing to sneer at. The majority of urban population additions have contributed little to increased spending and consumption growth. Migrants will typically save their money to compensate for the lack of access to social benefits, rendering them not much better off than when living in the countryside in some cases.

From these complications arise vexing questions: is urbanization really the answer or are there alternative options for elevating the quality of life for rural populations? Views are split.

"Most certainly," says Rena Singer from the Seattle-based Landesa Rural Development Institute, when asked if an economy can be considered 'developed' and 'rural'. "Developed refers to standard of living, not place of living," she says.

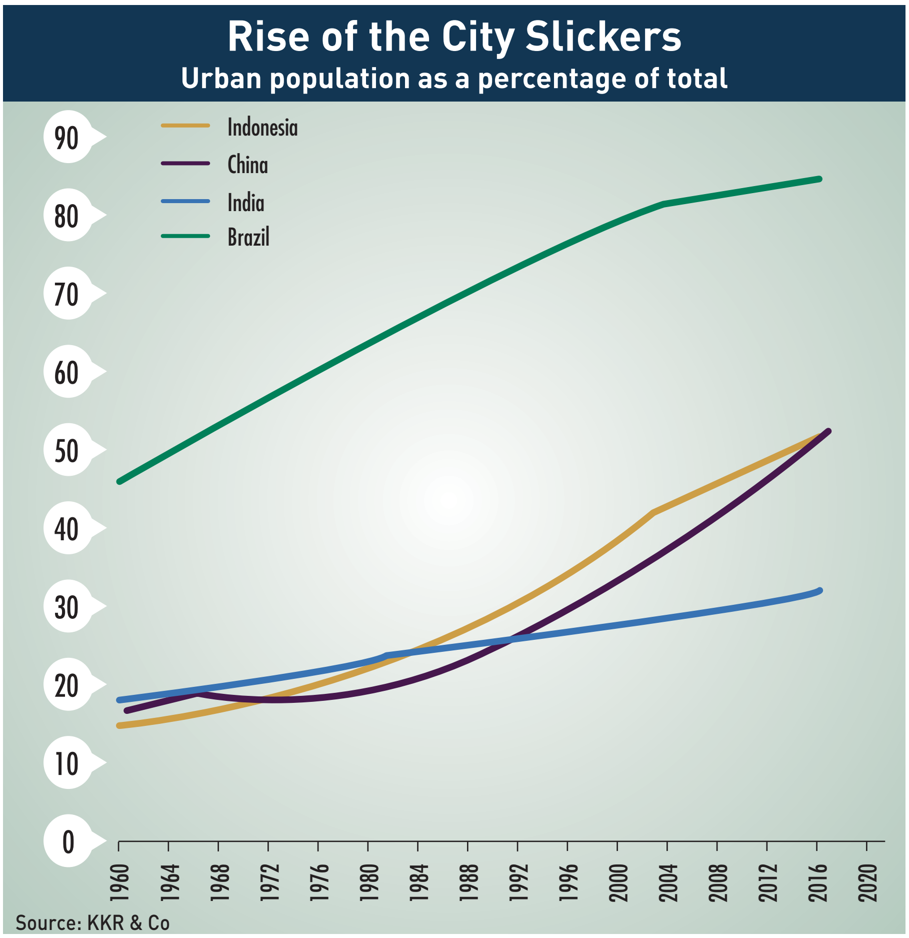
Conversely, Frey says a high rural population would indicate underlying problems with agricultural development. Wang concurs, surmising that if the countryside is working as it should, that will simply free people up to move to cities.

"[China's] productivity is relatively low when you consider many people are still in rural areas," says Wang from Capital Economics. "There's still a lot of room for China to improve in the agriculture sector, which means China does not need so many people to stay in rural zones to work in the agriculture industry."

The new plan looks to address agricultural productivity through a number of measures, such as mechanization and the transfer of land user rights from small farmers to specialized farms, rural cooperatives, and agricultural firms—leading to larger farm plots that are more efficient. Wang says a common scenario in the future might be one farmer on a combined larger plot of farmland making a better living and employing workers—versus 10 farmers each farming less than half an acre of land and living in poverty—with the other nine farmers 'sufficiently' compensated.

Intensive farming has already taken shape in pig farming. The Jiahua Pig Breeding Farm in Zhejiang province can produce 100,000 animals every year. "In the future, there will be more of these kinds of big farms. It will be more modern and better managed," says Wang.

Whether 'rural' can be equated with developed or not, China's government is decidedly uninterested in the question. For China, it's cities all that way, but as Frey notes: "that can only happen if agriculture productivity is rising."



Not One Drop...

China is already a water-stressed nation, a problem that expanding urbanization will presumably exacerbate.

A study by China's Ministry of Water Resources found that approximately 55% of China's 50,000 rivers that existed in the 1990s have disappeared. Furthermore, the State Forestry Administration released figures this year indicating that China had lost 340,000 square kilometers of wetlands, that's roughly the size of the Netherlands.

Unfortunately China has only just started to address its water problems, implementing progressive pricing on water in larger cities, which won't derail massive water shortages by a long shot.

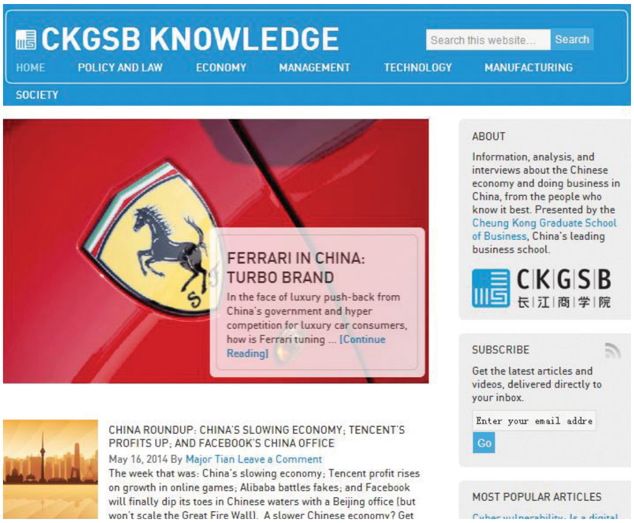
The key to avoiding that, Wang says, will be smoothing out the migratory patterns. Urbanization has typically favored the wealthier provinces on the eastern seaboard and southern coast, which has in turn increased resource pressures in those parts.

"In the plan, it looks like the government has realized this problem and they want to develop the smaller second- or third-tier cities in broader areas, not only in the coastal areas but in central or west of China, so that will ease tension a little bit."

In a break with the past, the future pattern of urbanization will likely be slow and measured. "I think China will make a lot of mistakes [but] I also think it will also get a lot of things right," says Frey.

From a more grassroots perspective, there is a raft of exciting new 'smart city' technologies—the Internet of Things, smart grids and meters, and even driverless cars—that are coming to bear, lending a technological element that has largely been absent from China's urbanization story.

Shanghai's iconic Bund skyline was deemed a space-age pipe dream when it was first conceived, and is now arguably the symbol of New China. So while many aspects of the new urbanization plan seem overly lofty, China may prove again that it does what it sets out to do, by any means necessary.



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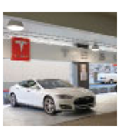

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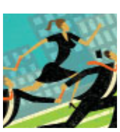

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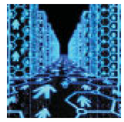

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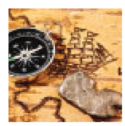

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Wealth Management For Sale!

The government is slowly catching up with the inherent risk of wealth management products, can banks continue to invent new skirting methods?

By Don Weinland

Bank deposits are boring, says Jane, a new recruit at a local bank in Shanghai. In a country where the government holds deposit rates artificially low, sometimes dipping below inflation, people are eager to shed the title 'depositor' for a more aggressive appellation—say, 'investor'. Bankers are just as weary, if not anxious.

Since 2009, China's biggest commercial banks have pieced together a universe of high-yielding investment options, known as wealth management products or WMPs. Compared to a bank deposit that might yield a paltry 0.8% after accounting for inflation, an annualized 5% or higher return from WMPs is attractive. As the country slowly liberalizes the interest rate on deposits, the banks are faced with mounting pressure to maintain high rates of profitability. That's already proving difficult with the advent of internet banking, which dodges central rules to compete for depositors' cash. Margins will begin to slip when the big banks have to start competing on interest rates. In the face of these challenges, WMPs are helping the banks make more money with their money.

And depositors have hungrily swallowed the products up, often emptying their deposit accounts to meet the products' minimum required investment. "Everyone these days buys some kind of wealth product. It's basic now," says Jane, who has asked to go by a pseudonym because she isn't authorized to speak with the press.

Not everyone is as excited with the burgeoning WMP market, however. China's financial regulators, particularly the banking regulator, have been uneasy about the rapid rise of these markedly opaque investment products. WMPs mature quickly, often too fast to produce the promised rate of return, some analysts fear. Not only do the investors not know the ultimate destination of their money—perhaps a risky real estate venture or a coal mine in need of debt refinancing—many also consider WMPs guaranteed by the banks in the same way as deposits. Most aren't.

Regulators have been chipping away at the wealth management market since 2010, but the past year has witnessed a determined attempt to rein in exponential growth, fearing the products pose a systemic risk to China's financial system.

Still, industry insiders say banks continue to ramp up WMP sales. "There isn't such a noticeable effect [from the regulations] so far," Jane says. "It seems like the number of people who sell WMPs is growing here."

Out of Sight

Confusion abounds on the definition of China's version of wealth management, and, for that matter, on that of its shadow banking sector.

When banks around the world take money from depositors, those deposits go onto bank's balance sheets. The deposits, guaranteed by the bank, earn interest (often at low rates) and the funds are lent out to a wide spectrum of borrowers.

But banks also take in funds that don't go onto the balance sheets. This is the starting point for shadow banking and the WMP market. These funds aren't called deposits, aren't always guaranteed by banks but often earn far higher interest than deposits depending on what banks do with them. Perhaps, most importantly for China's banking system, these funds aren't detailed in official credit data, making them seem at times invisible.

In 2011, China's central bank, the People's Bank of China, began issuing a monthly data report called total social financing, or TSF. The metric is the widest count of credit data available for China's financial universe and includes a gauge on 'non-financial lending', giving economists at least some sense of what goes on off the bank's balance sheets.

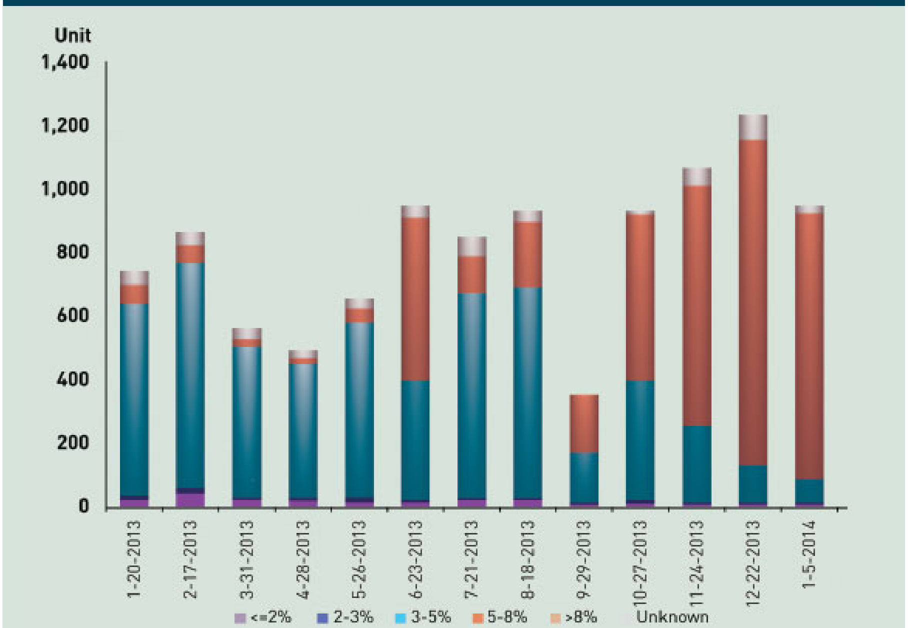
The non-financial lending at banks has come to be known as shadow banking but, as Standard Chartered Bank noted in a report earlier this year, it's better understood as the "shadow activity" of a bank. Shadow banks in their truest sense exist yet the term denotes unregulated lending houses so deep in the umbra that no official data captures their activity.

Mountain of What?

In truth, wealth management at banks can be a healthy form of financial innovation in developed markets, while also providing credit to needy borrowers willing to pay

WMP Smorgasbord

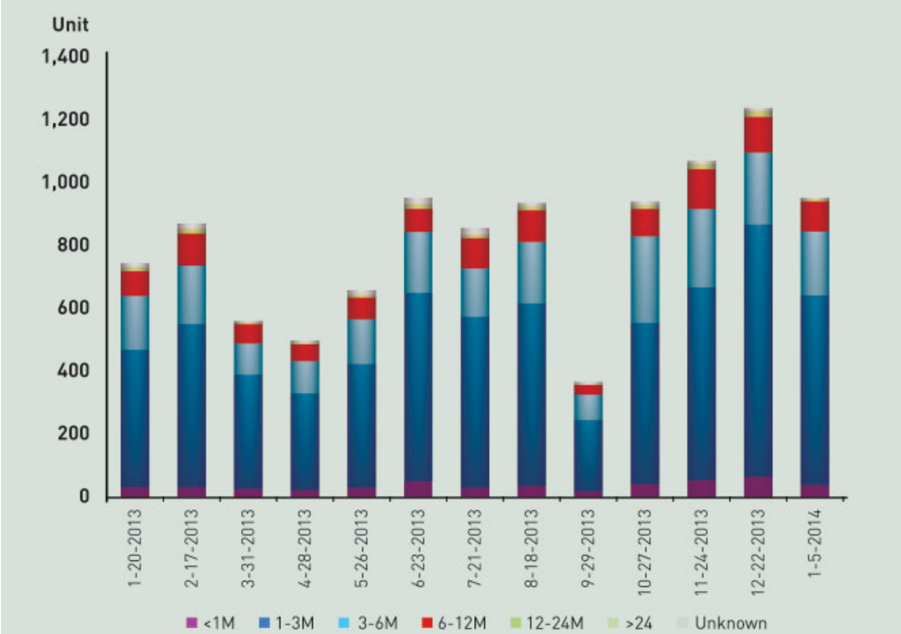
Number of WMPs issued by expected returns in 2013 (monthly)



Source: Wind, Bank of America Merrill Lynch Global Research

Fast Food Wealth

The number of WMPs issued by durations in 2013 (monthly)



Source: Wind, Bank of America Merrill Lynch Global Research

higher interest rates. The alarm stems primarily from the exponential growth of this quasi-regulated environment, coupled with a heightened sense of risk in the market. Experts such as Andrew Collier, Chief Executive at Hong Kong-based Orient Capital Research, have pointed out the deep linkages that WMPs, trusts and shadow banking in general have with other markets, like land, exposing the country to a high rate of risk.

Banks took advantage of the loosened monetary policy following the 2008 financial crisis to begin promoting WMPs as a way for depositors to get around the centrally imposed, and artificially low, interest rate on deposits.

The deposit rate is set at an annual 3.3% but inflation often reduces the rate to around zero or even a real annual loss in savings. On the other hand, bank-issued WMPs offer between 5-7% annualized return. Trust products yield an average of 9-11% annually.

Statistics from the central bank show that the threshold investment for a WMP is usually around RMB 50,000, opening the market to many middle-class Chinese from the mainland's developed eastern provinces. At between RMB 500,000-RMB 1 million, trust companies have marketed their products to a wealthier group of individuals. Both have sold quickly.

TSF data shows that shadow lending at China's banks has expanded six-fold since 2008 to about RMB 10 trillion in assets under management, according to research firm GaveKal Dragonomics. Trust products have increased by nine times in the short time period. The outstanding value of this kind of investment product, which is issued by trust companies but often sold by banks, also stands at around RMB 10 trillion. The expansion rate of off-the-books financing has far outpaced that of their plain-vanilla equivalent, deposits.

Unstable Empire

It's not just size. The inherent risk of the wealth management market can't be overlooked. One of the main concerns over WMPs is their maturation period, or the duration of time between when the investment is made and when the principal is paid back along with interest. For China's WMPs, that period is extremely short. Up to 80% of the products in the market have a lifespan of one to six months, according to a research report from CLSA Pacific Markets.

Very few assets can produce an annualized return of 5-7% within a three-month period. To meet customer demands, banks have pooled these assets, sometimes paying off old products with the creation of new ones. "This is similar to a Ponzi scheme in a sense," Patricia Cheng, China head of CLSA financial research, said in the report.

"The way these things are written, if you look at the details, they're really like spider webs. They create a cobweb that ensnares many parts of the financial system," says Collier, also the former president of Bank of China International in the US.

One potential risk that Collier is researching is the role of land in the trust market, which spills over into WMPs. Throughout the trust market, land is often the target investment, or used as equity or collateral, meaning much of the real value of WMPs is locked into the property market.

For years, China's real estate market has seemed like a safe bet, with prices in major cities climbing by more than 20% year-on-year for several years. But in 2014, the market has appeared to reach a tipping point after a decade of over-investment. Price growth has slowed and even fallen in some cities. Corporations with leveraged investments into real estate have never been more fearful.

"If property values decline by 10% to 15%, then all of a sudden, across many parts of this shadow banking empire, the collateral, target investment or whatever, is suddenly going to be worth 20% less," says Collier. "It will have a huge impact on the entire system."

Just Ordinary Folk

Despite the high level of risk, WMPs seemed to go unnoticed until a fateful day in December 2012, when banks, regulators and investors got their first taste of what the products were really made of.

RMB 200 million worth of products sold by Huaxia Bank nearly defaulted toward the close of the year. Photos in the

Chinese media showed fearful investors gathering at the Jiading branch in Shanghai with the hope of retrieving their cash. Barclays Bank was quick to note that Huaxia's faulty product was actually not a wealth management product but a private equity investment fund product. Still, analysts at global investment banks waited to see how regulators would react to the distress at the bank. Officials at Huaxia said the products had been sold without authorization and the bank, with the government behind it, eventually bailed out investors.

Instead of iterating the potential risk lurking in such loosely regulated products, the government gave an implicit yet strong guarantee to the industry. Sales were hardly affected. That's another major criticism of WMPs. The people that buy into them often think of them as deposits that are guaranteed by the bank, which in some cases can be seen as guaranteed by the government. However, many of the products are not guaranteed and a default could result in real losses for real people, not just for banks.

"Most of them are just normal people," Jane at the local Shanghai bank says of WMPs buyers at her branch.

Many ordinary people who would otherwise put their money in deposit accounts buy products with a guarantee on the principal, she says. Wealthier—not necessarily more experienced—people often buy higher-yielding products without guarantees.

Another product went belly up in Suzhou last July. The local branch of ICBC was selling an entrusted loan product with a projected annual return of up to 15%. When the WMP went bust, the bank told its clients, all of whom had invested at least RMB 1 million, that it was not guaranteed. But regulators once again couldn't bear its people, even wealthy ones, taking the hit. Although not made public, a Standard Chartered report said that officials pushed ICBC to bail out many of the investors.

Things Fall Apart

The third time was the charm—at least in eliciting a response from investors. In January, a $496 million trust product issued by China Credit Trust and sold by ICBC came to the cusp of default, putting at risk both the principal and interest owed to 345 wealthy investors. The product, a loan extended to coal miner Zhenfu Energy Group, carried 10% interest and a three-year maturity period. A legal battle had halted Zhenfu's equipment two years earlier, which subsequently deteriorated; the price of coal plummeted and repaying investors became impossible.

A mystery buyer eventually bought up the junk products via ICBC but the damage to the trust industry was done. Trust loans, one of three categories of non-financial credit at banks, fell that month while the two other categories that feed WMPs, entrusted loans and bankers acceptances, surged to record highs, according to central bank data. The shift showed that the near default of China Credit Trust in the same month had flustered investors.

And the trepidation didn't stop there. In February, total social financing took a sharp downturn. The People's Bank of China (PBOC), China's central bank, said the TSF fell to RMB 939 billion in the second month of the year from RMB 1.7 trillion a year earlier. That month, non-banking finance made up a mere 17% of the total credit picture, down from 43% in January and 42% in February 2013. Investors were finally catching on to the potential risk imbued throughout the WMP market.

"It seems that the rising default risk has started to erode Chinese investors' confidence," Wei Yao, China Economist at French bank Societe Generale, told investors in a note at the time.

At the same time, regulators have been hitting the market with new rules. The strongest of those may be yet to come.

The China Banking Regulatory Commission (CBRC) took an initial swing at the WMP business in 2009 by stopping banks from dealing directly with trust companies. The crackdown didn't work as planned. In response, banks simply restructured their products through securities companies. The massive increase in WMP funds moving through securities companies was the result of closing the direct passage between banks and trust companies. Now banks bridge funds through securities companies before moving them into trusts, something that has arguably increased the opacity of the industry.

The next significant attack on WMPs came in April of last year when the banking regulator issued the so-called "document No. 8", which divided the market into what the CBRC called "standard" and "non-standard" products, an entirely new distinction. The "non-standard" label pointed at loans structured through trust products that are generally used as a channel to provide financing without capital, one of the most risk-laden breeds of WMPs. Banks were asked to limit non-standard assets to 35% of their outstanding WMP balance, or 4% of total assets under management. They were told not to pool funds and instead manage the assets product by product so that regulators could see what constituted a specific product.

Again, hungry bankers circumnavigate document No. 8 relatively easily. A bank can simply sell non-standard products to a third party such as a broker then buy them back, a move that brings the asset into the standard category.

Masters of Illusion

Today the WMP industry exists in a state of unease and the CBRC may be winding up to deliver another blow to the wealth management industry, although it's unclear when that will come. Last November, Chinese media reported on a "document No. 9" that had recently appeared on the desks of executives at the country's biggest banks, a follow-up to document No. 8.

At the time of reporting, the full blow of document No. 9 had yet to be felt but Chinese media said that the CBRC will likely take aim at the interaction between China's WMP market and the interbank market. Part of the expected regulation was issued on May 16 in a notice called document No. 127. These new rules should have a mild effect on a relatively new product—and a nuisance to regulators—known as trust beneficiary rights, or TBRs.

During the past two years, banks have become increasingly clever in disguising their activity. Banks structure TBRs through the interbank market as well as through a third party in order to keep regulators off their backs.

TBRs are actually on-balance-sheet funds, or deposits, but by moving them through the interbank market they can be invested like WMPs. This presents a hall of mirrors in the hunt for growth in WMPs; the decrease in off-balance-sheet lending in April didn't account for this trick. In fact, that same month, banks had increased their exposure to TBRs by 57% year-on-year, according to a report from J.P. Morgan.

Document No. 127 will force banks to structure TBRs differently, ultimately labeling them with a higher degree of risk that will make the products more costly to invest in. However, May Yan, an analyst at Barclays, said in a research report that new rules should have a "neutral impact as they do not include some strict measures the market had previously speculated about".

Industry insiders may have reported demand for WMPs among urban Chinese people, but prospects of tougher regulations and an end to government backing for some of the products have made banks skittish.

In late February this year Fuzhou-based Industrial Bank stopped what's known as "mezzanine" financing to property developers. At the time, the move was interpreted as a sign that the bank was skittish on the property sector. However, mezzanine finance is a creative form of high-yielding, unsecured off-balance-sheet lending which could stand to get hit by new regulations. The slowdown in the issuance of these loans could be more closely related to risk in the WMP market than in the property market. Management at some banks has even stopped financing off-balance-sheet activities, Head of Research at JL Warren Capital Junheng Li said in a note to investors earlier this year.

The slowdown in off-balance-sheet lending can be attributed to both a heightened sense of risk and the prospects for an imminent issuance of new rules, such as Document No. 9, says Chen Xingyu, a Shanghai-based analyst at Phillip Securities. That said, the latter may have caused much of the slowdown experienced in the first quarter of 2014. The outlook for China's WMP market, in the short-term at least, is slower and more-tightly regulated.

> "We think new regulations will strictly control new products
>
> Chen Xingyu
> Analyst
> Phillip Securities

"We think new regulations will strictly control new products. In the future, most of the strategies for these products will be based on conservative views," Chen says. "The most important thing now is that the authorities realized that this is a huge potential risk, not only for the banks but also for the whole financial system."

The Right Direction

Regulatory hiccups are unavoidable, but judging by trends in the money management industry in more developed economies such as the US, the flow of cash from on to off the balance sheet is likely permanent, even necessary for banks to stay profitable in a more competitive environment.

The wealth management industry in the US exploded in the early 1970s with the advent of the money market fund, which, much like China's WMP industry, sought to circumnavigate centrally set interest rates on deposits by investing in short-term debt. Money market funds drew cash off the banks' balance sheets and put it generally into US treasury bills. In 1977, financial services firm Merrill Lynch introduced the "cash management account", a milestone in financial innovation. These money market funds gave customers a check-writing option, an innovation that began supplanting the function of banks.

"Essentially that service can replace banks," says Chen Long, a professor of finance at Cheung Kong Graduate School of Business. "Right after that, money market funds had explosive growth."

By 2001, money market funds in the US held four-times that of checking accounts at banks, Chen notes, demonstrating the movement of money off the balance sheets during the past 30 years. Such financial innovation helped US banks increase profits as the country liberalized interest rates.

China's wealth management industry could follow a similar trend—assuming strong regulatory framework is in place. In 2012, China's banks held RMB 122.4 trillion in assets, nearly four times the amount held by all other financial institutions such as brokers and asset managers, according to data compiled by CLSA. At present, Chinese banks are some of the biggest and most profitable in the world, owing in large part to low, government-set deposit rates. Yet, as the central banks move closer to a market-oriented rate, they'll need to compete on interest rates, which will drive down their margins.

"In this age of interest rate liberalization, you need to find new ways to make money. These products are important to [the banks]. I don't think they will shrink. I think money will continue to move off the balance sheet," Chen Long says.

That's the outlook for investors and banks, but from a regulatory standpoint, pumping more cash into the loosely regulated products is a worrying proposition.

But between the CBRC, PBOC and China's securities regulator, none are yet clear on the role that each will play in the wealth management market. "You need to have better coordination, in the sense that you can combine several regulatory bodies together," Chen Long says.

But regulators in China routinely scuffle for control of certain industries—teamwork is hard to forge. Deflating risk in the wealth management market will prove difficult until the powerful bodies that govern China's finances can come to terms with cooperating on market management.

Having a Senior Moment

China's aging population needs a housing solution. So what's stopping the industry from booming?

By Sarah O'Meara

Since the beginning of 2014, Jim Biggs has been living in a brand-new residential facility for senior citizens with dementia. He's just 54 years old, and has no problem with his memory.

Biggs, the managing director of Honghui Senior Housing Management, is one of China's senior living industry pioneers. An expert in elderly care services with 27 years of experience in the US, he is devoting every minute to making 'Friendship House' in Tianjin a success.

As yet, there are 20 empty rooms in the 26-bed facility, which opened in 2013. But he remains optimistic.

Few markets can promise such high customer demand as senior care in China.

By 2050, there will be more over-60s in China than there are people in the United States. And it's these numbers that keep smiles on the faces of those battling to establish residential care facilities in the face of inconsistent regulation, cultural resistance and onerous bureaucracy.

Yet, the elderly care market in China is still in its infancy, despite the imminent demands of the aging population, and it's still not clear what kinds of business models are best suited to help it grow up.

What Happens To Grandma?

At present, almost all nursing homes in China are publicly funded. According to the Ministry of Civil Affairs, nursing homes across the country have a total of 4.16 million beds. But it's not enough, says Biggs.

"If you take a look at the demographics, even if they were to start building today the government wouldn't be able to build enough beds for what they're demographically anticipating they're going to need. And they know this," he says.

In 2013, Wang Hui, director of the Department of Social Welfare and Charity Promotion under the Ministry of Civil Affairs, said China needs about 10 million more nursing home beds.

In Beijing and Shanghai, all public nursing homes are filled to capacity, with long waiting lists. While nurses are also in short supply: there are only 200,000 in the country, with just one tenth holding nursing licenses.

Benjamin Shobert founder and MD of Rubicon Strategy Group—a consulting firm specializing in healthcare, life science and senior care industries—works with governments and private companies to advise them on how to best access the world's fastest growing healthcare market.

"It's the dirty secret of the industry, but right now most operators are saying to themselves that we're probably 10-15 years away from having a viable customer base," says Shobert.

According to Joseph Christian, fellow at Harvard Kennedy School, where he is researching the senior housing industry in China, there are simply not the pension benefits or other funding sources available to senior citizens to allow them to pay what companies want to charge.

"Health insurance is only just beginning to come into the marketplace, and I think the country has to have that before the market can really grow," says Christian.

"In Japan, the government introduced long-term care insurance in 2000 and that's when the senior living market really began to take off."

Japan has a similarly challenging aging care crisis on its hands, with one in three people predicted to be over 65 by 2030. In response, officials developed a part-insurance funded, part tax-funded care model—to perform alongside the existing health system—that could fund wide-ranging care for retirees.

Fourteen years later, the country now has a competitive market of provision that entitles seniors to everything from home help to residential care. In contrast, China's national health insurance is by and large only applicable within public hospitals where resources are already strapped. Services that extend beyond the walls of the hospital are outside the scope of the insurance, also known as *yibao*.

Mrs. Lee, who preferred not to give her full name, arranged for her mother to live in Friendship House when it opened last year. Even though she is well versed in dementia care, she said she still had doubts.

Despite Friendship House costing a fraction of the equivalent compared to other developed countries, she says that rent costing RMB 800-1,000 per month is still seen as too costly by many. Financial considerations are seen as the primary factor, says Lee.

"I believe I made the right decision. But before my mother moved in, I had some concerns regarding the level of care. I was concerned about her lack of ability to communicate with the caregivers, and whether this would lead to bad situations."

Furthermore, Shobert observes that families are not yet feeling the full economic weight of having elderly relatives: "When the middle-class and upper middle-class sit down as a family and talk about who is going to stop their career to take care of mum and dad, then you'll see the industry take off. But we're not there yet."

Experiments in Senior Care

Senior living projects coming out of the private sector fall into three main categories: real estate targeted at senior citizens, high-end or needs-focused residential care homes, and lifestyle-orientated assisted living complexes.

"What we really have today are a few examples of what should be seen as pilot projects," says Shobert. "A bunch of people trying to figure out what is actually going to work, and it's still pretty early on to be able to say definitively what we're going to get out of that."

The real estate senior housing model focuses heavily on providing property to an older demographic. However, insiders say, these (often Chinese-driven ventures) rarely have an accompanying emphasis on supplying healthcare services.

High acuity assisted living projects that focus on niche areas of the market such as dementia care—where the service need is clearly established—tend to be run by a wholly foreign-owned enterprise and joint ventures. At places such as China Senior Care in Hangzhou and Friendship House, the price will also reflect the expertise of caregivers.

Continuing care retirement communities (CCRC), such as Cherish Yearn and Starcastle (both on the outskirts of Shanghai), focus on residents enjoying an enhanced lifestyle—restaurant style dining, in-unit housekeeping, shuttle service, planned activities—with healthcare assistance.

"I tell companies to focus on higher acuity models that are going to speak to needs that cannot be addressed with live-in help, like rehabilitation and dementia," says Shobert. "I think you're going to continue to struggle in the middle of the market, where you're not clearly differentiating yourself on the basis of a healthcare need."

Mark Spitalnik, CEO of China Senior Care, runs a wholly foreign-owned enterprise in the senior care sector, and deliberately chose to create a needs-based product.

His first high-end facility scheduled to open in Hangzhou later in 2014 will likely charge residents approximately RMB 40,000 per month.

Spitalnik points to examples of recent joint ventures between foreign companies and Chinese companies that have deteriorated because the Chinese side wanted a quick and profitable real estate flip while the foreign side insisted on the timelier pursuit of developing all the aspects of a fully equipped senior care facility. He notes Belmont Village and Life Care Services as two such examples.

"Most of the projects in China are driven by real estate. The developers are looking to do projects where they can develop and sell independent living properties, they're not primarily driven by providing care to seniors," says Spitalnik.

Biggs has also encountered Sino-foreign visions in discord. "It's rarely a meeting of minds in the business sense," he says. "In China they won't just come out and say, 'We just need you for the land. We're not really into the senior housing, we just want to buy land at a discount because it's for elderly care so we can build on it'."

Regulation Chokehold

When it comes to regulation, the senior care industry fights against complaints common to Chinese legislation: a lack of transparency, consistency and constrictive licensing arrangements.

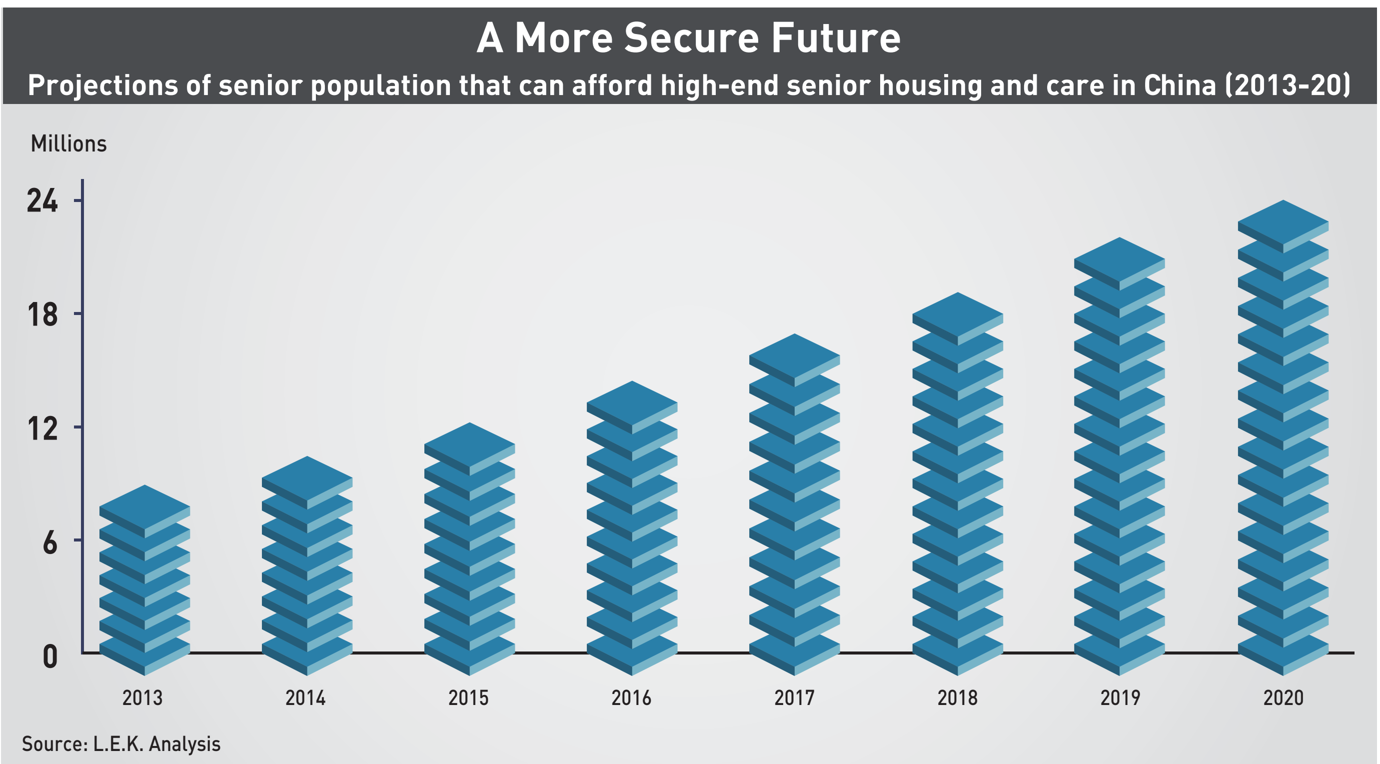
Experts say that in general the government is 'pro business' but modification of existing legislation can take time as it's caught up in the middle of wider healthcare reform. Plus, there's the perennial problem of a lack of coordination between provincial and central government.

According to Christian, the landscape remains almost impossible to negotiate without setting up a potentially unreliable joint venture with a domestic company. Spitalnik's venture is an exception in Hangzhou.

"In the Ministry of Civil Affairs' Measures adopted as of July 1, 2013, the government clarified and relaxed requirements of professional qualifications for staffing," says Christian. "While previously, the requirements mandated certain levels and competency of personnel, the measures stated that a senior living facility needs to employ management, professional and service personnel commensurate with the services to be provided, thus allowing more flexibility in the operation of the facility."

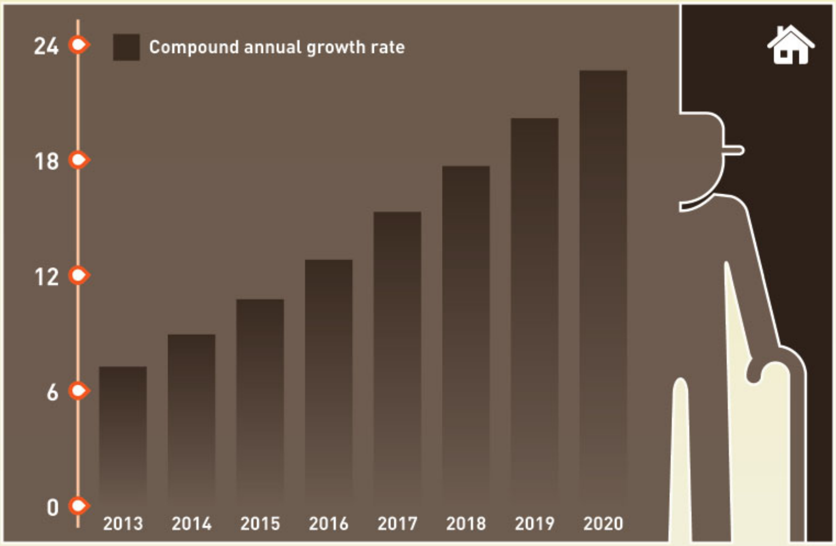
You can also establish branches in other cities, he adds. But the Ministry of Civil Affairs will require a separate license for each facility.

"As the Ministry of Civil Affairs' jurisdiction does not extend to the medical



Self-dependent

Population in elderly-only households as percentage of total elderly



Source: L.E.K. Analysis

functions of the facilities, which require approval of the Ministry of Health, this creates some uncertainty for investors," he adds. "However, it can vary from province to province, municipality to municipality and district to district. And even within one office, it's possible that different people will have different views on things, so you have to make sure you find the right person to advocate senior living projects."

In addition, there are major obstacles when it comes to the issues of land.

In 2006 and 2007, the PRC implemented a restrictive policy on foreign investment in real estate to stabilize property prices and reduce renminbi appreciation pressures.

"It's safe to say that there's a lot of work that needs to be done to clarify land right issues," says Shobert. "Right now that's probably one of the most problematic areas."

Current regulations also make it difficult to bring medical staff into your facility.

"Doctors and nurses need to practice in an appropriately licensed facility, which historically has been considered a 'medical institution'," explains Shobert, meaning assisted living facilities must meet the same regulatory standards as hospitals.

"The central government needs to populate a new body of regulations that addresses a less onerous regulatory standard for senior living than a hospital or "medical institution" would require," says Shobert.

Then there's the issue of finding staff if or when the medical license is obtained.

China currently has only 300,000 caregivers and of these caregivers, just 100,000 have "professional qualifications".

Biggs says: "We had staffing issues and eventually just went straight to the local caregiver training college and hired the kids right out of school, and trained them up."

But recruiting physicians is not so straightforward.

"Young physicians currently employed by government hospitals have no interests in migrating to us," says Michael Li, who runs the operations for senior living developer Cascade China, which has facilities in Shanghai and Beijing.

He adds: "One good thing about China's mandated retirement age [60 male, 55 female] is the sector technically has plenty of experienced, high quality retired physicians ready, willing and able to participate in the senior care services—if their original employers okay the work with an official seal of approval."

Retiring Gracefully?

Despite the sector's enormous potential, experts say that investors are currently reluctant to place bets on this market.

"What everybody says about senior living in China is that there's no proven business model. But there's a real herd mentality, so when one starts and it seems to be successful then you'll see a lot of people moving into the sector," explains Christian.

Last year, Chinese-owned firm Edward Healthcare, established a UK-based research center—The Edward Centre for Health Care Management Research—to work with the University of Manchester in exploring care systems, technologies and products that could be developed and adopted for use in China

According to Jackie Oldham, Professor and Honorary Director of the center, the company brings a hotelier component to senior care.

"After all, why does it have to be an elder care facility, why can't it be a holiday resort with specific facilities?" he adds.

At this stage, industry regulation is relatively slight so there is room for genuine innovation and tailored products that meet the needs of the Chinese market.

According to industry specialist Spitalnik, foreign companies can overlook the pressing cultural needs of Chinese consumers in their haste to impart expertise.

"For example, in China, if accommodation is too far away from the rest of a person's family and friends, it will be very unattractive. Chinese people also like the idea that the family can live in or around the area where their family's seniors are living."

Research has also found that affluent Chinese grandparents do not want to spend money on their senior living care. "They want to see money saved and directed towards the needs of the younger generations," says Shobert. "Finally, one thing I always say to clients, is never underestimate the ability and the willingness of the older Chinese to suffer," he adds."If they live in a place without some amenities, it's not going to strike them as particularly difficult. The senior living industry has to find a way to convince them they deserve more."

Taking on the World

Is Huawei's global branding push enough to erase the memory of public blunders and herald the next step toward global success?

By Suzanne Edwards

It's difficult to recall a case of more corporate schizophrenia in the past two years than that of Huawei, China's largest maker of telecommunication network equipment. When Eric Xu, Huawei's Executive Vice President and rotating CEO, declared in bombastic fashion that the company was no longer interested in the US market in April 2013, pundits reacted on cue, hailing the statement as childish, unwise and evidence that Huawei lacks business acumen.

This year, the COO of Enterprise for Huawei, US, Jane Li, dutifully recanted, indicating that Huawei would not leave the US behind but rather would continue to grow its enterprise business in the country. Li's statements were a mere fraction of an ambitious global branding campaign taken on by the Chinese company, which aims to heal wounds to its brand and prove that it deserves the title of world's largest telecom infrastructure maker, which it eked from Ericsson in 2012.

"They are moving rapidly towards a much more global [kind of] culture," says Martin Roll, Singapore-based brand strategist and author of *Asian Brand Strategy*, also currently analyzing Huawei for a new publication. "From a brand point of view, they are really progressing."

But significant hurdles remain. Some analysts say that Huawei is still mainly competing on price, though Huawei itself denies it, and the technology is solid but not a real threat to the likes of Cisco and Apple in their respective product categories.

As Huawei smartphone user "michi12oh7" said of the Huawei Ascend on a CNet product forum:

"I would NOT recommend this phone to ANYbody. It is absolutely pure rubbish! If I'd had the choice, I sure as heck wouldn't have even given it HALF star."

Then there's the ominous cloud of suspicion that hovers over the US, whose national security agencies are staunch in their distrust of Huawei, stemming from Ren Zhengfei, company founder and CEO, and his background in China's People's Liberation Army and made fresh by accusations that Huawei intends to use its equipment for spying. Furthermore the US is imploring its allies to regard the Chinese company with equal misgiving, which may complicate Huawei's global odyssey.

Huawei is showing signs of readiness to step out into the sun—launching a new high-end smartphone in Paris to much fanfare, sponsoring popular sports teams, sanctioning more executive interviews with the press, adopting a new slogan in "make it possible"—but will it all be enough?

Eating Crow

"I see it [branding push] as a response to the concerns raised in the US and Australia and India and a few other places," says James Lewis, Senior Fellow and Director of the Strategic Technologies Program at the Washington DC-based Center for Strategic International Studies, and co-author of a report on Huawei's competitiveness that the center put out last year. "They need to show that this is a company you can do business with."

Huawei's efforts come not a second too soon. Xu's comments about leaving the US severely complicated potential future negotiations with lawmakers and security officials should the National Security Agency ever revisit its decision to freeze Huawei out of the US telecom network equipment market in late 2013.

"It's a bit like the rules of diplomacy, you don't withdraw from the table, you seem like a loser if you do that," says Roll.

Huawei soon suffered decline in its share of the US mobile phone market in the midst of the tussles with Congress. In the third quarter of 2013, Huawei's share of the US mobile phone market was at 2.9%, down from 3.5% in 2011 when the country previously released country-specific sales figures, according to IDC.

And it's not just the US. "Their global position is still very strong, but it's not as strong as it was in developed markets. So I think you're seeing them do two things, shoring their position in developing markets and rebuilding in developed markets," says Lewis.

Huawei's consumer products may be the best salve for the branding wounds, allowing the company to breathe new life into its already established presence in emerging markets and regain ground in developed markets.

Globally Huawei ranks third in terms of smartphone market share, albeit a distant third, with 5% of the global market share in the first quarter of 2014 according to Strategy Analytics, tying it up with Chinese challenger Lenovo. Meanwhile Apple's share stands at 15% and Samsung is still the leader with 32% of the global market.

Huawei's strategy of building brand awareness into the US device market could undo some of the negative awareness from the national security debate.

Using other forms of recompense, Huawei initiated a flurry of sponsorship activity in 2012, coming to sponsor football teams in the UK, France, Italy and Ghana, as well as Bangalore's Royal Challengers cricket team, which the company landed in April of this year.

CSIS' Lewis concludes this is all well and good, indeed must be done for Huawei to show itself as a good citizen and expand its device business, but it will have little effect on the US' stance on security grounds.

"They're really separate. A device doesn't raise security concerns, the backbone equipment does," says Lewis. "I'm not sure Huawei always understands the deeply engrained suspicion that DOD [US Department of Defense] and FBI [Federal Bureau of Investigation] have towards them."

From Domestic Upstart to Global Powerhouse

1996

Huawei's first international customer dates back to 1996 with the sale of switches to the fixed line network of Hutchison Telecommunications, owned by Li Ka-shing

Source: Center for Strategic International Studies

1997

In 1997 Huawei established a joint venture with Beto Corporation in Russia

In the following years Huawei began selling to customers in Thailand, Brazil and South Africa, undercutting international competitors by 30% in some cases

2000

Huawei began securing contracts across Africa following a tour of the continent in 2000 by company CEO Ren Zhengfei and China's then Vice-Premier Wu Bangguo

And unfortunately, the US is throwing its weight around its clique of international allies. Huawei was recently barred from bidding on Australia's National Broadband Network following cyber-spying accusations while also facing an Australian government investigation into its proposed Perth-Singapore undersea cable.

In February this year, US officials announced that South Korea had agreed to amend its deal with Huawei, which was set to build up the countries wireless network, so that US communications won't pass through Huawei equipment but rather through separate networks.

But really what is the problem? Why the resistance? Is it good ole fashioned prejudice on the US' part or is there substance underneath the suspicion?

A Storied Evolution

Huawei, based in the southern China manufacturing metropolis of Shenzhen, was founded by Ren Zhengfei, a then-former People's Liberation Army (PLA) deputy director in the engineering corps. From the beginning, Huawei was determined not to rely on joint ventures with foreign companies as its competitors did. So Ren threw the company's resources into R&D, developing their own homegrown technology. The result was that Huawei was the first Chinese company to develop a large-scale public branch switch system.

Beyond the founder's previous occupation, what gives other countries pause about Huawei's motivations is the nature of its financing, which was heavily dependent on the state in its early days back in the 1990s.

According to a case study put out last year from CSIS on the competitiveness of Huawei, there were accounts of registered capital showing that a state-owned bank provided the then start-up company with an initial loan of $8.5 million. Huawei denies the existence of the loan, but the reports of its initial funding contribute to suspicions of hand-in-glove ties to the government.

In the early 1990s, Huawei also secured a key contract with the PLA, and in the mid-1990s the government began touting Huawei as a national champion. High-profile meetings between Ren Zhengfei and then-President Jiang Zemin precipitated many important government contracts.

Some say it was these high-level exchanges that unlocked more state-sponsored financing. In 1998 the Beijing branch of China Construction Bank lent Huawei RMB 3.9 billion in buyer's credit. Similarly, anecdotes arose of the government extending loans to cover for situations where Huawei was providing services to local government-affiliated institutions for free. It's unclear whether this money was ever repaid.

Today, Ren's refusal to consider an initial public offering just serves to further stoke the flames of doubt, being seen as a desire to maintain opacity in the company's finances and ownership structure.

But it's not just transparency. As Lewis notes, the company's decision to have four acting CEOs that rotate every six months has also thrown analysts off. "It's a little odd isn't it," Lewis says. "They may think it will help them with their image but it's not clear to me that it will."

But Lewis qualifies that this is a tried method with European companies, and is at the least an attempt to clear the perennial Chinese hurdle of succession planning in organizations that revolve around charismatic founding leaders.

In further moves to enrich Huawei's reputation beyond that of its founder and CEO, other company executives have strived to offer more accessibility by accepting more media interviews and getting their voices out there. Huawei's former Executive Vice President of Consumer Business, Colin Giles, spoke to media alongside one of the world's largest mobile trade fairs in Barcelona, owning fully that there were opportunities the company wants to take advantage of in the US.

Huawei CFO and Ren Zhengfei's own daughter, Cathy Meng, has come into the spotlight this year, offering some light commentary on the company's ownership structure. This is the kind of media access that Huawei needs to provide.

"I think they need to be open and transparent in a way they haven't yet been," says Roll, adding that Huawei, along with other large organizations in Asia, tends not to promote its own status and accomplishment like US companies tend to do.

2001	2004	2005	2006
In 2001 Huawei made its first pivot to developed markets with equipment sales to the Netherlands, Germany and France Huawei first opened an office in the US in Plano, Texas in 2001, where its US headquarters are still located. For the first three years of operation it did not manage a single US customer. Now, Huawei US has over 1,100 employees and covers 12 offices. Among its equipment/device customers are Leap, Best Buy and Level3 Communications	By 2004 Huawei's overseas revenues outstripped its domestic revenues as it sold cheap telecom equipment to developing markets	Huawei's first major break in becoming a global player was its deal with British Telecom in 2005, supplying equipment for its next generation network development. Huawei was involved in 14 of 19 3G network build-ups globally at the time	Soon after the BT deal, Huawei signed a deal with Vodafone, one of if not the largest carrier in Europe in mid 2006

What Exactly Does Huawei Do?

Cloud	Pipe	Devices
Application and software	Radio access	Personal devices (phones, tablets, mobile broadband)
	Fixed access	
Operations support systems	Core network	Home devices
	Transport network	
Storage	Data communications	Enterprise devices (Machine-to-machine, video comm.)
	Network energy	

Source: company

Coming to America

Huawei can't forgo the US completely for a number of reasons. "The US market is interesting for all technology firms for a lot of different reasons," says Roll. "For any Asian brands, or any other emerging market brands, [to] really succeed, you need to conquer the US market. You don't need to be dominant, but you need to be accepted."

Huawei is adjusting its strategies to gain acceptance in the US in other ways outside of areas deemed security-sensitive.

Firstly, they pulled out the big ad guns by letting the WPP family, namely Ogilvy & Mather and Burson-Marsteller, take point on campaign rollouts last year.

Huawei is also marketing its high-end "phablet"—tablet/phone—and the upcoming launch of some of its wearable devices to keep up with Apple and Google's smart watch and smart glasses respectively.

Even in enterprise, Lewis says that Cisco is "feeling the heat." Huawei's enterprise sales are still small compared to Cisco's, $2.4 billion to more than $30 billion in 2013 respectively, but it's growing much faster, up 33% year-on-year.

Whether or not Huawei's gains are due to competition on price is up for debate

"Nobody argues that we're winning on price [anymore], not even competitors do that," says Roland Sladek, Huawei's Vice-President of International Media Affairs.

Lewis counters that it's absolutely competing on price, just with less aggression than in previous years. "I mean the technology is good, so maybe they don't have to offer the same sweeteners they used to have to offer, but that's still one of the big attractions of Huawei," says Lewis of Huawei's appealing price points.

Roll says that may not be a bad thing.

New Lands, New Business

"Whether we like it or not, the world is at a stage where we are not flush with money when it comes to buying technology," says Roll, adding that European telecom operators have red profit lines and they're all looking for cost savings. "You would be very keen for a better value deal, and I think eventually a lot of the European telcos will surrender to that."

And Huawei stands ready to negotiate the terms of such surrender. "There are many, many projects there," says Sladek. "Europe is lagging a bit behind in modernization of its telecommunications equipment, so you have like suddenly 30-plus countries...seeking to modernize their equipment, so all these 30-plus countries are tremendous business opportunities."

In terms of research, Huawei announced its collaboration with London's Imperial College to develop a joint data science innovation center this year. This will add to Huawei's 10 already-established R&D centers throughout Europe.

Huawei was also contracted to build up India's 4G LTE network on the 2300 MHz frequency in 2010—though allegations that Huawei has hacked into India's telecom networks have surfaced—and signed a deal with LG Uplus in South Korea in April to provide WDM/OTN technology for common public radio interface (CPRI) backhaul on LG Uplus' LTE-A network.

Huawei has also sold undersea cables that form core internet plumbing in the Philippines and in Portugal, signifying its desire to become a more substantial part of global internet infrastructure.

"Having the benefit of being able to penetrate emerging markets, which surely have a price point issue… for now it works very well for them," says Roll. "It actually does make sense that a company from China, at this stage in China's development, will serve another emerging market, because who would know it better than another emerging market?" he adds.

But for devices, Roll cautions against overplaying one's hand in producing the 'emerging market' phone as it can dilute the enterprise business. Huawei has to be mindful of its brand structure. In such a case it could make sense for Huawei to spin off their device business arm all together.

"Open the Books"

Without a public listing and the corresponding transparency, Huawei must volunteer more financial information.

"They really need to open the books," says Roll. "Really embrace the world in a way we haven't seen yet."

As if following that advice, Huawei announced 2013 performance results earlier this year: a net income of RMB 21 billion ($3.4 billion) for 2013, or 36% more than it reported for the previous year. Sales of Huawei's Carrier Network unit improved 3.9% to $26.6 billion. The company maintains that two-thirds of its total revenue comes from outside of China.

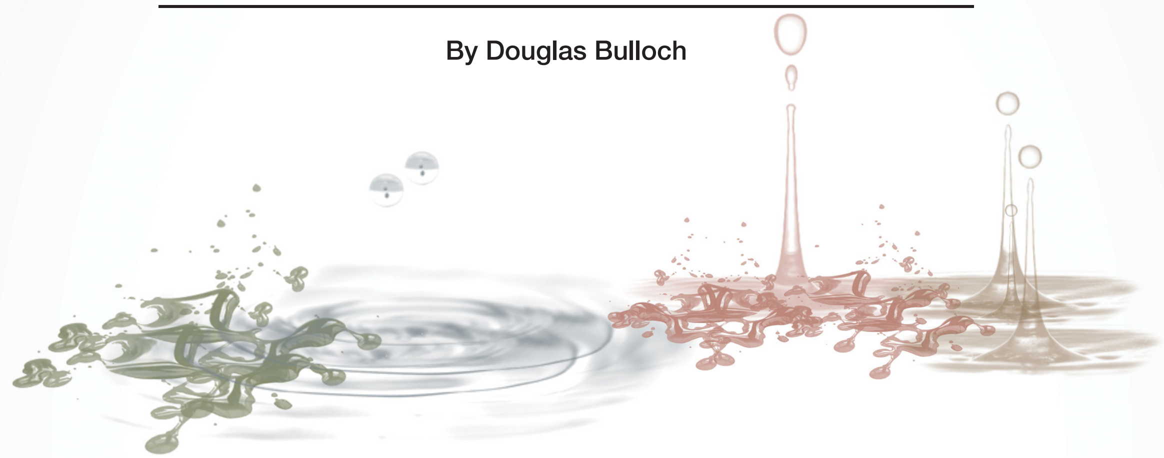
Analysts hesitate to draw any discernable strategy in the 'where' of Huawei's global expansion, but Huawei's Ren has more than once likened the company to a "wolf", circling the "cities"—developed markets—by taking over the "countryside"—developing markets.

"If they play it out well, it could actually [be] a significant strength for them," says Roll. "Because that will be the company that really reaches out… and says: 'You know what, we're gonna enable everyone to get a mobile phone'… and if they play that extremely well, and are obviously very careful about it because Huawei cannot change the world, they can showcase citizenship, and that's how you get a seat at the table."

The X-Change Factor

China's capital account liberalization and the new normal

By Douglas Bulloch



Strolling through Hong Kong Central district at the junction of Garden Road and Queens Road Central, passers-by may not realize that they are at the epicenter of the next big step in global finance. Aside from remnant colonial buildings the architecture is 21st century urban, with signature tower blocks and landscaped plazas, threaded with walkways and transportation links. A closer look reveals the headquarters of all the big regional banks, transforming an anonymous cityscape into the prime arena for Chinese currency transactions, and the physical home of the internationally traded renminbi. The whole comprises a cat's cradle of unstated hierarchies, visible and invisible, all tuned to the distant rhythms of China's economic reform program. This is where speculation meets hard numbers, where the renminbi finds its value, and where hopes and fears become profit or loss.

On the 15th of March 2014, the People's Bank of China (PBOC) announced that the yuan or renminbi would now be permitted to trade in a wider band, around a reference rate of exchange against the US dollar. The change—from 1% to 2% daily variation—is welcomed by Patrick Bennett, Executive Director of Macro Strategy Asia at the Canadian Imperial Bank of Commerce.

"It's a good step. I think it was well telegraphed for some time, and I think the goal of policy makers in China is to move to a more market-oriented system," says Bennett. "We've had a lot of those small steps," he adds, reinforcing a tangible sense of progress on the long road to internationalization of China's currency and the liberalization of the capital account. China's emergence as just another 'normal' economy in a globalized trading system is ostensibly desired by all, but placed in a wider context, doubts linger about what 'normal' is likely to mean when China eventually gets there.

Case in point, the PBOC's large-scale, parallel interventions in the foreign exchange market, the aim being to depreciate the value of the renminbi against the dollar. The effect of these interventions has brought the value of the renminbi down by nearly 3% so far this year, cancelling out the whole of last year's steady appreciation, prompting a strongly worded response from the US Treasury in their April report to Congress on exchange rate policies. The renminbi remained 'significantly undervalued', the report declared; a reaction which highlights both that the dollar/renminbi exchange rate rests on a very raw political nerve, and that the level at which the renminbi trades is not the same thing as the band within which it's permitted to trade. China still maintains an exchange rate peg, and still intervenes in the foreign exchange (FX) market in pursuit of policy objectives. China may be edging closer to normal, but it's not there yet.

On the Level?

The market view, however, remains more muted. "I think they genuinely prefer to advance this market-based reform. Widening the trading band has also helped to play down expectations for the currency as a risk-free bet on the appreciation of the renminbi," says Song Gao, Managing Partner at PRC Macro Advisors, Beijing. This is consistent with a broad consensus that the equilibrium value for the renminbi is probably somewhat higher against the dollar than where it's currently pegged, but reflects little sympathy for the US Treasury view of significant undervaluation.

"There is still more money wanting to go in than come out," says Bennett. "The idea is to get the currency to a level which reflects supply and demand, and let the market be a better arbiter around that," he adds. "I absolutely don't believe the PBOC would seek to weaken the currency if exports slow down or growth weakens."

Song and Bennett highlight that the market's views of the PBOC's behavior is mixed. Many traders were caught off guard by the rapid depreciation of the renminbi, and remain wary of re-entering the market. But regardless, the move was broadly interpreted as a successful effort on the part of the PBOC to counter perceptions of a one-way appreciation that had become baked into prevailing market expectations.

"What we lost sight of was where the value of dollar/China [renminbi] was," says Bennett. So while the renminbi has depreciated about 3% this year, the "daily fix"—which is the PBOC estimate of the current value—has only moved about 1.4%, viewed as "hardly a seismic shift".

The Big Reveal

In addition to sending a message, the wider daily trading band gives the PBOC more latitude with its interventions. A narrow trading band renders the market extremely sensitive to even slight movements, placing greater pressure on any move by the central bank to adjust the rate. For any band, the closer the exchange rate moves towards the upper or lower limit, the greater the chance of central bank intervention, creating arbitrage opportunities that might also interfere with the functioning of the market. A wider band gives the PBOC more room to maneuver without setting the market ablaze.

Perhaps even more revealing is the implication of an important shift in the thinking of China's leadership. "The widening of the band indicates that Beijing thinks that the renminbi has reached a reasonable equilibrium. They perceive that the value of the currency will be subject to more volatility, rather than a straight trend of appreciation or depreciation," says Song Gao, which, according to Bennett, implies a move away from the traditional understanding that China remains an emerging market, and towards its gradual arrival as a developed economy. "Emerging markets tend to trend, developed economies are cyclical." Of course this does not suggest that China is already a normal economy, but perhaps that normality arrives in stages.

> "
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>
> Song Gao
> Managing Partner
> PRC Macro Advisers

Capital Accounting

Ahead is the much larger project of opening up China's capital account, towards which the widening of the daily trading band is a mere baby step. In this respect, China is remarkably self-contained for the moment. The Bank of England released a report in late 2013 estimating that although the Chinese economy accounted for approximately 10% of world GDP in 2011, it nevertheless held less than 3% of global overseas assets and liabilities (comprising cross-border direct investment, bank lending, equity ownership and central bank foreign currency reserves). The same report forecasts that China could expand from holding 3% in 2011 to holding over 30% of global overseas assets and liabilities by 2025. If the forecasts are remotely accurate, the scale of likely capital inflow and outflow raises eyebrows and regulatory pulse rates, begging the question: can China's regulatory framework handle an internationalized currency and liberalized capital account?

A further study from the Centre for International Finance and Regulation in Australia has forecast capital outflows increasing from $250 billion to $5.5 trillion in the next 10 years, and the inflows increasing from $222 billion to a staggering $7 trillion. These transactional volumes invite some thoughts on the impact of potential dislocations, and given that the foreign exchange market will serve as one of the principal conduits for these enormous flows, it is not entirely surprising that so much attention is paid to the pace and sequencing of efforts to internationalize the currency.

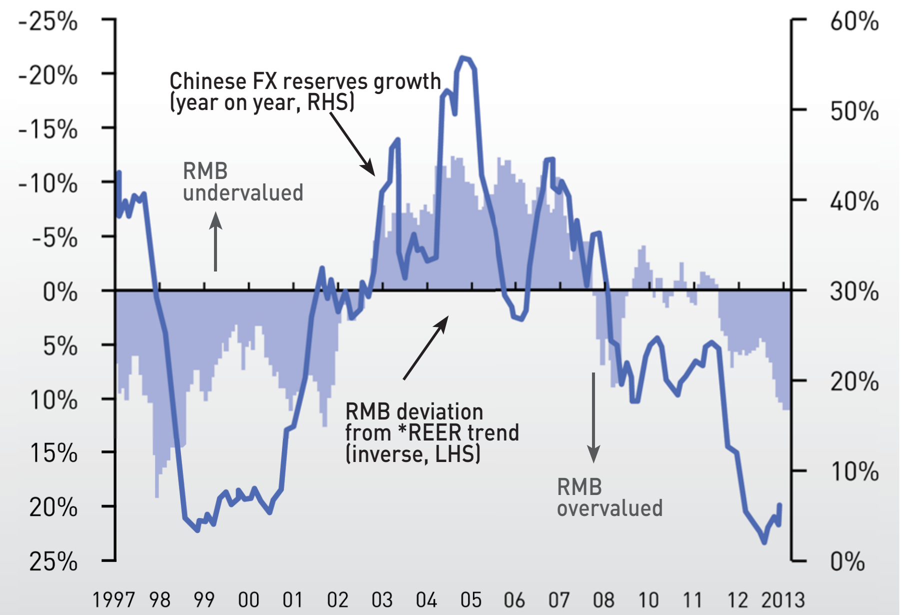
Destination 'Normal'?

Fortunately, as Andrew Walter, Professor of International Relations at Melbourne University, makes clear, the rough outline of China's progress towards full integration in the global economy, an internationalized currency and an open capital account has been agreed for years. "It was, broadly speaking, a matter of consensus among the leadership and the reformers as well, about the appropriateness of the destination, but where there was relatively little consensus, and conflicts between the IMF (International Monetary Fund) and the Chinese tended to emerge on 'how quickly' and 'what sequencing of steps' and so on."

Unfortunately, Walter adds, "we're seeing a lot of contradictory developments in China under the new leadership in the last 18 months." "They are deeply split between liberal minded reformers and a number of people in the private/party sector, who are probably less sophisticated, that don't like things like liberalized FX rates because they don't want to deal with

Curating the Currency

RMB valuation and pace of reserve accumulation



Source: Deutsche Bank *REER - Real Effective Exchange Rate

> There is a push within China to become more normal
>
> Patrick Bennett
> Executive Director
> Macro Strategy Asia
> CIBC

the consequences—exchange rate volatility and higher exchange rates—and want to continue to use the banks as primary tools of control in the political economy"

Walter refers to persistent soundings from within the inner echelons of the Chinese political hierarchy: there is just too much at stake and that the program of economic liberalization—normally associated with China's Premier Li Keqiang—must take a backseat to a program of political consolidation within China.

"Xi Jinping needs powerful allies, and a lot of powerful allies are opposed to the reform agenda," Walter says.

The possibility emerges that China's relations with the rest of the world are perhaps more conditional than the assumption of a linear path of internationalization and liberalization might suggest. "First of all, we have to acknowledge the fact that Chinese leaders have been historically only focused on domestic issues, even in the last three decades of reform," says Song Gao, adding, "it just happens to be the case that all of a sudden they wake up and realize that they have become the world's second-largest economy."

Shifting Expectations

History is also dragging down prospects for renminbi internationalization. In 2009, Zhou Xiaochuan, Governor of the PBOC, explicitly referred to the Triffin Dilemma—a paradox of conflict between a country's national economic incentives and global economic incentives when that nation's currency is also a reserve currency, first iterated in the 1960s by economist Robert Triffin—in criticism of the of loose US monetary policy in a world where the dollar is a reserve currency. Ironically, the same dilemma could be in store for China if the renminbi becomes a reserve currency, as it would also be subject to the pressure of appreciation as a consequence of other countries holding reserves denominated in renminbi. In that scenario, China could very well end up running a current account deficit, accumulating debt, and suffering the effects of an artificially appreciated currency.

But Walter suggests that China's complaints are simply an exercise in flexing an "increased voice." "[This is] primarily a negative form of influence or power, an attempt to retain autonomy to ensure that the IMF isn't able to dictate what China chooses to do." Walter says. In effect, China's trying to exert its influence to institutionalize flexibility toward its anti-market behaviors. Bennett takes a more optimistic view. "The IMF and World Bank are organizations where the Chinese do not have a great deal of—or any—influence, and I think for sure they want to have more say."

With the widening of the daily trading band China has taken one small step in the direction of liberalization, while undercutting the move with accompanying FX market intervention. This double move has effectively raised the prospect of currency internationalization and capital account liberalization. But at the same time it has reminded the key players that the PBOC will continue to seek outcomes that suit China's interests rather than meekly surrendering to the uncertainties that accompany market forces. China remains on the path to meet international expectations, but we can anticipate that they will exercise greater influence over how those expectations evolve. As Bennett summarizes, "there is a push within China to become more normal, and for normal to look a bit more Chinese."

Innovating To Shape Tomorrow's Leaders

By Xiang Bing

Set against the backdrop of the financial crisis, tectonic social shifts and technological disruptions have left us with rising uncertainty. The transformative changes of recent years have left us ill-equipped to respond to the new global reality of hyper-connectedness and pronounced fragility. As a result, it is imperative that business schools, having been criticized for their slowness in responding to the new realities, take serious measures to innovate to keep abreast of these changes and to develop the new generation of business leaders, who can address some of our most pressing challenges.

For centuries, man has been encouraged to chase his individual material wellbeing. Business schools were originally designed to help companies and individuals pursue financial targets. While the world's economy has grown at an unprecedented rate, we have encountered many serious national and global problems as a result, including an enormous waste of natural resources, severe environmental damage, a widening income gap between the rich and the poor and an imbalance of the global economy. This is why our goal as an educational institution should no longer limited to manufacturing the next generation of Wall Street or Silicon Valley magnates. Business school students must seek to enrich their lives by broadening their horizons and contributing to sustainable and inclusive development. Furthermore, in an increasingly globalized world, it is essential for business leaders to understand the history, philosophy and other perspectives of other cultures. As a pioneer in this regard, it has been gratifying to see so many other business schools join CKGSB's efforts in including humanity studies into curricula for their degree and non-degree programs.

Business schools have typically limited their education to helping companies and individuals make more money without caring much, if at all, how their wealth should be used. But this does a great disservice to our community by exacerbating the already yawning gap between the rich and poor, and giving rise to further social problems. Instead, therefore, business schools should be responsible for teaching the entire cycle of the creation, the utilization and the circulation of wealth. This is particularly important to those B-school students who are already very wealthy. CKGSB has been instrumental in promoting philanthropic responsibility and breaking down the social hierarchy, thus fostering social harmony. At CKGSB we encourage our students to donate their money but also, more importantly, their time: all our EMBA students are required to do six days of community work, audited by our staff, to finish their degree.

Traditional business schools have also tended to focus on full-time MBA programs that help young professionals and mid-management climb the corporate ladder, and leave those who are already at the top underserved. But in this new global reality, where most change will come from the top, it is the chairmen and CEOs who need to update their knowledge and refresh their thinking in order to lead their companies to deal with these new challenges. As science and technology drives the world forward at ever increasing speeds, leaders must stay ahead of business trends. That is why CKGSB has developed a top-of-the-pyramid approach which offers open and customized programs for chairmen and CEOs in China, as well as other countries in Asia, and large MNCs headquartered in the US and Europe.

Increasingly, as a result of globalization, business leaders are required to lead global teams with global vision. As such, the future of management education belongs to those business schools which can successfully develop a global learning platform by leveraging the best educational resources around the world. CKGSB has been experiencing its own globalization by working with leading business schools, public policy schools and think tanks, regardless of where they are located in the world, as long as they can add significant value to our students' global learning experience.

As the center of gravity of the world economy shifts towards the East, management education, led by the American and European schools for more than a century, is expected to enter a new era of two-way exchange with more knowledge flowing towards the West. CKGSB's faculty represent ideal carriers and originators of such an exchange, combining their original insight generated from their first-hand studies in China with a firm academic grounding in Western management theory, since many of them returned to China after receiving tenured positions in top business schools in the West. They have helped CKGSB lead the new trend of introducing China business and management insight to leaders in both public and private sectors in the West.

We must focus on constructive innovations that stems from the competitive spirit to build a better product or service that addresses a new market or segment. We have made a considerable amount of progress in a short space of time, but the road ahead remains long. We are happy to share our innovations, and we welcome suggestions from others that can benefit all of us.

Xiang Bing is the Founding Dean and a Professor of China Business and Globalization at Cheung Kong Graduate School of Business.

Conversations

"It's about making sure that you give the reader the platform they want, embrace every platform and make [content] available on as many platforms as you can"

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Chris Stibbs

CEO of The Economist

"In most organizations, successful takers are the most visible people... Takers risk quickly but they also fall quickly"

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A Finger on the Reader's Pulse

Chris Stibbs, the new CEO of The Economist, on staying competitive in the fast-changing world of publishing

By Neelima Mahajan

Few publications have the kind of loyal readership that *The Economist* enjoys. Despite being more than 170 years old (it was first published in 1843), the magazine has continued to stay relevant—and grow its readership—especially in a time when print media is in decline. *The Economist* has succeeded where several publications have failed: in adopting a multi-platform approach to content.

Chris Stibbs took over as CEO of The Economist in mid-2013 when his predecessor Andrew Rashbass left to join Reuters as CEO. Stibbs, who was the group's Finance Director and the Managing Director of the forecasting and advisory service Economist Intelligence Unit prior to becoming CEO, seems well poised to continue to grow the brand. In this interview, he talks about his priorities for the group, the continued push into digital and the rise of content-led marketing.

Q. You took over as the CEO of The Economist last year. How will you define your priorities for the company?

A. The priorities of the company will be similar to what they have been for a while. But we just need to accelerate in a number of areas. We need to accelerate our digital mobile offering; in our ability to deliver content-led marketing solutions; in much of the work Economist Intelligence Unit does for the industry; and geographically we need to accelerate more of this West to East shift, especially with a focus on China.

Q. Your predecessor Andrew Rashbass had this rather nice philosophy about what The Economist needs to do, which he termed as Lean Back 2.0. To what extent will you be following that, or maybe tweaking it? [Note: Rashbass divided reading into 'lean-back' and 'lean-forward' experiences. A 'lean-back' experience is one wherein you physically lean back and immerse yourself in what you are reading. This is common in print. Reading on the web is a much more 'lean forward' experience: it is akin to 'snacking' and people are much more interactive. According to Rashbass, reading on digital devices also gave a similar 'ritual immersive pleasure' people found in print and termed it Lean Back 2.0.]

A. Lean Back 2.0 is really a philosophy about how you read *The Economist*. So the whole idea that once a week, you get this ritual pleasure from sitting back, and reading in-depth about interesting and relevant things that happen around the world, as opposed to this internet experience where you 'snack' on a regular basis. That will always be at the heart of the experience of reading *The Economist*. In the world of increasing digital connectivity, proliferation of platforms and digital devices, we need to ensure that that the weekly experience remains relevant in the daily lives of our readers. To do that, we need to explore around this Lean Back 2.0 experience, around frequency–more frequent delivery of that kind of content, and different platforms continue to proliferate, and the digital platforms, and the media that we use.

Q. It's interesting that you mention platforms, because The Economist as a company is multi-platform itself, not just in terms of media—be it print, digital or online—but also in terms of your research unit and other affiliated businesses such as your conference division. How do all the seemingly unrelated pieces fit in, and how does your revenue mix across these platforms differ?

A. At its heart, The Economist [the company], whether it be the Economist Intelligence Unit or *The Economist*, is about helping people to understand the world. Through the pages of *The Economist*, be it an app, be it a website, be it *The Economist* magazine in print, what we're really trying to do is help intellectually curious people understand the world better, feel smarter about the world when they've had that lean back ritual reading experience. The Economist Intelligence Unit is about helping businesses operate beyond their domestic boundaries. So this analysis of 204 countries of the world, bespoke analysis [is] to help people understand the risks and opportunities in markets beyond their boundaries. [This] again, has at its heart a desire, a need to understand the rest of the world beyond your own boundaries. Just about every other platform builds on that in some way, shape and form.

Q. So how does the revenue contribution vary across these platforms?

A. To date, the biggest revenue stream by far is our circulation of *The Economist*, and the second biggest are our marketing/advertising solutions, and then we have The Economist Intelligence Unit. The Economist Intelligence Unit is very, very profitable.

Q. How has this revenue mix changed over time?

A. We have seen large shifts in recent times, and we continue to see large shifts. With the structural decline of print advertising, we are seeing pure advertising decline quite significantly in our revenue stream. What we are seeing growing quite rapidly are the investments we are making behind our circulation, our circulation revenue. More and more of our revenue is being generated directly from content as opposed to advertising.

Q. And how about print versus digital? How are they both growing for you?

A. Well, because we adopt this multi-platform approach, we don't think about substitution of print to digital. What we think about is we will be on every platform that a reader wants to consume us in. Therefore, we tend to offer all these multi-platform packages because that's what our readers tell us they want. On a Saturday or Sunday morning a reader may pick up the print magazine and read an article. On their commute to work, [they] may read an article on their smartphone. In their office or in a coffee shop on a workday, they may read it on the tablet. To define them as a print or digital reader is irrelevant, to be honest. It's about this multi-platform.

So, the shift in readership between print and digital is almost irrelevant in our minds. It's about making sure that you give the reader the platform they want, embrace every platform and make it available on as many platforms as you can. Because of that approach we're not seeing a significant decline in print readership. What we are seeing is a significant increase in the proportion of people who also read us digitally. So you're seeing the digital component increasing rapidly, but you're not seeing the print component decline, although probably spending slightly less time on print because of this multi-platform approach. [We] don't see a substitution, in our eyes, of print for digital revenues.

Q. And in what way is this multi-platform world impacting advertising for you?

A. That's an interesting question because if you think about our multi-platform world, we have seven million odd users who come to our website very month. We have a million and a half subscribers to *The Economist*. You take into account that it's passed on [and read] by 4-5 million people and you have some half million or a million users of tablets or smartphones. So you have a bigger audience, which is now coming to you in all sorts of different ways, but it's a bigger audience. And so there's a bigger audience to monetize. However, you have to monetize it in a different way. Monetizing a digital customer doesn't carry the same yield as monetizing a print customer does combined. So it's very different. But more and more we talk about our entire audience, and about how we can give our clients the opportunity to reach those audiences in all the different parts of their lives.

Q. You were one of the first big media groups to get into native advertising, and ever since others like The Wall Street Journal and The Washington Post have followed suit. What prompted the move and how is it paying off?

A. I think that's an interesting question, because you might debate whether we are doing native advertising or not. It depends on how you define native advertising. Certainly what we do not do is native advertising as it has become known, which is content produced by clients and embedded into your editorial. All of our content is produced by *The Economist* editorial staff. What we do is we create content for our clients, on their behalf, but we keep complete editorial control. And all of our clients know that our editorial control means that if we create content for them, we do it with complete independence.

It's the same independence we would have when we created an article for *The Economist* or the Economist Intelligence Unit. So we don't do native advertising where we allow clients to produce our own content. We don't create content, which is influenced in tone by the client. But we do create content and when we do, we don't embed it in the editorial in quite the same way as some others do. We make that distinction much clearer, and we tend to do it as part of a bigger integrated package. So we're creating portals, we're creating, maybe, whole blogs which are sponsored.

But we put up quite strong Chinese walls between the commercial side and the editorial side, to ensure the independence of the editorial side.

Q. How is this impacting your ad revenues? Is it becoming a major revenue stream?

A. It's still relatively nascent. What is becoming quite a revenue stream for some publishers is native advertising, as I described it earlier, but we're not doing that. So we're not capturing that revenue stream, as our editorial guidelines don't allow us to do that.

But the slightly more sophisticated version of it, which I just described, is becoming a growth revenue stream. But as of yet, it's not a major revenue stream, but it is becoming a major advertising stream. I think there's a lot of money headed that way and in 2-3 years it will be a very significant revenue stream.

Q. Some publications like the Financial Times are consciously staying away from native advertising because they feel it might confuse readers by blurring the lines between editorial and paid content. Can you take one example of something you've done with regard to content-led marketing, and also explain how you maintain the 'Chinese walls' that you described earlier?

A. The best example I can think of is our flagship work with GE for the 'Look Ahead' program. In the industry of content-led marketing it's quite a flagship program. GE, as a brand, wanted to be known for innovation, industrial innovation and they wanted that industrial innovation to stand for something that's good for the world. [They wanted] to make the point that in some ways in the modern world, innovation is not just about software—industrial innovation is good for the world. *The Economist* is quite well known for its ability to write about the impact of technology on the world. So we were an ideal partner to develop content for GE. We create the separate editorial content, just for the GE contract, mainly based in our New York office. And we created a portal, hosted by GE, but we create all of the content and control the content that goes onto the portal. We integrate that into a marketing advertising package. We then also create a blog on our own website, created by *The Economist* editorial team, which GE sponsors, but this is created by *The Economist's* journalists, the team that creates the portal is separate, and is kept separate. We then push it out to social media a lot and to our audience. It's an integrated solution, it's not just about native advertising.

Q. It also seems that you're pushing for advertising based more on psychographics rather than demographics.

A. Yes and no. We always characterize our audience as being ideas people, as being influential. We always said our audience is characterized by their psychographic rather than their demographic. They are the intellectually curious. They are influencers. So, we characterize our audience by their psychographic. That's how we promote our audience to clients, as a psychographic. So rather than saying our audience does this job, or makes this amount of money, it's about the fact that we have a disproportionate number of influencers in the world.

Q. You recently inducted Google CEO Eric Schmidt to your board as a non-executive director. What does that mean for what The Economist wants to do going forward?

A. We want to accelerate the whole digital era around digital connectivity: this idea that digital connectivity is driven by ease of access. We need to keep *The Economist* relevant in the daily lives of our consumers who have built their lives around their weekly laidback experience. What Eric does for us [is] he brings a good challenge to the board. But you know the thing about is *The Economist*, it was found in 1843, and we have a rich heritage, and the challenge for *The Economist* is to combine the heritage and everything we stand for with the modern world. Eric brings a wonderful knowledge of the modern world: he built Google, and he also is an avid reader of *The Economist*, and he understands that legacy. What Eric does is he challenges us. It is still up to me and the rest of the board and the rest of the executive management, to find what that strategy is. I think we will accelerate this idea that we need to be more relevant in daily lives, but we will still lean back on that weekly package.

Q. Talking about competition, traditionally publications have viewed other publications as competition. But now we also have content aggregation apps like Flipboard. And your predecessor said he viewed them as a "head on competitor". What is your view on such apps that are becoming increasingly popular? Do they take away your audience? Are you wary of them?

A. I think we both embrace them, and we're wary of them at the same time. In the modern world, you have to embrace the technologies, the places your readers want to read you. You can't dictate in the modern world to the consumer how they should consume you. As a philosophy, we want to embrace as many ways of consuming as possible. Within that, of course, we have to be commercially realistic, and so what that really means is embracing all of those mediums, those ways of reaching consumers, but at the same time [place] restrictions on the content we allow to leak out, because as you heard earlier content is our biggest revenue stream. It is very important to us, but still it's a big world out there and we still want people to sample it, use it, but we have to restrict that to an extent that we still monetize it effectively.

Q. The Economist has already successfully transitioned to a print-only publication to the digital world. What's next for the growth of the brand?

A. I would say it's a transition from this weekly experience to the multiplatform experience, not substitution. We need to accelerate the frequency in a way that is both meeting the demands of the modern world but still a rich *Economist*-like experience. We need to look at platforms, we need to look at the media, always ensuring what you get is an *Economist*-like experience. We need to go beyond that weekly package of a multi-platform experience.

(Visit CKGSB Knowledge for the full interview and to watch the video. knowledge.ckgsb.edu.cn)

The Good in Giving

Adam Grant, author of *Give and Take*, is convinced that 'giving' paves the path to success. You just have to be smart about it

By Neelima Mahajan

Giving is good, we have all been told. It makes you a good person and it is the right thing to do. Now Adam Grant, Professor of Management at Wharton School of Business, is joining the chorus. Grant, who among other things is also a professional magician and a former All-American and Junior Olympic springboard diver, has studied different styles of reciprocity. He divides people into three categories: givers, takers and matchers.

All through life we come across people who fall into these categories. Takers, often the most hated, focus on getting as much as they can from others. They feel entitled to receiving more than they give. They often try to walk away with the majority of credit while working on collaborative projects. Givers, on the other hand, help others without any strings attached. That might involve sharing knowledge, being a mentor, or introducing people who can benefit from connecting. Matchers sit in between: they believe in quid pro quo and in trading favors evenly.

As Grant dug deeper, he found a correlation between giving and success: contrary to popular belief, giving actually helps you succeed in the long run. Grant's book on this theme, *Give and Take*, has scorched bestseller charts and received much critical acclaim.

In this interview, Grant explains why giving is a good thing, and also when too much giving can be counterproductive.

Q. From your perspective, why was it important to study reciprocity styles?

A. Particularly in the west, we tend to look at success driven by individual forces like hard work, talent, and luck. We overlook the ways that our interactions and relationships with other people shape what we achieve. I was excited to understand that.

The other reason was because I was struck by the sheer number of people who said: 'My goal professionally is to be able to make a difference and give back, but I also refuse that because I'm afraid it will sacrifice my success.' They basically become takers or matchers and show that they can accumulate enough wealth and power. They have the freedom to start giving back. I had evidence that the fear about the consequences of giving might be misguided. I was struck by the fact that although there are people who succeed first and then start giving back, it seems to be more common that people who give first succeed later.

> My view is that when karma occurs, it's usually because most people are matchers. Matchers believe in a just world—what goes around comes around

Q. Do you believe in karma, in the idea that what goes around comes around?

A. Yes and no. I'm trying to use science to explain why karma happens and also when it happens. My view is that when karma occurs, it's usually because most people are matchers. Matchers believe in a just world—what goes around comes around—so matchers hate seeing takers succeed. That's unfair. They also hate seeing givers fail, because people ought to get rewarded because they are generous. So matchers often become the karma police. They go out of way to make sure that takers' reputations are known, so that other people can protect themselves. They are also very motivated to spread the reputation of givers, so that givers benefit from their action of helping, caring and compassion. If you are in an organization where there are a lot of matchers, you actually are more likely to see what looks like karma.

Q. Does the idea of giving intersect in any way with the concept of 'servant leadership', an idea in which the leader puts the needs and development of others first?

A. There is a point for conversion for sure. Servant leaders tend to be givers. Givers often embody servant leadership which is again, more like saying 'when I lead, I'm going to put other people's interest ahead of my own'.

I actually had a mixed reaction to the language of servant leadership because it suggests self-sacrifice. I think that's a wrong approach because if you sacrifice yourself for others, you put yourself as the doormat. Successful givers are more likely to look for ways in which they can align their interest with others.

Q. Are the three reciprocity types—givers, takers and matchers—hardwired personality traits or does our style change from one situation to another?

A. I would say exactly halfway in between. If you look at the data, there is a personality component in that. If you are a giver in one role of a relationship, you're more likely to be one in another. There is a general trait that givers tend to have in common like empathy or feeling a sense of responsibility. There is also a lot of fluctuation. We all have moments where we give, where we take, and where we match. For me, your style is how you treat most of the people most of the time as you make different choices. If a taker changes their tune and says, 'Instead of trying to get something, I'm going to propose a trade', or: 'I'm going to offer something without asking or expecting anything in return', if you make those choices repetitively in different ways, then your style can change over time.

Q. In your book you say we often categorize givers as chumps and doormats. If giving is such a good thing, why do givers get such a bad deal?

A. A lot of people are afraid because of takers. Many people overestimate the number of takers because there is a lot of evidence that they are bad and stronger than the good psychologically. The worse acts of selfishness often get burnt into our memories more vividly than some of the greatest acts of generosity. A lot of people just get scared away— either they are victims of takers or they have experienced their extreme selfishness.

A lot of people confuse being a taker with being a narcissist. They think that they have to say yes to all the people all the time with all the requests. That is the recipe for becoming a doormat: burning yourself out and running into a bad deal. People should recognize early on that just because you are motivated and help others, doesn't mean you have to become somebody who dumps everything to help anyone who asks no matter what. Most successful givers are a lot more thoughtful and selective about whom, how and when they help, so that they are not being overly generous to takers. They tend to choose a couple of ways of helping that they enjoy, which is more likely to make giving energizing and efficient rather than distracting from their tasks.

Also be careful of the block-out time to say: 'I have my own priority and ambition. I need to get my own work done. Proceeding with that, I will also help others in separate periods of time.'

Q. But there is also this temptation when you see takers winning as well.

A. Yes. That's part of the other reason that people move in the taker direction. They look at the hierarchy. In most organizations, successful takers are the most visible people. Even if the dominant [style] in your organization is matching or giving,

As you start to notice that things are out of balance, or feel resentful of the people that you are helping, that probably is the sign things are going towards the wrong direction

the takers are really credited and in the spotlight. It's easier to spot them. Takers rise quickly but they also fall quickly. It's a lot harder to sustain success as a taker than as a giver or a matcher, because most people are matchers and matchers are often on a mission to take down takers.

New evidence suggests that, in fact, takers are also motivated to eliminate takers. If you are a cheater, you want to be the only one who cheats because otherwise cheating doesn't give you any advantage. The takers are the ones who say, 'I'd want to be the only taker in the system or that won't help maintain my success'. So takers not only pull off the matchers but other takers as well.

Takers burn a lot of bridges. They destroy their relationships and reputations. At some level, if you are a successful taker, people are gunning for you. If you are a successful giver, people are more likely to be rooting for you. I think that just made it easier to succeed.

Q. If I am a giver, is there any way that I can recognize the point where giving becomes not so much of a good thing, where I move from being a smart giver to being a doormat?

A. The easiest sign is when you start keeping scores. Most givers prefer not to keep track of the help they give. They don't feel that other people owe them. But when things get out of balance, most of us have our basic matcher instinct kick in. As you start to notice that things are out of balance or feel resentful of the people that you are helping, that probably is the sign things are going towards the wrong direction.

Related to that, if you start feeling out of energy or exhausted, you may be stretching yourself too far. The sign that things are going well is that people are coming to you with meaningful requests, and they are actually relying on your expertise and your interest. [But when] people are coming to you with all kinds of things that you are not actually uniquely qualified [to deal] with, that's an early warning signal.

Q. Are there any techniques one can use to become a smart giver?

A. The 'five-minute favor' is one of my favorite techniques. So many people think that they have to be Mother Teresa or God to be a giver, but that's not sustainable for most of us. The point of the successful serial entrepreneur Adam Rifkin is you can just become a giver by doing more 'five-minute favors' every week. It's just a way of adding high value to other people's lives at a low personal cost. Adam's favorite is to make introductions. He's made three introductions every day for the past seven years. That's added tremendous value to other people's lives. Through the introductions he has made, dozens of companies have been formed.

Smart givers end up consolidating their helping so they try to make it more efficient.

A former student served in the military and then he worked for a major tech company. A lot of military veterans would reach out to him for career advice on making the transition from military to business. He was taking more than a hundred calls per month in his free time. He became smarter about this. He scheduled an equivalent of virtual 'office hours' once a week. Instead of having the same conversation with 20 people each week, he had this same conversation once with 20 people.

Q. In most organizations, the reward systems are geared around individual performance and in such cases, giving does not seem like such a great idea.

A. Organizations often create a work system where they are evaluating and promoting individual accomplishments. That is not the most fertile environment for givers because it's very easy for takers to maximize their individual success and climb up the ladder. I'd like to see more organizations that have a dual matrix that values on the one hand, individual achievement, and on the other hand, how your achievement benefits others. While being efficient and successful, you are making others more successful. The data shows that in the long run an organization that can balance its considerations actually achieves higher performance.

If you are stuck in an organization which basically rewards takers, the first thing you have to do is align your giving with your organizational goals. You are not just helping indiscriminately, but you are focusing your energy and contributions on the most direct ways that you can make your organization more successful. That's more likely to get rewarded.

The other thing you can do is to build a protective community of givers and matchers. Figure out who the non-takers are in your organization and bring them together to try to support and help each other. In that way you can shield yourself.

Q. Are there any companies that have successfully implemented such measures?

A. Yes, one of my favorite examples is Corning Incorporated that makes Gorilla Glass for iPhones and iPads. The highest achievement you can get as an engineer or a scientist at Corning is to be named a fellow. Fellows get jobs for life and a lab for life. They have a huge amount of freedom and resources to work on the most exciting innovation projects that are meaningful to them and the company.

> Figure out who the non-takers are in your organization and bring them together to try to support and help each other. That way you can shield yourself

There are two categories of the matrix that they use to evaluate the chance of becoming a fellow. One, being the lead author on a patent that's driven enormous revenue for the company. Two, whether you are contributing to other people's success along with driving your own success. One of the things they look at is if are you a supporting author on other people's patents. It often takes 8-10 years to get a patent through [so you] help others for 10 years and get a little bit of the secondary credit. Very rarely [do] takers wait patiently. You have to be a great individual achiever but you also have to be someone who helps people around you to be a fellow. They weigh these two measures equally.

Q. What is your favorite example of a giver?

A. There is a woman called Kat Cole. She is a single mother who has three jobs to support her family. The day that Kat was old enough to work, she started working at a restaurant. She became the first person in her family to go to college. But she was so busy helping others in the restaurant that she had to drop out college because her grades suffered. Then one day in the restaurant a cook quit, so Kat volunteered to help cook. Another day the manager quit. She organized the schedule so everybody would know when to come to work. She volunteered to help behind the scenes without asking or receiving any credit or recognition. And it's a story that really tells the horrible downside of giving. Kat was so helpful that she dropped out of college. But as we know, giving can be inefficient in the short run but extremely valuable in the long run. In Kat's case, she was invited to apply to open up the first restaurant in Australia. She was working in the US at the time.

She said she wasn't qualified because she had less education and less experience than all the other candidates. But because she has found every way to help all the colleagues, she was the only person in the restaurant that has done every job. They were giving her this position because she is more knowledgeable and more skilled than everyone else. One of the things that drives us crazy is that givers actually have a knowledge and skills advantage. They learn more and build more expertise than matchers and takers because their time spent solving other people's problems enabled them to gain the whole set of insights, ideas and information that nobody has.

Kat went to Australia, opened up a new restaurant, and did the same thing in Asia. Then she went back to the US for corporate training. Her career just skyrocketed. At the age of 32, she was named the President of a billion-dollar brand called Cinnabon. If you ask her what made her successful, she will tell you that more than anything else is the fact that she was a giver.

Strange Bedfellows

Renowned economist Stephen Roach says the US-China relationship is unhealthy and may cause further imbalances in the global economy

By Major Tian

China and America once shared a cozy equation where 'Made in China" went hand in hand with American consumerism. This is now changing, as China embarks on its transition from an export-led economy to a consumption-driven one, says Stephen Roach, Senior Fellow at Yale's Jackson Institute of Global Affairs and former Chairman of Morgan Stanley Asia.

Roach, a well-known expert on the Chinese economy, believes that this change is necessary, as the way China and the US rely on each other is no longer healthy for either party. In a recent book titled *Unbalanced: The Codependency of America and China*, Roach says that the US paid its price for its overreliance on China's cheap goods and capital in the financial crisis of 2008, and China's economy could also be in danger if it continues with the old growth model.

And while China's economy is showing more signs of slowing down, Roach believes that the country is on the right track, leading reforms that would shift the world's second-largest economy toward a healthier growth model. On the other hand, Roach sounds the alarm for American policymakers that the US needs to adjust its role accordingly and shy away from current excess consumptions.

In this interview, Roach takes a hard look at the changes that are happening in China's economic system and elaborates on the shifting dynamics of the China-US relationship.

Q. You suggest that the US and China have been in an unhealthy codependent relationship. Where are you coming from and what are the issues at work here?

A. Both economies have relied heavily on one another, as two codependent partners in a relationship would be expected to do. It started innocently in the late 1970s and early 1980s. Both economies were pretty needy. China post-Cultural Revolution needed a new source of growth in the external demand, and the American consumer provided that. The US in the midst of a difficult stagflation needed cheap goods and cheap capital, and China provided that. But over time this dependence led to unbalanced conditions in both economies. Too much saving, current account surplus, unbalanced macro structure, environmental degradation, pollution in China… all can be traced to an export-led manufacturing-driven production model that just went too far, courtesy of the American consumer.

In the US, [it was] the opposite. Savings deficits, current account deficits, excess consumption, reliance on asset bubbles and large fiscal deficits…. In many cases, much of that can also be traced to support from the surplus Chinese saver. So as the case for a codependent relationship, you need to become healthier.

Q. Why are these issues so important, and why now? What's at stake here?

A. We've had huge gyrations in the global economy. The financial crisis of 2008-09, in my opinion, triggered by the US, taking its imbalances—in part attributable to the unhealthy codependence on China—to an excess. And so the US is already going through a wrenching adjustment to reflect the current unsustainable state of imbalances in its economy. And that dependence on China played an important role in pushing the US too far. China can go down the same route. If China does not change its economic model, it too will be prone to the same type of crisis that America went through.

And the good news is that China has woken up to that. It has embarked on a very tough period of structural change and transformation, shifting from a producer model that has been very successful, to a consumer model. That shift is hugely important and very much the focal point of the leadership in Beijing right now.

Q. How should China go about pursuing its consumerist goals?

A. It's a very complex, enormous undertaking. I've stressed three major building blocks to the story: more job growth, especially in the service sector and that's beginning to happen; higher wages through urbanization, where urban workers on average earn about three times as their counterparts in the countryside and that's beginning to happen; and thirdly, address the shortcomings of the social safety net. You can boost labor income by job creation and urbanization, but people will not spend the money. They'll save it out of fear that there's no security for the future. And the recently concluded Third Plenum of the 18th Party Congress held last November does provide a number of potential reforms that will address the safety net issues, the one-child family planning policy, *hukou* reform (*hukou* is China's household registration system, a hurdle for citizens to migrate freely), interest rate liberalization, and also a proposed 30% tax on state-owned enterprise profits by the year 2020. These are all to fund the welfare system. These are all big positives in addressing the social safety net. Now it's up to the Chinese leaders to implement [this]. I'm constructive on that but the proof still remains to be seen.

Q. As China changes its model, what will happen to exports? People are saying this is the end of 'Made in China'. Do you believe that?

A. Not for a second. China still has a very powerful manufacturing base. A lot of supply chains in Asia still have their hubs in China. China is not giving up on manufacturing in any way whatsoever. In fact, it's really moving up the value chain focusing much more on what the government refers to as strategic emerging industries, industries such as electric cars, alternative energy, biotech, new-age information technology where there are plans to really significantly increase the growth rate in all these industries between now and 2020.

> If China maintains its import share, there's an enormous opportunity for producers

Q. Which sectors are likely to see more imports?

A. I think that China historically is a very open economy. Its import share of GDP has averaged about 28% since 2002. Compare that with Japan, Asia's first growth miracle, where the import share historically was one-third that—about 9%. So if China maintains its import share, there's an enormous opportunity for producers and trading partners around the world to participate in this shift to internal demand. The one I stressed the most in the book is the one that's been tapped the least by foreign trading partners of China. That is the service area. Services are increasingly tradable. The services' share of China is tiny. It's now up to 46% and had been 43% in 2011. It's going to grow probably into the 55% to 60% range between now and 2025.

That increase will be around $12 trillion, just the increase in the scale of the Chinese services sector. And under some, I think, reasonable assumptions in describing the openness, the tradability of the Chinese services sector, that's a bonanza for the rest of the world. It could be anywhere between $4 trillion and $6 trillion between now and 2025. So a broad variety of services competitors, especially those in the, US which is preeminent in services, will have an opportunity to participate in China. And that would mean anywhere from retail trade, to domestic transportation, to supply chain logistics, and finance. The big one, I think, is the opportunity for foreign companies to get into China's healthcare big time.

Q. Would you say that China has landed softly?

A. I hesitate to use these words "hard landing", "soft landing". Hard landing is sort of a devastating house of cards falling down scenario. I've never been in that camp in China. Most people are always looking at China with a hard landing right around the corner. The growth rate is slow, but the employment generation in China has actually accelerated.

So what does that tell you? It tells you that when you pick apart the numbers and you see where the growth rate has slowed, it is predominately in the so-called secondary sector which is manufacturing and construction. You would expect that given the focus that manufacturing has on export-led economic growth. The rest of the world is still growing very slowly. Where the growth rate has picked up is the services sector, the tertiary sector. For the first time in modern Chinese history, the services sector is now the largest sector in the Chinese economy—46% in 2013, and actually exceeded that of manufacturing-and-construction combined [which is] 44%.

So what you have is that the composition of GDP growth in China is shifting from capital-intensive manufacturing to labor-intensive services. GDP is slowing, employment is picking up. That's not a landing. That's a great transition from the old China to the new China.

Q. There are also some fears about China's economy, such as the real estate bubble, shadow banking, and increased local debts. Are these fears overblown?

A. I think all these fears are based on legitimate concerns. There has been too much debt in China, and there has been rapid growth in shadow banking. There has been excessive house price appreciation, making affordable shelter increasingly difficult for many Chinese people. But the question you asked is the right question. Are these concerns at risk of bringing the entire economy down? Are they preconditions of massive amounts of systemic risk, the likes of which we saw in the crisis in 2008 and 2009? My answer is absolutely not.

For every one of these problems, there are factors on the other side of the equation that should temper your concern. The property bubble is at the top of everyone's list. What's missing in an assessment of the excess house price appreciation is the fact that there's an enormous organic demand for shelter in China given the extraordinary pace of rural-urban migration. It's been running 15 to 20 million a year since the year 2000. We'll do another 100 million between now and 2020. Newly migrated residents of urban areas need shelter.

Shadow banking, it's worrisome. The shadow banking sector in China, by the International Monetary Fund or Financial Stability Board estimates, is growing rapidly. But it's growing off of a low base. The Financial Stability Board estimates for 2012, the last data point available, the shadow banking sector in China is 26% of GDP. The global norm is over 110%. So it's growing rapidly off of a low base. And the debt situation in local governments is definitely worrisome. The government has conducted an audit indicating the extent of the problem. The People's Bank of China is definitely sending strong signals that it's trying to implement much tighter conditions on overnight bank funding markets to slow down the pace of credit creation and awing China of this dangerous string of debt-intensive growth.

Q. China has already started making some changes. What about the US? What does the US need to do more of? Have they started to make some progress already?

A. No, we haven't. China is tweaking its model but we haven't tweaked ours at all. We said, "We'd like to just keep doing the same thing, thank you." We have adopted quantitative easing, for example, by the central bank. The idea the Fed has is that consumers will spend their wealth created in the stock market. It is an excess consumption model again. But it's really far more sinister than that, because the wealth effect only works for wealthy people. That's why it's called the wealth effect. Very few Americans actually own stocks. So the design of that policy is really aimed at providing increases in living standards at the very top of the income distribution. We have a horrific income inequality problem in America. It's really a sad state of affairs. We need to stimulate saving.

President Obama to his credit in the State of the Union address did announce a new savings program for low and middle-income individuals, but we need to do much more than that. The sooner America wakes up to the longer-term imperatives of boosting its savings rate, the better off we will be as a nation.

Q. Are you suggesting that the US and China should swap roles?

A. Switch places, that's always a dangerous thing in any marriage. But I do think that the US has lived beyond its means as its means are defined by the income-generating capacity of the US labor market. We've done that for too long and we have squandered our saving which is our ability to invest, grow and consume for the future. So we do need to save more as a nation and our savings rate is the lowest any leading nation has had in modern economic history. So, lacking in saving and wanting to grow, we borrow surplus savings freely from abroad, from places like China, Germany and Japan. Those days are coming to an end. China is putting its savings to work in supporting its economy, not our economy. America has ignored its infrastructure, investing in human capital and the manufacturing capacity. It ignored its competitiveness. We've been slipping steadily in the global competitiveness surveys conducted by the World Economic Forum for each of the last seven years. The only way we're going to prosper is to figure out a way to grow apart from spending beyond our means and saving and investing are an essential part of that. The sooner we do that the better.

Q. You have said that the "marriage" of China and the US is one of convenience, not love. In your opinion, is it possible for them to love each other with the new model?

A. It's hard to say. Certainly with the situation in Russia, there looks to be a little bit more love in the eyes of president Obama and Xi Jinping when they saw each other recently in Europe at this nuclear summit. Love is probably a stretch for these two leading nations. They have so much in common though. There's a lot that they can gain from each other in treating the relationship as an opportunity as opposed to a threat. I've been myself discouraged from time to time as I appear in front of the US Congress testifying on a variety of issues and find that the political sentiment in the US is overwhelmingly predisposed to view China as a threat.

That's not to say that China doesn't push the envelope sometimes in the rules of engagement in global commerce and behaviors acceptable in the global economy. And China should be held accountable for that, whether it's matters of intellectual property rights, trade practices, human rights and other issues that nations or its partners may feel strongly about. Now China is at a critical juncture, a juncture that many developing economies are unable to move through. This is the middle-income area that often proved very challenging for poor countries to go through. China's determined to do it and if it does do it, and I'm confident that it will, that's an opportunity for the US to participate in as opposed to feel threatened by [it].

(Visit CKGSB Knowledge *for the full interview and to watch the video: knowledge.ckgsb.edu.cn)*

Of Risk and Recovery

Philippe Legrain, economist and author of *Aftershock*, on the risks that could further disrupt the global economy

By Liu Jing

Image Source: FT Live

In 2008, the financial crisis brought the global economy to its knees. Today, six years later, the world has still not fully recovered from the impact of the crisis. At the same time, several big structural shifts are reshaping the global economy as we know it. Philippe Legrain, a British economist and author, specializes in economic issues pertaining to the global economy and also Europe specifically. He has authored four books including *Open World: The Truth about Globalisation; Immigrants: Your Country Needs Them; Aftershock: Reshaping the World Economy After the Crisis* and the most recent *European Spring: Why Our Economies and Politics are in a Mess—and How to Put Them Right*. Legrain has also been at the heart of Europe's economic decision making: between 2011 and early 2014, he was Principal Adviser and head of the analysis team at the Bureau of European Policy Advisers to the President of the European Commission.

During a recent visit to Beijing, Legrain sat down for a lively exchange with Liu Jing, Associate Dean and Professor of Accounting and Finance at CKGSB, who is an acclaimed expert on the Chinese economy. Read on further to understand better the big shifts in the global economy, how the European Union and the US are recovering from the crisis, and China's role on the global stage.

Q. What are the mega-trends that are affecting the world?

A. There are three big trends at the moment. First, there is a cyclical shift this year which is the recovery in the US and to a lesser extent in Europe, with the associated risk of tapering of quantitative easing (QE) in the US, [which may impact] emerging economies, and therefore indirectly China. Second, a big structural shift [is underway]: the new wave of technological innovation whether it is digital, manufacturing, 3D printing, or in the field of energy. Here in China, obviously, it is the shift from an economy which has been primarily based on imitation and the mobilization of resources to one that is more based on innovation and, then, overriding that huge geopolitical shift, which is the rise of China and how the US will react to that, what strategies China should pursue in response.

Q. How would you rank the risks the global economy is facing?

A. In terms of the impact of QE, we've already seen some disruption in emerging economies. Some people have talked about a 'Fragile Five' [a term coined by Morgan Stanley to describe fast-growing emerging markets that are overly dependent on foreign investment: Brazil, India, Indonesia, South Africa and Turkey]. I've listed a 'Tenuous Ten': economies that are particularly vulnerable [Brazil, India, Indonesia, South Africa and Turkey plus Argentina, Chile, Russia, Ukraine, Venezuela. Emerging economies most at risk of a crisis because of current account, currency, commodity and political exposure]. The risk is one could have an all-out emerging economies crisis. Even if one doesn't, it has important implications for the world and for China. For example, Chinese exports to these economies and other trading partners may be affected. Then there are financial linkages, for example, Chinese banks are invested in Indonesia, South Africa and elsewhere. Then you have indirect linkages, which are not always as apparent but can also be significant. Last but not least, the impact of commodity prices. If we see a weaker growth, in the Tenuous Ten, China enjoy lower commodity prices.

Q. Would you say that the risks are more concentrated on developing economies, than on the advanced economies?

A. For the past few years, most of the risks have been in advanced economies. This year, in a sense, the West has exported its problems to the rest of the world. For the past five years, the US and the Eurozone have been struggling with very difficult issues. Whether it's the banking system or the associated levels of high debt, they've taken exceptional policy measures to tackle them. In the US, it's QE. In the Eurozone, it's a big shift towards running current account surpluses. Both of these imply capital inflows to emerging economies. Now you're seeing the pressure in the opposite direction: as QE is tapered and then reversed with high US interest rates coming, you will see capital flowing back from the US. Likewise, the market pressure on emerging economies is going to amplify that pressure. You see [that] for China, which is caught in the middle. You have the opportunities [to] sell more to the US and Europe, it's more attractive there compared to before. But you have potential backlash from the tensions in emerging economies.

Q. China is undergoing a structural change from a manufacturing, export-led economy to a consumption-driven and service economy. Obviously, such big change is going to pose a lot of risks.

A. No one would have forecast China would have done so well over the last 35 years. Or even over the past five years against the backdrop of the worst financial crisis since the 1930s. One has to give credit to Chinese policymakers, and [also] the benefit of the doubt in tackling the huge challenges ahead. There is awareness at the highest level of the shifts that need to be made, that pursuing a certain level of GDP growth is not necessarily the best thing. It's also where the GDP is coming from, and its implications for the labor market. Clearly, there are vested interests that benefit from the current configuration, and it is a political challenge to overcome [them]. Many of the arguments made about the potential vulnerabilities of the Chinese economy are misconceived. So many people in the West are saying [they] invested too much. If you look at its capital stock per person, it's actually relatively small, and if you continue to grow at a rapid rate, it can rapidly become appropriate. In a sense you are building before the demand comes. Likewise, debts have built up, particularly, at the local government level. But assuming you have a high rate of nominal GDP growth, provided you stop adding to those debts, you can also grow out of them quite quickly. In terms of the financial sector, generally, people have talked about the expansion of shadow banking. Clearly there has been some bad lending and some mistakes. On the other hand, it's also a natural reflection of the regulation of the state-run banking sector. Many of the things that we are seeing in China exist in the West, too. The development of money market funds came from the regulation of bank deposits in the US, it's natural we're seeing that in China too. The risks of a financial crisis in China are greatly overstated. If you have an economy which still has a largely closed capital account, if you have a government whose solvency is unquestioned, and if you have a large foreign exchange reserves which can be brought to bear in the event of problems, China is well-placed to handle this transition. I won't say this is forever. The bigger challenge is a shift from an economy based on imitation to one based on innovation.

The things that we are seeing in China exist in the West, too. The development of money market funds came from the regulation of bank deposits in the US, it's natural we're seeing that in China too

Q. What is the number one risk facing the world in the next 3-5 years?

A. In the short run, it's the potential impact of the unwinding of QE. We live in a world where the financial sector dominates everything and the core country is the US. The monetary policy decisions of the US Federal Reserve and, in turn, their impact on the US financial sector, and therefore, the global financial sector dominates everything. If you look slightly further out, technology and structural shifts start becoming more important.

Q. You have seen European economic decision-making firsthand. Are we getting out of the problem in Europe?

A. The crisis in the Eurozone began as part of the broader crisis in the Western financial system. It is part and parcel of what happened in the US, Britain and elsewhere. In 2010, the solvency of the Greek government came into question, and because of policy mistakes, sovereign bond markets in the Eurozone panicked. There was a threat that countries might be forced to default and the Eurozone might break up. That panic came to a head in the summer of 2012. The European Central Bank (ECB) intervened, and the panic is now over. You can see countries [that] only a few years ago had to pay double-digit rates, could now borrow at 3% or 4% which is lower than they could borrow before the crisis. That financial element to the crisis, I think, is over. The ECB has solved that problem. What remains is the legacy of the [time] prior [to the] crisis: a banking sector, which is overladen with bad debt. It is like a zombie banking sector. And the household sector, in particular, which too is the counterparty to that, is high in debt. An economic process which has only partly been completed, i.e., you've seen a shift from countries running current account deficits, now to surpluses, so now you see them being net-lenders abroad. You've seen a big rise in exports in countries such as Spain. But you haven't seen the full structural shift that needs to happen. These legacy problems need to be tackled. The ECB this year is conducting a comprehensive assessment of the balance sheet of Eurozone banks. It will report at the end of the year before it becomes a single supervisor, with luck, this will lead to a restructuring of the banking system, and that, in turn, will provide credit for businesses to be able to grow. The issue of restructuring of unsustainable debts is not yet on the agenda, and needs to be. The last element which is in terms of the economic adjustment, we need to have an increase in investment. In that area, Chinese investment can play an important role. There are a lot of opportunities now as the Eurozone economy begins to recover.

Q. What about the argument many years ago that there's a structural issue in the EU? So, somewhere along the line you will have problems in terms of fiscal policy. Each country decides its own fiscal policy, so there's this a sort of mismatch. So you know there will be a crisis, but you don't know when. In that sense, the probability of a crisis is a certainty.

A. It is true that when the Euro was created in 1999, many people said that a single currency requires a common treasury, a common budget; most federal systems, whether it is the US or Germany or elsewhere have such a system. The Euro was slightly different because it's not a single country, but it's a single currency shared by many countries. I think that is not what caused this crisis. This could have caused a crisis, but in fact it was a financial crisis which was part and parcel of the broader Western financial crisis. Its origins come from excessive risk-taking in the banking sector, from excessively low interest rates by the US Federal Reserve and by the ECB, and foreign financial deregulation which made this bad lending possible. Yes, that is potentially a problem in the future. But I don't think this is what caused this crisis.

Q. So you seem to be saying the cause of the crisis is actually very similar between the US and the EU: too much risk-taking, too much leverage. To what extent are the two major economic blocs similar?

A. Many people like Alan Greenspan blame China and the global savings glut for the US financial bubble. This is a ridiculous argument, which is to say, "We are the most powerful country in the world, I'm Alan Greenspan, I'm in charge of monetary policy. Sorry it's not my fault, and it's China, a relatively small economy, which caused this". If you look at one country, at one region that played an important role in the US financial bubble, it's Europe. German, French, British banks invested into the subprime market, in the CDOs (collateralized debt obligation) and all these complex bets on US house prices. And that, in turn, the initial transmission mechanism from the US crisis to the Eurozone came in the summer of 2007, when French and German banks which were exposed to subprime ran into difficulties. The two crises are intimately linked. In the case of the European banks they didn't just lend badly in the US, [but] they also lent badly in Southern Europe: housing bubbles in Europe and bad consumer loans in Portugal, and too much lending to the government in Greece.

Q. When the crisis hit, different places had different issues. In the US, some people said that we should let the banks die, but others said the banks are systemically important, and we need to save them to save the economy. In the end, there was a national rescue plan for the banks and the economy, but there are wealth transfers in this process. In the EU, it seems to be even more complicated: different countries are arguing about who should be paying for the rescue. It seems to be the European countries got together and decided we need to save the EU. To your mind, how difficult was it to actually come to this solution?

A. The ultimate issue in a financial crisis is drawing a line under the losses and sharing them out, hopefully in a fair way, or at the very least, in a way everyone can bear them. In the first part of the financial crisis, the banks that got into trouble were bailed out by national governments in Britain, France, the Netherlands, etc. In the second part of the financial crisis, when Greece ran into trouble, in effect, European governments lent money to Greece so that Greece could repay its creditors which, in turn, were French, British and German banks. It was an indirect bailout of the banking system. At the moment, there is a kind of battle between how these losses are ultimately going to be borne. Germany thinks that as much of the burden should fall on Greek taxpayers. It's pretty clear that Greek taxpayers can't bear the full burden, which will be pushed onto German taxpayers. Ultimately, there has been a transfer of the losses from the German banks to the German taxpayer, that issue is still unresolved. What has been resolved is the firm conviction from all sides that they want the Euro to stay together. There were questions about whether Greece was going to stay in the Euro. There were questions whether Germany wanted Greece to stay in the Euro. That question is resolved now, everyone wants to stay in the Euro, everyone wants to make it work well.

What's up for debate is how we go about achieving that.

Q. Going forward, how would the crisis actually affect the rules and regulations, and how the EU is put together?

A. We've seen big changes in this crisis. We're seeing the creation of a banking union with the ECB acting as the single supervisor for bigger Eurozone banks. The creation of a single resolution mechanism, i.e. a single mechanism for restructuring and ultimately closing down banks that run into trouble. We have common EU regulation, in particular, capital adequacy which is based on the global Basel rules. We have seen changes in the fiscal area: more elaborate fiscal ratios set and enforced in Brussels as well as national limits on borrowing imposed in domestic constitutions. And we've seen a new mechanism for tackling excessive macroeconomic imbalances, for example, excessive credit growth, or large current account deficits. There's been a lot of institutional innovation during this crisis, many people think that we need to go further, but we discussed earlier on, potentially the need for a Eurozone budget, which would act as an automatic stabilizer, in the same way as the US federal budget does, which France is pushing for, and which would be a good idea. There are also moves to try out to complete the single market; the EU single market is the biggest single market in the world. For the moment, it's mostly in manufacturing goods. And then there is energy, which is even more important now with the crisis in Ukraine, which is connected to the domestic energy market. So you can have trade across countries in energy which would not only be of huge benefit economically, but also important in terms of energy security.

Q. So what is your projection of the European economic recovery in the next three years? In the US, the economy seems to be on a good footing.

A. Europe is obviously doing better compared to two years ago. At the moment, real GDP growth will be roughly 1%. Nominal GDP growth will be 1.5-2%, because inflation is so weak. That is, not a particularly strong recovery, but it is better than the rapidly shrinking economy two years ago. Looking further out there's hundreds of other imponderables, so I would only hazard a guess for this year.

Q. What is the European view on China's rise?

A. I think there are two views: there are some that welcome the rise of China as creating a multi-polar world rather than one dominated by the US. And there are others that fear the rise of China, partly for economic reasons, partly for cultural reasons. Personally, I've always been of the belief that China's rise is a good thing, that it would be economically beneficial for Europe.

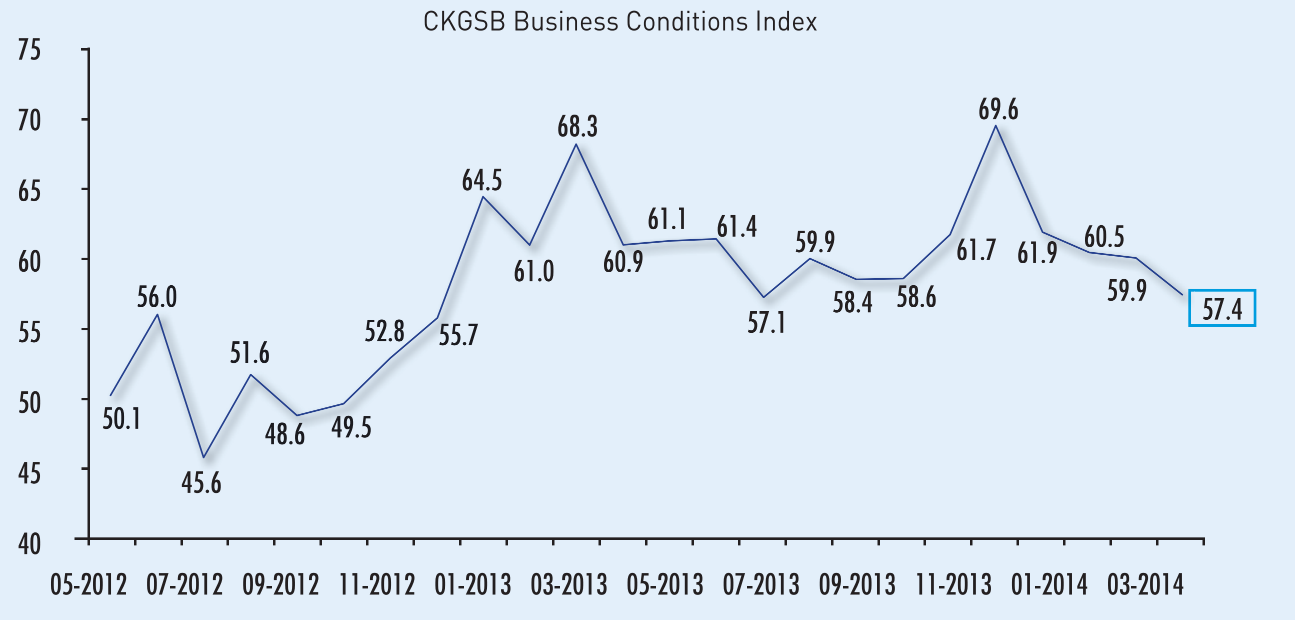
(Visit CKGSB Knowledge *for the full interview and to watch the video: knowledge.ckgsb.edu.cn)*

Down But Not Out

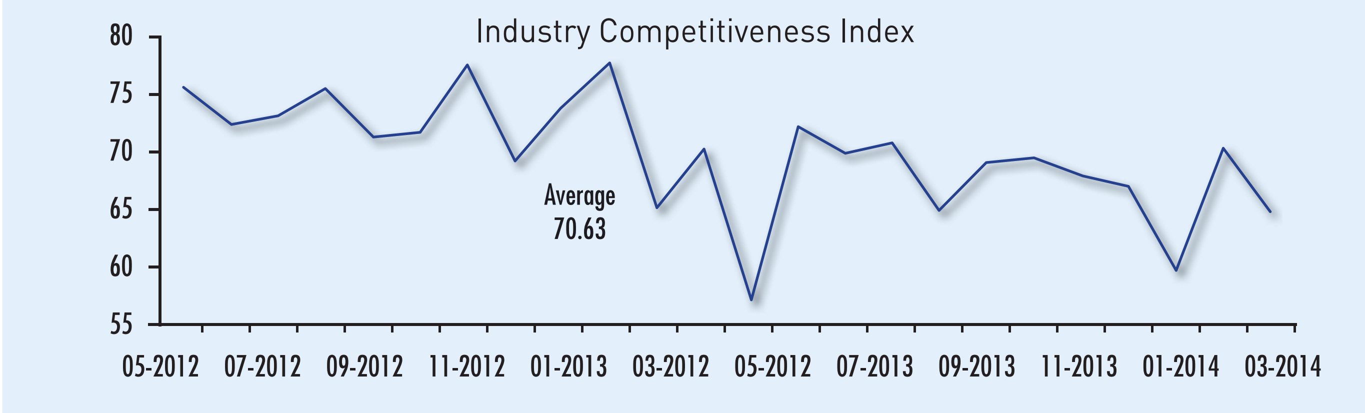
The latest CKGSB Business Conditions Index shows that entrepreneurs are feeling the slowdown

Business sentiments in April have waned in light of economic data that fell short of expectations. Each month CKGSB's Case Center and Center for Economic Research conducts a survey of leading entrepreneurs in China to gauge and track changes in their business sentiment. The result is the CKGSB Business Conditions Index (CKGSB BCI), directed by Li Wei, Professor of Economics and Emerging Markets Finance. and provides a barometer on the state of the economy as viewed by China's entrepreneurs. The CKGSB BCI reads 57.4 in April, and has averaged 59.9 over the last four months with 50 being the threshold between a positive and negative economic outlook (see CKGSB Business Conditions Index). Since the beginning of the year, this forecast has become cautious, resulting in the business community losing some of the winter's bounce in expectations. China's growth has slowed, and the effect of new policies on future forecasts remains to be seen. In the questionnaire respondents indicate whether their firm is more, the same, or less, competitive than the industry average (50), and from this a sample competitiveness index is derived (see Industry Competitiveness Index). Consequently, as sample firms are in a relatively strong competitive position in their respective industries, so CKGSB BCI indices are higher than government and industry PMI indices. Users of the CKGSB BCI index may thus focus on data changes over time to forecast trends in China's economy.

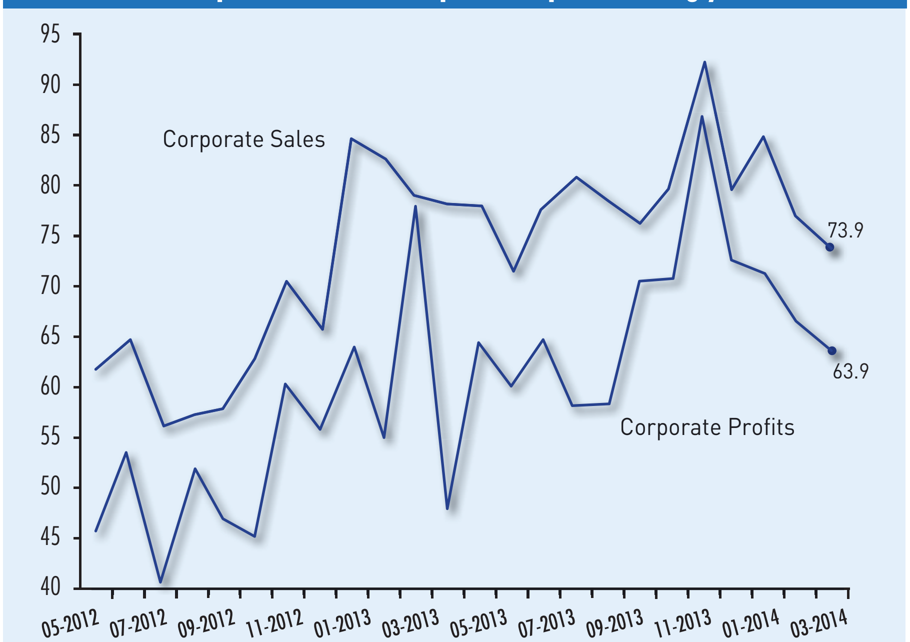
Batten down the hatches...



...rough waters may be ahead



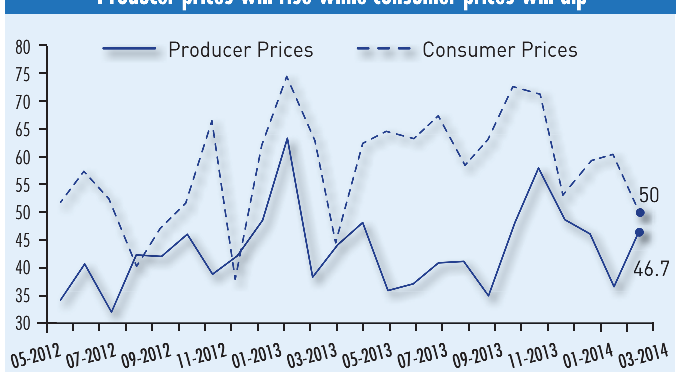
Prospects for sales and profits taper accordingly...



The corporate sales index registered 73.9, and the profit index registered 63.9, each lower than last month (see Corporate Sales and Corporate Profits). This quarter has seen a downward trend. Comparing these two indices with the overall BCI, we see that their downward trend is positively correlated with business operational forecasts. In April, labor costs and overall costs registered indices of 89 and 77.2 respectively (see Labor Costs and Overall Costs), both at a high level. These two costs indices show that the majority of sample firms expect costs to increase compared with this time last year. The consumer prices index dropped 10.9 points to 50 (see Producer Prices and Consumer Prices), showing the trend for the forthcoming period is a lowering of prices. Producer prices rose 9.8 points to 46.7, evidence of a narrowing of exposure on last month.

...as will overall costs

Producer prices will rise while consumer prices will dip

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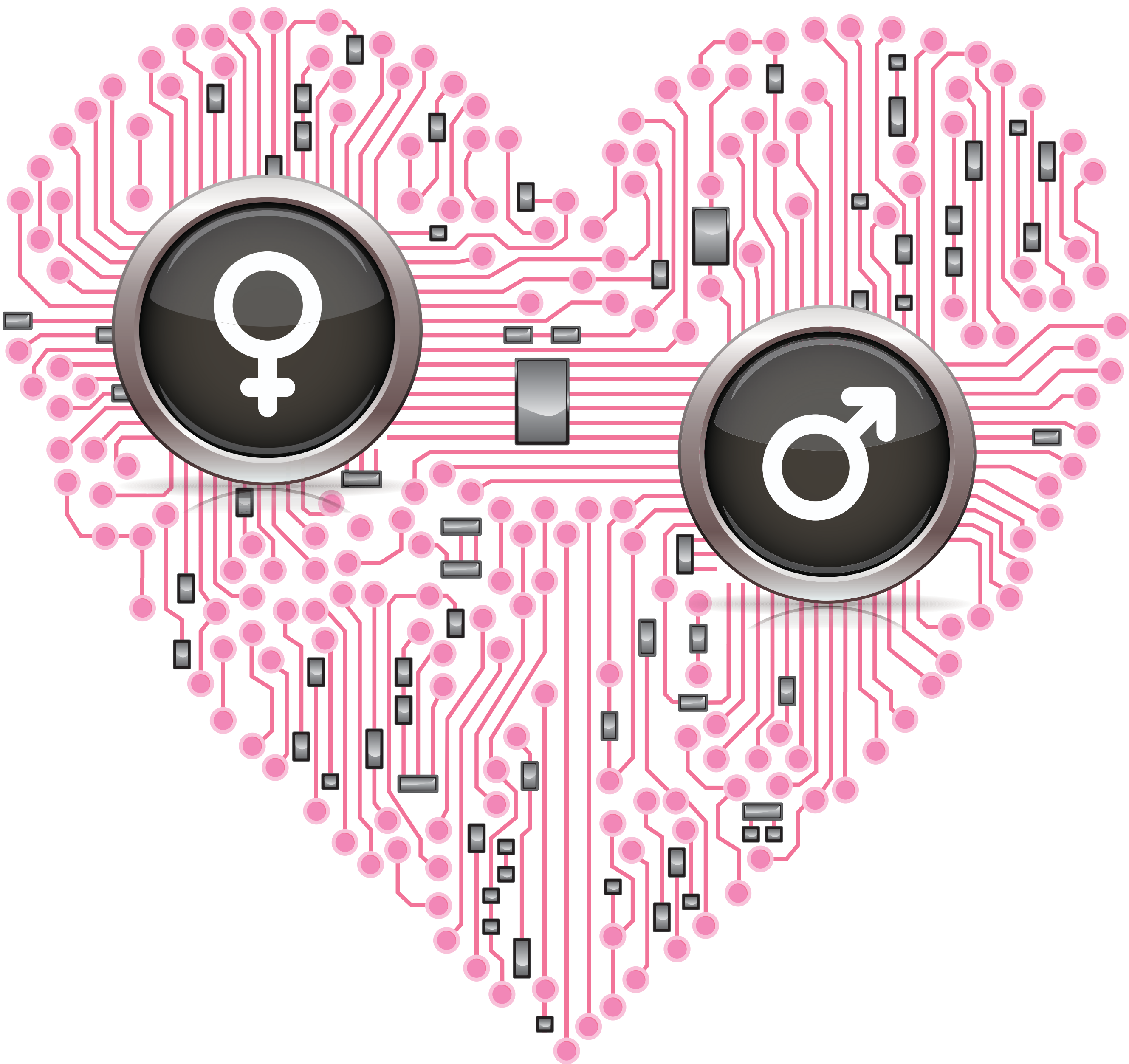
Heart 2 Heart

Online and mobile dating should be a natural fit for China, so why are these businesses not making more money?

By Sunny Oh



Swirling pools of onlookers and parents pore over a bulletin board in Shanghai's bustling marriage market, nestled in People's Park in the city's center, occupying what was formerly a colonial racetrack. Filled with well-thumbed advertisements listing their children's qualifications, salaries, horoscopes and blood types, the bulletin board is akin to a stock exchange. Children are described as practical investments to be bought and sold. Parents meet and match children, spending the better part of their day hunting for potential spouses for their children.

But online dating services threaten to overturn these more traditional methods in which parents act as cupid. Liberal young white-collar workers are turning to online dating platforms like Jiayuan to reassert control over their love lives, often, to the displeasure of their parents. One mother, who declined to be named, said, "Those online matchmaking sites are no good… [they] don't let parents get involved."

This inter-generational conflict, however, is pettier than it seems. A confluence of trends ranging from growing gender disparity to longer working hours, means searching for a potential spouse, let alone a girlfriend or boyfriend, is now more difficult than ever. Recent societal attitudes and governmental policy are also encouraging couples to tie the knot. Leta Hong Fincher, the author of *Leftover Women: The Resurgence of Gender Inequality in China*, says the Central government really began bringing unmarried woman into the limelight with the use and promotion of the term "leftover women", first coined in China's 2010 National Marriage Survey. Thereafter state and independent media devoted wide coverage to this social phenomenon, exerting pressure on women fitting into this category to exit the category as quickly as possible.

Like over-zealous parents, online matchmaking platforms are positioned to benefit from all this. And the figures reflect that up to a point. Analysts project that the mushrooming industry will be worth in excess of RMB 22 billion in 2015 from 2.6 billion in 2009.

A matchmaking event in Shanghai in China May 2013

Not Too Rosy

But industry players have yet to really capitalize from the sector's rapid growth. Three companies—Baihe, Jiayuan and Zhenai—occupy the lion's share of the market, but none have been able to convert their dominance into sizable profits. Earnings for Jiayuan, which surpassed 100 million registered users in January of this year and retaining its title of largest online matchmaking platform, grew 2.5% year-over-year for 2013 even as revenues jumped 8% according to earnings reports. Jiayuan's share price has fallen more than 50% since its IPO. Perhaps learning from Jiayuan's experience, the two other matchmakers fell back on similar plans to hold IPOs, suggesting even their own management didn't have much self-confidence.

Amid middling profits, online matchmakers have struggled to coax China's notoriously stingy internet masses to give up their cash. China's online matchmakers work on the business model of restricting access to "premium" features. They unlock this access upon the user paying an annual or monthly fee that can reach hundreds of yuan. It also entitles users to pay a discounted price for sending a flirtatious message to a love interest.

But more casual users are deterred by these hefty sums, leaving only a small portion of users to ever register for premium

For app users, they use them anytime and anywhere. The market for online dating apps will at least reach the same level as online dating

Sun Mengzi
Analyst
Enfodesk

memberships. For Jiayuan, the average number of monthly paying users for the third quarter of 2013 was 1.37 million, this compares to 1.25 million in the third quarter of 2011, according to the company's earnings reports. In recent years, the number of paying users has rarely exceeded the 1.5 million mark.

Of those using online dating websites, the paying user ratio rarely exceeds 30%, according to internet consultancy iResearch. And with more Chinese users inclined to play the field by using all three platforms, paying dues, then, to all three companies can be prohibitively expensive.

Web companies would usually then leverage their millions of users to attract advertising, but iResearch reports that online matchmakers have struggled to find suitable sponsors; as a result, advertising proceeds only play a bit-part role.

Diversify, Diversify, Diversify

The success of these companies, then hinges on a growing base of paying users. "The number of their registered members is their most important priority," says Sun Mengzi, an analyst from Enfodesk. To that end, she feels online matchmakers should spend more on advertising. But previous attempts at raising their profile have all but wiped their profits and have done little to increase the number of paying users. This has prompted them to attempt different, sometimes inventive, ways to revive flagging profits. Some regularly hold massive dating events in grand exhibition halls and others advertise themselves as pseudo-social networking websites.

All now provide more one-to-one consulting via brick-and-mortar stores. For Baihe, this has been a particularly fruitful venture; half of its profits come from these "offline" stores. Satisfaction rates for these VIP services tend to be higher. As one user bluntly explains, "Guys from VIP can be better choices. If you don't pay, guys on the page are ugly, poor, short or whatever, but not good."

Unlike online dating through websites, VIP services generate trust, something incredibly valuable to online matchmakers. Personal matchmakers can perform background checks to filter out online Lotharios, or worse, outright criminals. But fees for these VIP services can go into the thousands of yuan, a significant chunk of an office worker's salary.

Mobile Rising

If growth lies anywhere, it is in mobile dating. People can use dating apps in their downtime, a distinct advantage over flicking through online profiles on the computer. Whether it be walking to work or shopping for groceries, mobile dating offers an unprecedented level of convenience to belabored white-collar workers. "For app users, they use them anytime and anywhere," says Sun. She says that even by conservative estimates, "the market for online dating apps will at least reach the same level as online dating websites." Analysts from iResearch project that the market for mobile dating will achieve double-digit growth rates by 2015.

With margins so thin, online matchmakers are only successful if they stray from their original bread and butter—internet dating. But if a company achieves some measure of success in, say, mobile, there's little preventing competitors from copying profitable ventures and ideas. As it stands, this makes it difficult to foresee if any of China's internet's cupids will ever make money at losing their arrows.

Disciplined Leisure

Jo Lusby of Penguin China is swimming in literature for work, so what stands out?

Jo Lusby

Given the nature of my work, leisure reading is a bit different for me than for the average reader. Being a book publisher gives you a justification for reading pretty much anything, at any time, regardless of how trashy or otherwise indulgently "pointless" it may be. I have to be careful to not turn reading into a chore. If I'm reading a book that I love, I find myself thinking about whether there is a Chinese equivalent that we could find, or whether it would work in the Chinese language. Occasionally I find myself just turning pages in order to get a book 'done', rather than actually reading and digesting it.

Case in point, when I moved to China in 1998, I had already read *Wild Swans*, a product of the time when Cultural Revolution scar literature dominated English language books from the country. Early on I started reading the fiction of Mo Yan in translation, and I remember borrowing my roommate's copy of *Chairman Mao Would Not Be Amused*, which is still to my mind the best anthology of contemporary Chinese writing out there, even if it is now around 20 years old.

But for someone who wants a non-fiction grounding in China, I would recommend *Out of Mao's Shadow* by Philip Pan and *China Shakes the World* by James Kynge, which, despite being a few years old, are great books. *Mr. China* by Tim Clissold is still the best "how not to do business in China" book.

When determined to read for pleasure, I enjoy international fiction interspersed with spats of serious, non-fiction. My last book was *Strange Weather in Tokyo* by Hiromi Kawakami, a quiet love story set in Japan. I'm currently reading the Century Trilogy [*Fall of Giants, Winter of the World and Edge of Eternity*] by Ken Follett, and my next book will be a choice between Glenn Greenwald's NSA expose *No Place to Hide*, former Beijing journalist Evan Osnos' new China book *The Age of Ambition*—much like a collection of his essays for *The New Yorker*—or Louisa Lim's *People's Republic of Amnesia*.

My current favorite author by a very long way is Norwegian author Karl Ove Knausgard. His multi-volume autobiography is being published at the rate of one book per year, which is just not enough—I'm completely addicted.

Critical acclaim is by no means a guarantee, however. I have tried and failed three times to read *Wolf Hall* by Hilary Mantel. It won every prize it could, and I'm confident the problem is entirely mine, but I have finally admitted defeat and shelved it for the time being.

One thing I don't read about is the publishing industry; doing so seemingly defeats the purpose. Having said that, I'm very much looking forward to reading *Creativity Inc.* by Ed Catmull, about how Pixar manages corporatized creativity—something that is very relevant to what we do, albeit in a different medium.

Jo Lusby is the Managing Director for Penguin, China

Business Bestsellers in the US

No.1 **Capital in the Twenty-First Century**
by Thomas Piketty

No.2 **Think Like a Freak**
by Steven D. Levitt and Stephen J. Dubner

No.3 **Habit Stacking**
by S.J. Scott

No.4 **Strengths Finder 2.0**
by Tom Rath

No.5 **Flash Boys**
by Michael Lewis

No.6 **The Fourth Revolution**
by John Micklethwait

No.7 **Stress Test**
by Timothy F. Geithner

No.8 **Girlboss**
by Sophia Amoruso

No.9 **How To Win Friends and Influence People**
by Dale Carnegie

No.10 **The Obstacle Is the Way**
by Ryan Holiday

Source: Amazon (not including repeats based on format)

Business Bestsellers in China

No.1 **Trade War**
by Xiaobo Wu, Bing Zhou

No.2 **Internet Thought**
by Dawei Zhao

No.3 **Micro-brand**
by Daoyong Qiu

No.4 **Chinese Financial History**
by Yulu Chen, Shuzhong Yang

No.5 **Do What Billionaires Tell You**
by Jin Mai

No.6 **Micro-marketing of Enterprises**
by Zhouyu Shen

No.7 **What is Internet Thinking?**
by Jianbiao Xiang, Hua Cai, Rongjun Liu

No.8 **Big Data**
by Zipei Tu

No.9 **Why Rich Chinese Become Poor**
by Tingbin Zhang

No.10 **Marketing Psychology**
by Haoxuan Li

Source: DangDang.com