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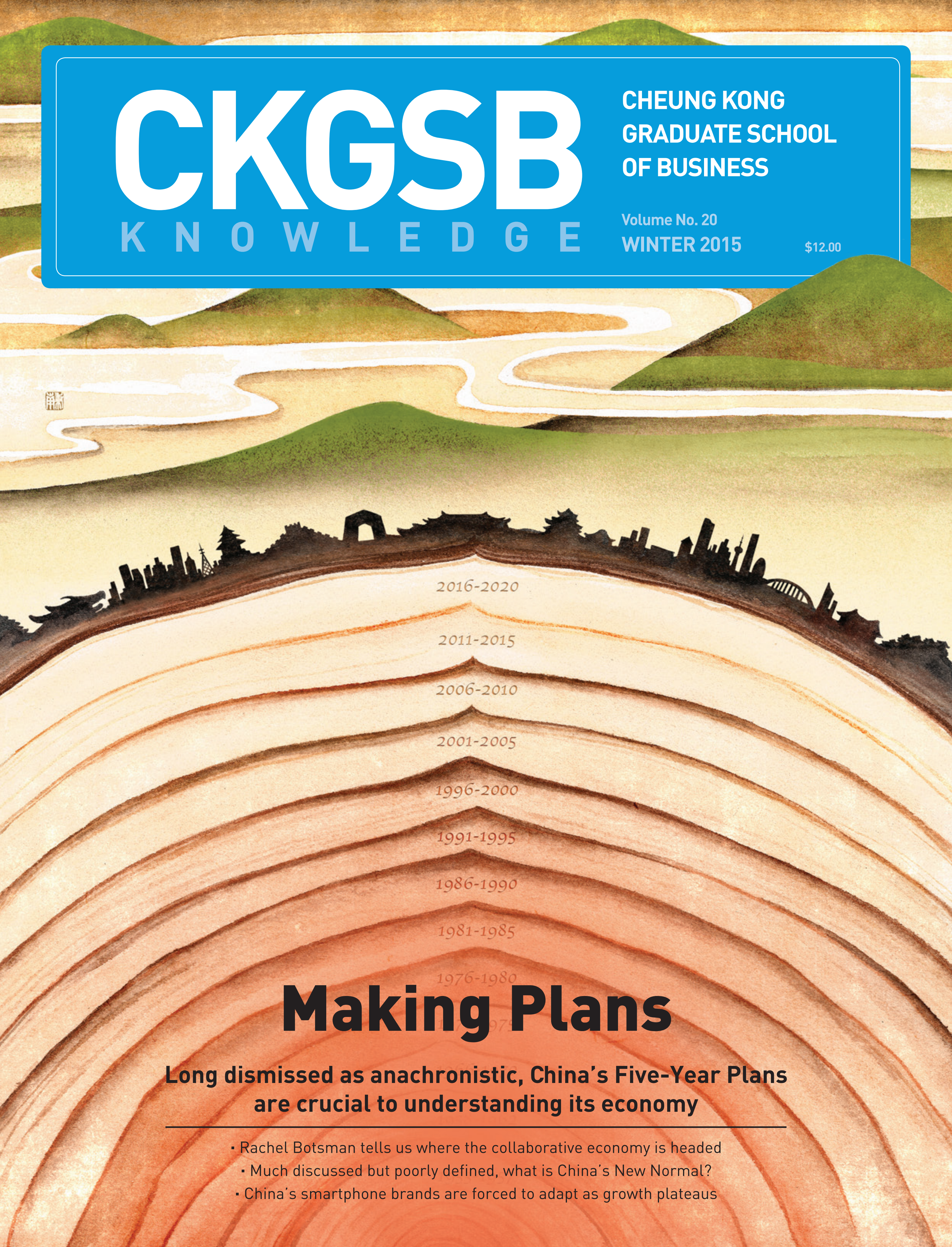


# Making Plans

## Long dismissed as anachronistic, China's Five-Year Plans are crucial to understanding its economy

- Rachel Botsman tells us where the collaborative economy is headed
- Much discussed but poorly defined, what is China's New Normal?
- China's smartphone brands are forced to adapt as growth plateaus

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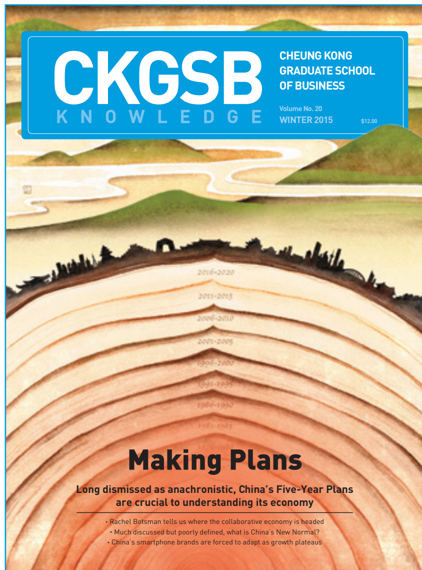
# Understanding China's Planned Economy

China's recently released 13th five-year plan reminded me of how the country has changed since 1979, the year I became an undergraduate of the Department of National Planning and Statistics at the People's (now Renmin) University in Beijing. One of the major courses was National Economic Planning, primarily about Wassily Leontief's "input and output tables", taught by a Chinese professor who used to study in the Soviet Union. Many of the graduates of our department ended up working in the development of China's five-year plans. Over the past 30 years, the meaning of the plans has been changing along with the decision-making process of China. As the market, instead of the state, plays a much more important role in China's economy, the so called "plan" is more like a "direction" or a "guidance", as you will read in our cover story on page 20. We walk you through the history of central planning in China, and how it has changed over the years. We also talk about how, despite its many weaknesses, it serves a useful role in guiding the country forward.




All China watchers these days are concerned about the country's slowing GDP numbers and they often come across the term 'the New Normal'. But what does the New Normal really mean? What kind of growth rate will China's economy witness in future and what impact would that have across sectors? How is it preparing for the New Normal? Please turn to page 10 to know more.

On a related note, another story in this issue explores the theme of China's exposure to the world, a topic that's particularly relevant now because of the slowdown here. Will China's economic slowdown have a ripple effect on countries across the world? If yes, how big will the damage be? Or are other countries relatively insulated from what's happening here in China? For more on that please read our story 'When China Sneezes' on page 32.

On a lighter note, we turn the spotlight on a rather hard-to-understand demographic: the population of millennials, or 18 to 35-year-olds, in China. When I look at them, I often wonder how different their life is compared to ours when we were growing up in the China of yesteryear when the monthly income of most households was less than $20. They have much more money to spend. They are much more exposed to the West. They are relatively unfettered by responsibility. They care about their individuality more than we ever did. They are also a very important demographic for marketers, and unfortunately not an easy one to cater to. In our story 'New Youth' (page 27) we explain what China's millennials are like and how companies can go about trying to understand them.

In the interviews section, this time we bring you three thought leaders, two of whom have won prestigious awards at the recently concluded Thinkers50 gala (the third was shortlisted for an award): Brian Robertson (page 62), Rachel Botsman (page 58) and the incorrigible Henry Mintzberg (page 65). While Brian Robertson talks about the revolutionary concept of Holacracy, an idea in self-management that is starting to take root in organizations across the world and shaking up traditional management models, Rachel Botsman talks about another disruptive idea: that of the sharing economy. In his interview, Henry Mintzberg, a management academic who has ruffled many feathers over the years with his radical ideas, talks about the need to rebalance society.

Well, I hope you enjoy reading this issue of *CKGSB Knowledge*. As always, we look forward to your comments and feedback.

*Yours Sincerely,*

Zhou Li
Assistant Dean, CKGSB

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

# China Data

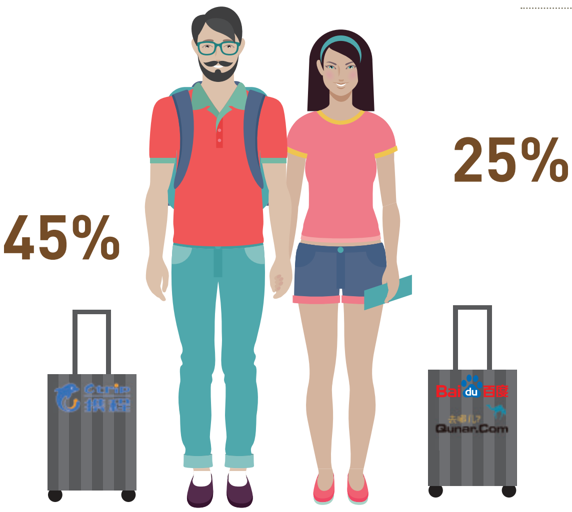
The stats you need to know

## Funding Charge

Private equity and venture capital investment in telecommunications, media and technology in China over the first half of 2015 reached **$15.6 bn**— almost as much as the full-year figure in 2014, **$15.9 bn**.


Source: PwC

## Traveling Together

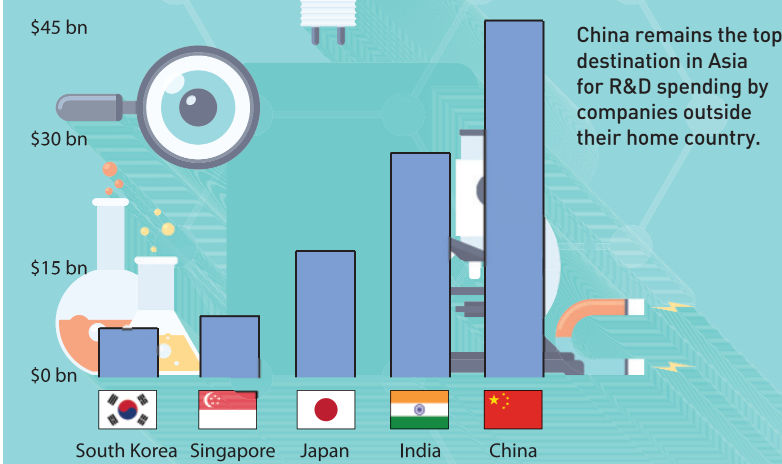



As part of a share swap deal involving two of China's largest online travel companies, Ctrip will take a 45% stake in its rival Qunar, while Baidu, which backs Qunar, is to take a 25% stake in Ctrip. Qunar and Ctrip will remain separate companies.

Source: *Wall Street Journal*

## Away From Home

Corporate R&D spending done by firms headquartered outside of the country in 2015




China remains the top destination in Asia for R&D spending by companies outside their home country.

Source: Strategy&

## Treat Yourself

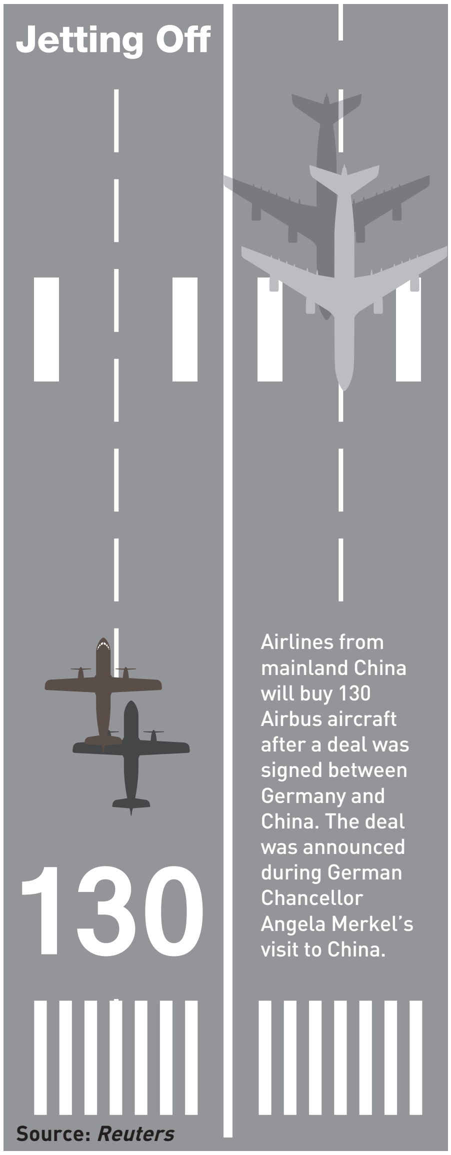

China's annual Singles Day sales yet again broke records this year, with Alibaba leading the way with RMB 91.2 bn ($14.32 bn), an increase of 60% over last year.

Source: *Reuters*

## Towers of London


Source: *China Daily*

## Jetting Off




Airlines from mainland China will buy 130 Airbus aircraft after a deal was signed between Germany and China. The deal was announced during German Chancellor Angela Merkel's visit to China.

Source: *Reuters*

## Warm Welcome

UK and China seal £40 bn ($60.7 bn) in deals after Xi Jinping's state visit, although some have cast doubt on the figure.

Source: *Financial Times*


## Baby Boom?


In October, the government announced all couples will be allowed to have 2 children. Concerns have been raised over China's ageing population and this is being seen as a remedy.

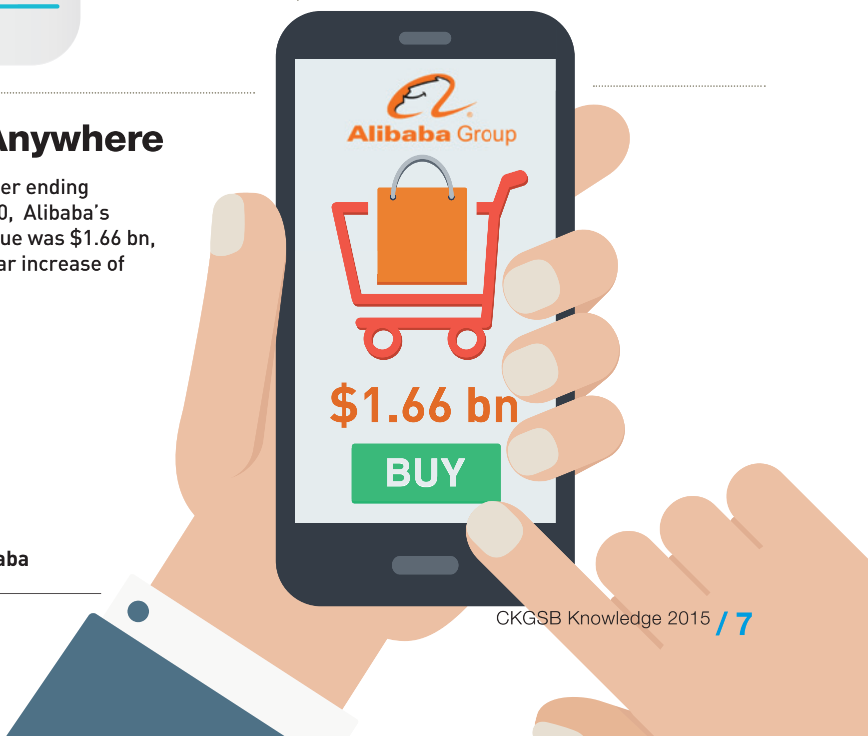
Source: *Reuters*

## Shop Anywhere

For the quarter ending September 30, Alibaba's mobile revenue was $1.66 bn, a year-on-year increase of

183%.

Source: Alibaba

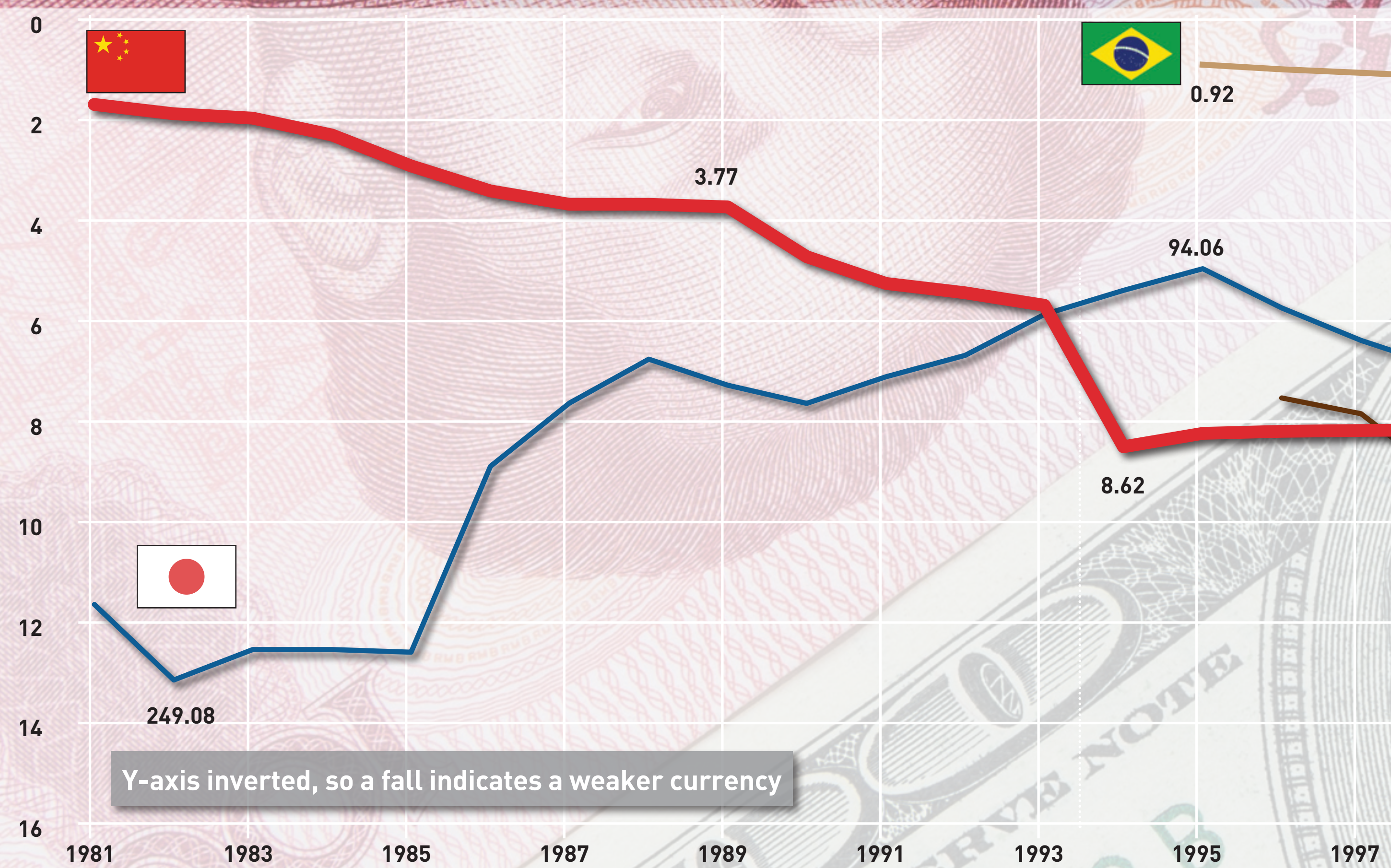


# RISE AND FALL

## THE CHANGING VALUE OF THE WORLD'S MOST CONTENTIOUS CURRENCY

In August, the renminbi was suddenly devalued after market forces were introduced into the way its trading band was calculated, once again casting the spotlight on this most contentious of currencies. Typically, thanks to the interventions of US politicians, the conversation has centered on accusations that the renminbi has been kept artificially low as part of a ploy to boost Chinese exports. However, such a view hasn't been supported by analysts, and in the Summer 2015 issue of *CKGSB Knowledge* several went on record as saying the renminbi was in fact overvalued.

### ANNUAL AVERAGE EXCHANGE RATE (LOCAL CURRENCY UNIT PER $)

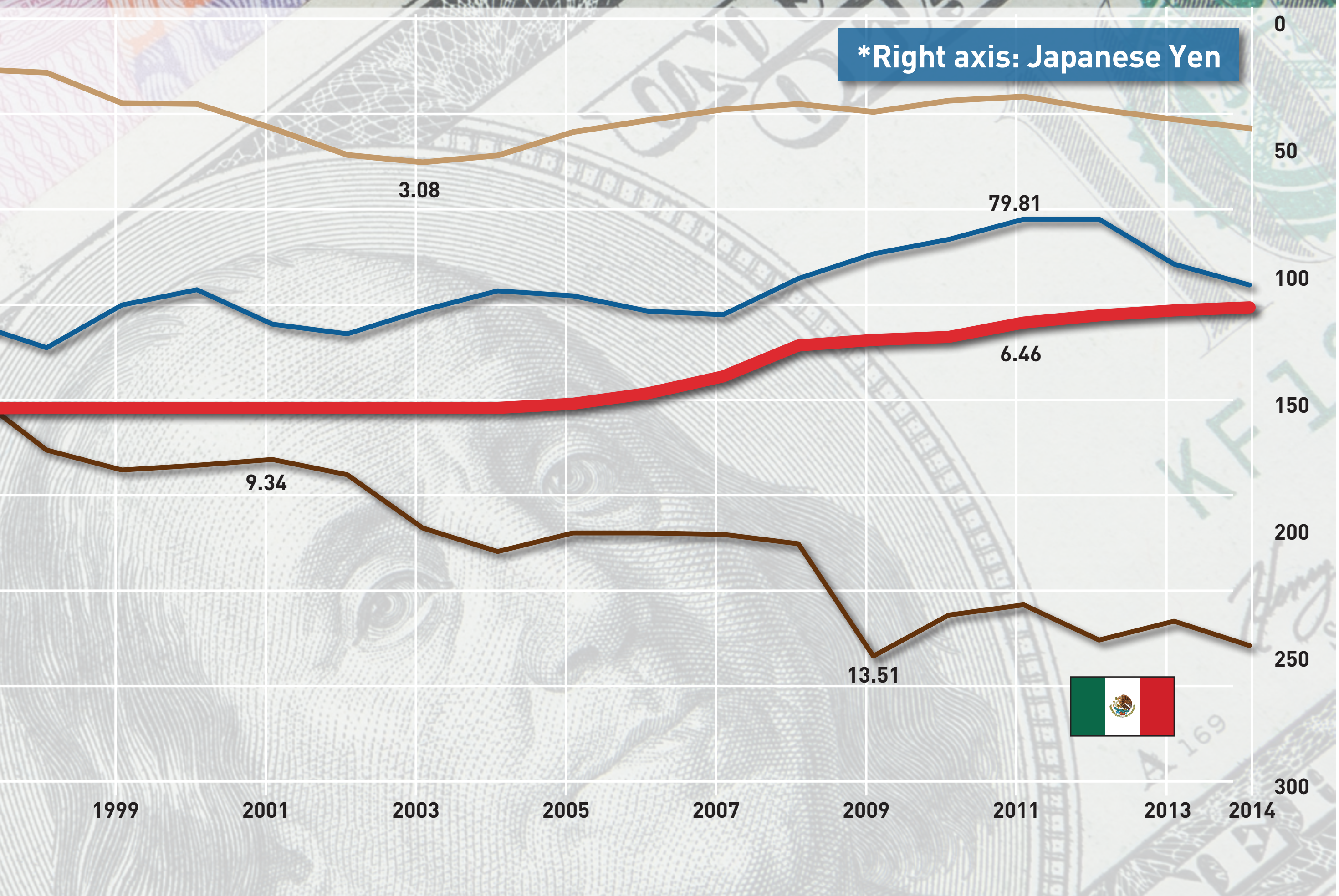


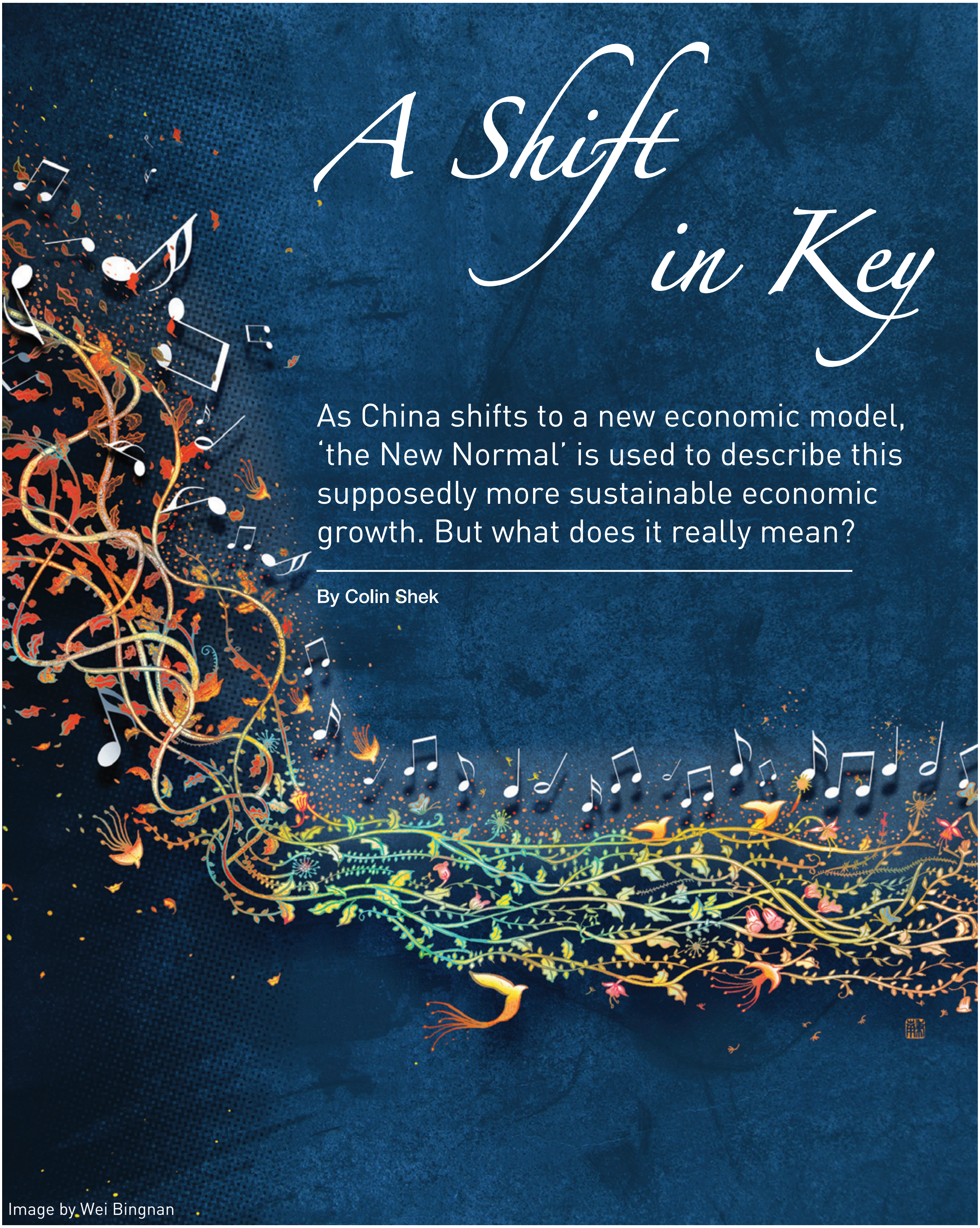

Sources: World Bank, Oanda

## A Decade Of Difference

US Dollar Exchange Rate, Monthly Average (Bid)

| | | Oct. 2005 | Oct. 2015 |
|---|---|---|---|
| CHINESE RENMINBI | RMB | 8.07 | 6.34 |
| MEXICAN PESO | MXP | 10.83 | 16.58 |
| BRAZILIAN REAL | BRL | 2.25 | 3.88 |
| JAPANESE YEN * | JPY | 114.66 | 120.09 |





# A Shift in Key

As China shifts to a new economic model, 'the New Normal' is used to describe this supposedly more sustainable economic growth. But what does it really mean?

By Colin Shek

Image by Wei Bingnan

Until recently, Zhengzhou probably felt like China's future. The capital of the inland Henan province has been on a construction binge over the past dozen years, building out to become the heart of hinterland China. The largest high-speed train station in the world opened on the eastern boundary in 2012, burnishing Zhengzhou's credentials as a transport hub. Zhengdong district, completed in 2013, is larger than the rest of the city put together.

Zhengzhou built itself up by gorging on investment and debt. Now development has slowed in tandem with the rest of China. GDP growth fell to 9.6% in the first half of 2015, an improvement from 9.3% in 2014 but down sharply from an average of more than 13% in the past decade.

Zhengzhou is confronting the 'New Normal', a stock phrase used by President Xi Jinping while touring the city of 9 million people last year. In recent months, it has become a near-ubiquitous mantra for Chinese officials. The problem is there have been no attempts to define the slogan, and Beijing has been happy to leave it vague.

"Xi just talked about China being in a New Normal and there was no attempt at describing it," says Michael Pettis, Professor of Finance at the Guanghua School of Management at Peking University. "It just doesn't have any meaning… but I think most people assume the New Normal means growth of 6-7% is what we can expect for the next several years."

## New Narratives

China watchers generally echo that view. Gone are the days of double-digit growth. The consensus now is the New Normal will usher in a steadier, stronger, more sustainable economy led by consumption and services. So the slogan is intended to refocus the minds of officials on the quality of growth instead of quantity, says Michelle Lam, a Hong Kong-based economist at Lombard Street Research in London.

China's economic data, from trade figures to manufacturing and services PMI, have been weak for months, belying the reassuring optimism espoused by the New Normal and making it increasingly difficult to believe the leadership's mantra. That is reviving longstanding worries over the trustworthiness of China's statistics and its true growth. Lam believes the world's second-largest economy has now entered a critical period in its post-crisis adjustment, posing serious risks for the rest of the world. "The sharp growth slowdown… [will] be a stern test of Beijing's resolve to reform in coming quarters," she says.

> "The Chinese public have shrugged off the gloomy outlook by opening their wallets, with retail sales of consumer goods in October rising by 11% over last year

Other analysts believe the New Normal goes beyond the economy, to portend a retrenched market environment—one potentially less hospitable for private and foreign businesses.

David Hoffman, Senior Vice President Asia and Managing Director of the China Center at The Conference Board, says a characteristic of the New Normal has been a U-turn from the market orientation supposedly championed by the Communist Party two years ago.

"What we're seeing is a tightening of controls on the emergent market forces that now are active in China, after years of incremental opening. These market forces are not being allowed to play a more decisive role in the economy," says Hoffman, citing as an example the state's quick and heavy-handed containment of the stock market crash this summer, and the ongoing state support for over-capacity industrial sectors.

"In our view, the New Normal business environment is one that is more tightly controlled, less open to market influences, and for those reasons, a more difficult operating environment for Western multinationals," says Hoffman. He pins the pullback from market forces on fears of economic instability. Subjecting China's acutely overbuilt and uncompetitive industries to real competition from Western and private domestic firms would undoubtedly usher in a wave of 'creative destruction'—a cornerstone of capitalism, whereby the market delivers innovation and productivity growth by forcing out inefficient players.

But creative destruction is likely seen as being more harmful than helpful, says Hoffman. China is in a tug of war between "markets and masters"—that is, using markets to drive growth and innovation, or relying on government-led economic engineering to do so.

That does not bode well for foreign firms. Their independence from the state and well-honed competitive instinct make them a wildcard.

"The investigations on product quality and safety, on tax evasion and on monopoly practices are designed to curb multinationals' influence and competitiveness in the Chinese market, in aggregate, and are all a byproduct of these tensions between market forces and non-market forces," says Hoffman.

## A Painful Transition

When Xi used the phrase in Zhengzhou last year, fears were mounting over a slowdown in the Chinese economy. American and European demand had not recovered to support Chinese industrial growth. Worse still, disappointing imports were signaling weaker domestic demand at a time when China was vocal about the need to shift the economy away from an export and investment-led growth model to one driven by internal consumption.

"Growth rates had been slowing significantly and, for a long time, people didn't really expect it. They thought that there'd been some sort of model that China had created that was capable of generating very, very rapid rates of growth," says Pettis.

That view began to shift in mid-2014. "There's a big debate about how much China's going to slow. People even think the Chinese economy is going to collapse. I think the context of the New Normal is concern about the sustainability of the Chinese economy and the government is trying to build confidence by saying we've more or less bottomed out."

### Appetite for Consumption

A core component of the New Normal mantra has been a long overdue shift in the growth model, away from debt-driven investment and exports to consumption and services. Until recently, investment accounted for at least 50% of China's GDP. Nowhere was this more evident than in the construction binge that has taken place over the past six years. In Zhengzhou, for instance, thousands of workers are racing to finish a second terminal and runway for the city's airport by December, just three years after construction broke ground.

The government faces two formidable challenges: raise the proportion of consumption in GDP—58.4% in the first nine months of 2015 from 50.2% in 2014—and slow down debt expansion.

The tasks are intertwined because slower debt accrual would weaken growth in investment, which risks damaging the economy and creating a surge of unemployment. Pettis says that to mitigate this risk, China has "got to get consumption up in order to smooth this transition away from debt and investment."

So there is some relief in the fact consumption remains a bright spot in the economy. The Chinese public have shrugged off the gloomy outlook by opening their wallets, with retail sales of consumer goods in October rising by 11% over last year—the highest growth rate so far this year. And a recent consumer confidence index from ANZ and Roy Morgan found nearly 43% of respondents reported being better financially off in October than a year ago, compared with 16.9% who felt worse off.

Unlocking more consumption will involve expanding demand for tertiary services like healthcare, education, tourism and financial products. To do that, policymakers will need to first bolster the household share of income and reduce the country's national savings rate—which stood at 50% of GDP in 2013, according to the World Bank. Lam says the bulk of household financial wealth is tied up in interest-bearing deposits, so freeing up deposit rates will transfer income from firms to households as savers get rewarded properly.

### Manufacturing Turmoil

China's slowdown has been self-imposed through its rebalancing act. But an unexpectedly sharp decline in some areas of the economy over the past year—partly due to weak global demand—sparked fears of a more serious slump.

The problem has been exacerbated by Beijing's insistence on sticking with high growth targets—7% for 2015—and the resulting reliance on credit to produce the

**Bulls and Bears**

**Growth forecasts for China's GDP in 2016**

| | |
|---|---|
| World Bank | 7.0% |
| OECD | 6.9% |
| Asian Development Bank | 6.7% |
| Goldman Sachs | 6.4% |
| Economist Intelligence Unit | 6.4% |
| IMF | 6.3% |
| Barclays | 6.0% |
| Nomura | 5.8% |
| The Conference Board | 3.7% |

Source: The institutions, CNBC, Nikkei

output needed to hit that goal. Pettis says that because the credit system has been designed around implicit state guarantees, a large portion of financing is misallocated to the less-efficient, highly indebted economic sectors.

The New Normal narrative has been damaged by recent trade and market developments. Economic growth is weakening in a way not seen for years, with a deceleration to 6.9% in the third quarter—the slowest since early 2009 in the aftermath of the global financial crisis. A series of surveys have pointed to contraction in the manufacturing sector—Caixin's purchasing managers' index slumped to a six-and-a-half year low of 47.2 in September—while a severe slump in the real estate market has deprived local governments of land sales, their main revenue source.

Evidence has mounted that the government lost some control over the economy. The meteoric rise and then crash of the stock market over the summer left investors rattled, but what was worst in the eyes of many was Beijing's reaction to the turmoil. An unprecedented government intervention to prop up plunging share prices was criticized as heavy handed and ended up discrediting China's equity markets.

While the stock market was roiling, the Chinese central bank carried out the biggest devaluation of the renminbi in two decades. That jolted financial markets and renewed fears of a 'currency war', while sowing more doubt over the health of the Asia's-largest economy.

Another shock has been the belated effort to resolve local government borrowing and misspending. The National Audit Office's first attempt to estimate the size of local government debt uncovered a stock worth 26% of GDP at the end of 2010. It was 32% of GDP in mid-2013, and the latest study by the Chinese Academy of Social Sciences showed debt had jumped to 47.5% of GDP by the end of last year.

These slew of problems have prompted more bearish takes on the economy. Most independent forecasters have cut their outlook for growth this year to between 6% and 7%. Lam from Lombard Street Research says, "It is difficult to see growth above 3-5% in Q4 and 2016 as the correction of China's massive overinvestment is now underway in earnest."

> "
> What we don't see is a lot of reforms that would let markets drive productivity and competitiveness
>
> David Hoffman
> Managing Director, China Center
> The Conference Board

The impact of the slowdown and restructuring pressures have been especially acute in China's coalfields and old industrial bases. The coal-dependent province of Shanxi shrank 4.7% in the first six months of this year from the same period a year earlier. The three rustbelt provinces of northeast China have also been hit particularly hard—Heilongjiang contracted 4.2%.

The challenges confronting these provinces reflect what China is also facing nationally—curtailing the power of state-owned enterprises (SOEs), allowing market forces to play a greater role and finding new drivers of growth now that the infrastructure and housing boom is arguably tapped out. Structural changes are desperately needed, but hard to swallow for regions that flourished under the old Soviet-style command economy.

The question for policymakers is how to implement changes in Heilongjiang and elsewhere without causing greater pain and upheaval. A failure to adapt to the New Normal could see them left behind, as reforms such as increased environmental oversight and SOE restructuring accelerate their decline.

That would not be so terrible, argues Hoffman, who points out that having cities and provinces grow at different speeds arguably makes China's development more "normal" in international terms. One unusual aspect of China's rise is that virtually all its cities grew rapidly over the last decade and more, rather than a mix of peak performers and stragglers.

But a looming productivity crisis resulting from the overinvestment will mean "China doesn't have a cohort of 650 cities all growing at above-average rates", says Hoffman. "If you think about it, this makes China more normal. In the US, we're used to a Silicon Valley and a Detroit. So is all of Western Europe. This is actually very normal."

### Labor Pains?

The economic slowdown that China is experiencing would lead to a higher unemployment rate anywhere else, as companies downsized or went bust. But China has defied that assumption as its official jobless rate has held rock-steady at around 4%—though it did tick up for the first time in recent years between the second and third quarter and unofficial figures put the number higher. But Lam argues the New Normal is likely to have had minimal impact on labor markets so far for three reasons.

Firstly, China's demographics have helped the economy rebalance toward consumer spending. A shrinking migrant population and labor force—caused by the end of surplus rural labor and an ageing population—has helped raise incomes. Secondly, a buoyant internet-based service sector has emerged to employ more people per unit of output than manufacturing and heavy industry. Lastly, local officials have been subsidizing SOEs to avoid layoffs that could cause instability.

**Consumption is envisaged as being an integral part of the New Normal**

But Lam believes the New Normal's impact on employment will begin to tell soon. "Our labor market conditions index suggests that the labor market has now finally started to feel the chill from feeble demand. The next 12-18 months will be critical to assess whether faltering job growth and rising unemployment stir social discontent and, if they do, whether Beijing will keep its cool," she says.

As growth disparities set in across the country, Hoffman believes China's 'migrant miracle'—the unprecedented flow of labor from countryside to city that underpinned the country's transformation—will ramp up in years to come. "Just like the Bay Area or New York attract jobseekers from all over the world, similarly, the cities growing more powerfully here will draw on a talent pool around the region to relocate." This will accelerate the regional growth disparity to some extent, as it will create brain drain in the cities that migrants are leaving.

## Reform Reckoning

At the heart of the New Normal is an old idea—reform. Overhauling China's economy to put it on a sustainable path has been discussed for years, but the government ignored the calls in favor of short-term growth objectives. That stubbornness appeared to subside two years ago when the Communist Party unveiled sweeping plans in November 2013 that ranged from a relaxation of the country's strict one-child policy to the scrapping of controls over interest rates.

Implementation has fallen far short of expectations, however, and Pettis believes this should not come as a surprise. "Historically, these types of reforms are very difficult to implement," he argues, pointing out only democracies or high centralized autocracies—such as China under Deng Xiaoping—tend to be successful. He pins the failure to reform on the huge vested interests—Chinese groups that risk losing power—that have been sharply criticized by the leadership for resisting reform.

"This whole issue is a political issue more than anything else," says Pettis. "Economically, they know what to do. If you look at the reforms proposed in 2013, they're more or less the right things. The problem is they're politically very hard to pull off."

Reform is becoming more urgent, especially now that China's previous, investment-led growth model has run its course. Persistently weak global growth and an overvalued renminbi mean exports will not drag China out of its economic mire, and Beijing can no longer throw money at unproductive investment without inflating domestic debt. Non-financial debt, including shadow banking and the grey economy, already reached 240% of GDP last year, according to Lombard Street Research.

Outsiders have very clear ideas on how China should reform, but whether their prescription matches Beijing's is another question. Foreign governments and multinationals may be banking on greater liberalization and a more open market, but some analysts believe Chinese-style reform is about making the state a better business performer.

"What we see is a lot of effort—so-called "reform"—to perfect the way the state sector operates—to make it more productive, efficient and stable through non-market means," says Hoffman. "What we don't see is a lot of reforms that would let markets drive productivity and competitiveness."

This year's continued economic weakness, coupled with rising financial distress and some policy missteps, have renewed the debate over whether China faces a hard or soft landing.

But that is a fundamental misreading of the situation, argues Pettis, who says the options are not soft or hard. Instead, he envisages China undergoing either a 'long landing'—growth rates falling by 100-150 basis points annually—or a more painful scenario, whereby growth does not dip but debt grows so rapidly the country hits debt-servicing capacity. "Then you will get what people will call a hard landing, but it will be a very hard landing," says Pettis.

Hoffman concurs. "We don't believe that China has soft-landed in a 'New Normal' 7-8% range. Instead we think China is on a long, slowish descent, has been for several years now, and is already at a much lower rate of growth than the official numbers suggest."

That may not be music to the ears of China's officials or the more Panglossian analysts, but it does suggest the New Normal will not lead to the crash landing or apocalyptic collapse predicted somewhat gleefully by doom-mongers. Xi and other leaders may have left the terminology up in the air, but, pending reform, they still have a chance of landing somewhere in the middle of these two contrasting outcomes.

# Welcome to the WeChat Galaxy

## Tencent is creating a whole universe in its WeChat app, and could become Asia's preeminent internet company in doing so

By Matthew Fulco


Image by Beibei Nie

Alex Zou can't imagine life without WeChat. The Hong Kong-based private banker and Beijing native uses Tencent's ubiquitous mobile app to pay his bills, hail a taxi, order food and shop. "I spend about 40% of the time I use my smartphone on WeChat," he says. "It's useful to chat with my friends, but it's the convenience of the other functions that makes it so important to me."

In just over four years, WeChat has evolved from a simple free messaging app into China's paramount mobile portal. With 650 million monthly active users, it has a commanding position in the world's biggest smartphone market.

Tencent has used WeChat to create a mobile ecosystem for China, which has more smartphone than PC users. By steadily integrating value-added services into the app, Tencent has made it increasingly useful to both consumers and businesses.

That innovative strategy means WeChat has more opportunities than other messaging apps to make money. In contrast to Facebook, which earns most of its revenue from advertising, WeChat monetizes by integrating online payment functions that encourage shopping through the app and selling games. In the second quarter, Tencent recorded RMB 4.5 billion ($701.4 million) in revenue from games purchased through WeChat and its older instant messaging app QQ, up 11% year-on-year.

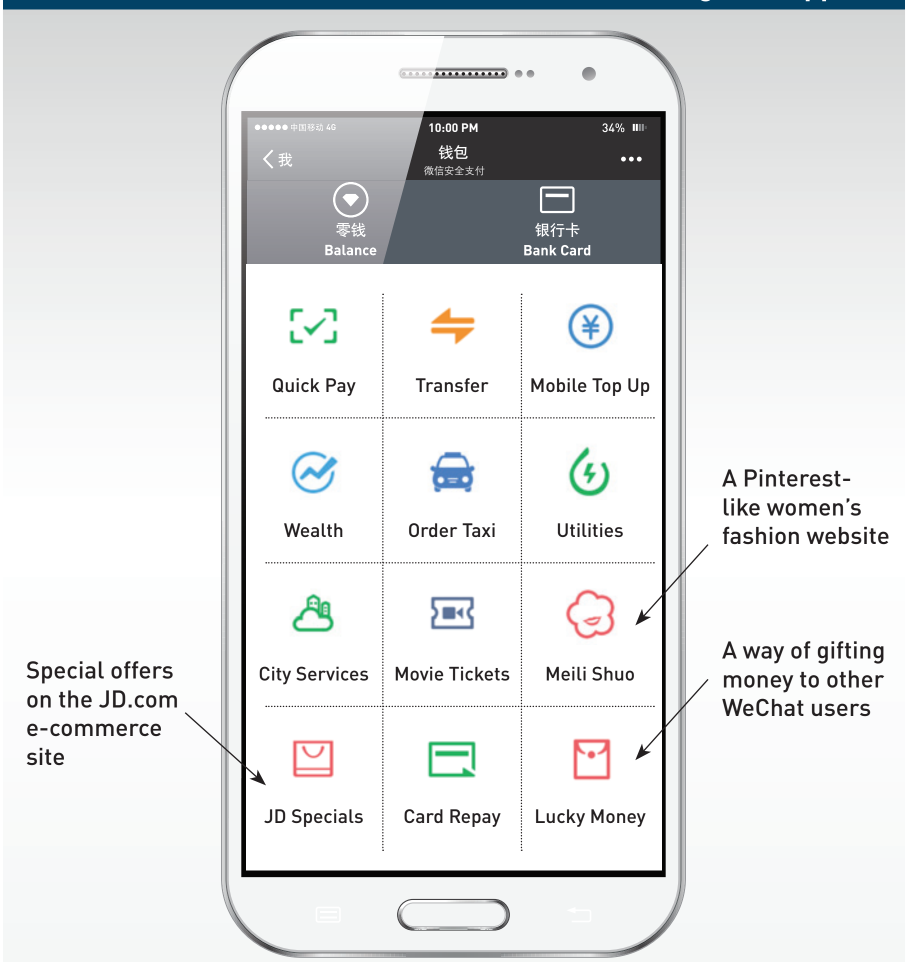
Analysts are sanguine about WeChat's potential. Nomura Securities estimates WeChat's average revenue per user (ARPU) is at least $7—seven times the ARPU of WhatsApp, the top messaging platform globally.

At the same time, WeChat's disruptive capacity is formidable. It has hobbled text messaging in China—once a big revenue source for China's telecom carriers—and curbed the clout of Sina's Web-based micro-blogging service Weibo.

With a dominant position in China and Tencent's vast resources at its disposal, WeChat could become one of the most powerful apps in the world.

**The World of WeChat**

**Some of the numerous services available through the app**




## Made for Mobile

WeChat grew out of Tencent's efforts five years ago to take the lead in China's then ascendant mobile internet market. "Executives realized they could no longer rely on PC games and the QQ messenger service to drive growth," says Jenny Chen, Marketing Manager of WalktheChat, a Beijing-based consultancy that advises companies on how to use WeChat. "They needed a mobile platform."

In late 2010, Tencent assembled a team of 10 developers in its Guangzhou research and development center to begin work on a smartphone messaging app. "It was an entirely different team than the one responsible for QQ—a team with expertise in mobile," Chen says. Kik Messenger provided inspiration for the team, whose leader Allen Zhang was concerned the Canadian messaging app could one day threaten Tencent's QQ.

In early 2011, Tencent launched WeChat. Within a year, the app had attracted 50 million users, and by the first quarter of 2014 it boasted 396 million users globally, according to data compiled by Tencent.

How did WeChat grow so fast from the onset? For one thing, it had an early mover's advantage as the first mobile instant messaging service launched in China, notes Helen Liu, an analyst at the Taipei-based Market Intelligence & Consulting Institute (MIC). Secondly, its easy-to-use and flexible interface design allowed it to integrate smoothly with smartphone contact lists and the email addresses of QQ's 800 million users, she says.

Some observers have suggested China blocking access to Facebook from mid-

2009 helped facilitate WeChat's rise. "We think the absence of services like Facebook may have contributed in a small way to WeChat's success, but was not a decisive factor," says Liu. As a PC-based social-networking platform, Facebook would vie for users with Chinese counterparts like QQ, RenRen and Kaixin, she adds.

Rather, "WeChat arrived in the right place at the time—just as affordable smartphones became widely available in China," says Jamie Lin, co-founder of the Taipei-based AppWorks accelerator—Asia's largest by start-up alumni—and an expert on the mobile internet.

Critically, Tencent made voice input a prominent feature of WeChat, betting Chinese consumers—many who had never learned to type on a PC—would prefer speaking to cumbersome Chinese character input, Lin observes.

"'Push to talk' let migrant workers in China's biggest cities instantly speak to their parents living in the remote countryside," Lin says. "All that was required was a smartphone and internet connection."

That was an early example of the innovative thinking behind the WeChat app, "the first time voice input was integrated into a social media platform on the mobile internet," he says.

To be sure, monetization has been important to WeChat's meteoric ascent. However, "WeChat was not thinking about monetization until 2013," when it began selling games and launched its payment and official account platforms, Liu says.

Indeed, when WeChat launched, China's other internet giants downplayed its earning potential, Lin notes. "Alibaba and Baidu didn't take it seriously," he says. "They said, 'you will never make money on it; it's just for text messaging.'"

> "
> It's going to be possible to leave your wallet at home… and pay… with WeChat
>
> Jamie Lin
> Co-Founder
> AppWorks

### There's An App For That

How wrong they were! WeChat hasn't just made money; it's become the go-to mobile platform for China's 667 million internet users.

Official, or public, accounts are integral to the success of the WeChat ecosystem. There are more than 10 million of these accounts, which WeChat approves after a brief application process. Since the cost of opening an official account is low, they are a valuable platform for small businesses. And since WeChat users can typically complete payment without opening their mobile browser, it is easy to make purchases within the app.

The WeChat public account Kidsbookmama reached monthly revenue of RMB 500,000 ($78,800) by May 2015, just a year after launching, according to WalktheChat. Managed by a publisher and writer of children's books, the WeChat-only shop is usually open for business just one week a month. That creates an impression of scarcity and incentives quick purchases, while customer service is prompt, says Chen.

WeChat can also be a powerful tool for existing celebrities to boost their star power. Logical Thinking, run by talk show host Luo Zhenyu, is one of the most popular WeChat accounts in China with 3,500,000 followers and 30,000 paid members, according to WalktheChat.

Luo is able to reach a huge number of followers instantly with a daily voice message sent at 6:30 am. His followers are then given the opportunity to buy the exclusive items he sells in his WeChat store. Those include books, seats at private-dining events, artwork and designer furniture, says Chen. For instance, "before selling a book, he lets his followers know the book can only be purchased through his account," she says.

Another pillar of the WeChat ecosystem is payments, used by about 20% of the app's users. The setup process is quick, requiring users to simply link an ATM or credit card to their accounts. Once that is done, the user can instantly make a purchase on WeChat Wallet services, all official accounts and via any associated promotions.

"It's incredibly convenient, especially for paying a credit card bill," says Derek Wang, a sales manager for an advertising agency in Shanghai. "It's faster than paying via a mobile browser."

Taxi hailing has become one of the most popular aspects of the WeChat Wallet, buoyed by its integration with China's popular ride-hailing app Didi Dache—in which Tencent has a large stake. Once Didi Dache—which later merged with Alibaba-backed Kuaidi Dache to create the current company, Didi Kuaidi (the apps remain separate)—integrated with WeChat in January 2014, Didi Dache doubled its registered users from 20 million to 40 million.

Tencent is further developing the financial-services arm of WeChat with the Weilidai loan service, which allows customers to borrow up to RMB 200,000 without guarantee or collateral. The service is operated by WeBank, an internet bank launched in January 2015 by Tencent and Chinese financial firms. With it, Tencent intends to provide micro-loans to consumers and small businesses, to whom Chinese banks typically are hesitant to lend, using data gathered from hundreds of millions of handset users, analysts say.

### WeLeaks

With access to all that user data comes the responsibility for Tencent to safeguard it. Yet it is questionable how well the company is prepared to combat cybercrime. In May 2014, cybercriminals used a banking

Trojan malware masquerading as the WeChat app to pilfer the financial data of Chinese Android users. When the malicious app was launched, a page appeared requesting users to provide their contact and banking information. That data was then sent back to an email account controlled by the cybercriminals.

More recently, WeChat was infected in the September hacking attack on Apple's Xcode software used to create iOS apps. The hackers embedded malicious code in those apps by duping developers into using a "tainted, counterfeit version" of Apple's software for creating iOS and Mac apps, Apple said. After the incident, WeChat said that no user information had been stolen or leaked, and emphasized its preparedness to deal with such attacks.

Meanwhile, following former US National Security Agency (NSA) contractor Edward Snowden's revelations of Washington's spying, people are warier than before about protecting their privacy. Some WeChat users outside of China worry their personal information is subject to government surveillance. "I do worry saying something offensive to the government on WeChat could affect my ability to travel to China in the future," says a Japanese researcher formerly based in Beijing who declined to be named.

According to WeChat's Terms of Service, "We and our affiliate companies may share your Personal Information within our group of companies and with joint venture partners and third-party service providers, contractors and agents…" including for "security" purposes.

Lin of AppWorks does not think that policy will deter use of the app outside of China. "Besides, the NSA is watching users of WhatsApp," he says. "You have to be careful about anything you say on any social media platform."

## New Territories

A tougher challenge for WeChat will be recalibrating its China-centric platform for a global audience, analysts say. After all, competition is nil at home, where China's Great Firewall makes it difficult to consistently access top global messaging apps from Line to Kakao Talk to WhatsApp.

> "
>
> In the short term, WeChat will have a hard time competing [abroad] with local champions
>
> Helen Liu
> Analyst
> Market Intelligence & Consulting Institute

Not having to face foreign messaging apps at home means WeChat is less prepared to deal with them on their home turf. "In the short term, WeChat will have a hard time competing with local champions such as Japan's Line, South Korea's Kakao Talk, India's Hike and the US's WhatsApp," Liu says.

Indeed, outside of China, WeChat seems best known among international users with a connection to the Middle Kingdom. Those users find the app handy mostly for its social-networking functions.

Philip Tomlin, a British market research analyst based in London, says he uses WeChat to keep in touch with friends he met while living in China. "A lot of them are not on Facebook and WeChat has the 'timeline' function so it's easy to see what they've been up to," says Tomlin, who worked in Shanghai from 2011 to 2014. "In the UK though, it's not a mainstream app yet."

Even in Chinese-speaking Taiwan, WeChat trails market leader Line by a considerable margin. Jay Lin, a Taipei-based software engineer, attributes that to the Taiwanese dislike of voice input and affinity for Japanese brands. "Most Taiwanese are reserved and prefer to type on messaging apps, using stickers [of which Line has many more than WeChat] to express their emotions," he says. "As a Japanese brand, Line is more trusted here than WeChat."

Still, WeChat remains determined to expand internationally. In Hong Kong, it has fared better, buoyed by the close links between the former British colony and the Chinese mainland. WeChat is the No. 4 social media platform in Hong Kong with a 23% market share, behind Facebook Messenger, Facebook and WhatsApp, according to a May 2015 report compiled by the Hong Kong-based web design firm Go-Globe.

"I use WhatsApp for my daily communication all over the world, while WeChat is important when we need to communicate with friends and business partners in China," says Patrick Chan, Director of the Hong Kong-based media services company Kenet Media. "WeChat is a good channel for marketing on the mainland," he adds.

WeChat has done even better in Malaysia, where it has a 95% smartphone penetration rate, according to *Marketing Magazine*. Local initiatives are a key part of WeChat's success in the Southeast Asian country. Those include working with Malaysian designers on localized stickers and using the app as the official platform for voting and interaction with fans on entertainment sites.

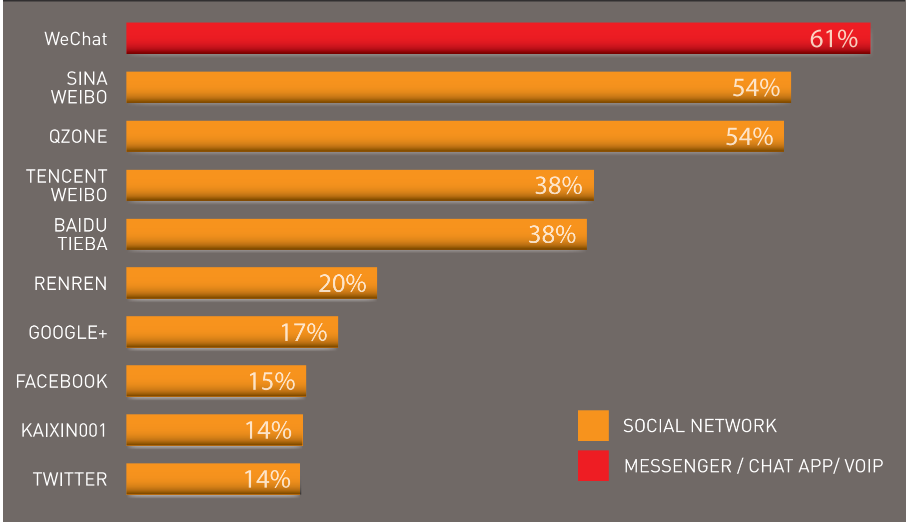
In Singapore, WeChat is working with the ride-hailing service Easy Taxi. The launch in the summer of 2014 was a "tremendous success, fueled by the same kind of promotional discounts that helped WeChat become a preferred service for booking taxis in China," WalktheChat's Chen says. That strategy helps WeChat to both boost the usage rate of the app and its payment system—which is crucial to making it profitable in the long term, she adds.

## The Golden Goose

WeChat's global ventures remain at a nascent stage, but it looks unstoppable at home.

## Size of Your Network

Percentage of internet users in China who claim to have used each platform, Q2 2015




Source: We Are Social/GlobalWebIndex

The app's omnipresence can be explained in part by to the "network effect", according to Michael Wu, an equity analyst at Morningstar Research. "Combining massive scale, strategic vision, and top-notch execution," WeChat has been able to "monetize its popularity into a lucrative business," Wu wrote in an October research note.

With that in mind, consider Tencent's bid to displace archrival Alibaba's Alipay as China's top mobile payments provider. At first glance, that looks unlikely to happen—in the fourth quarter of 2014, Tencent's share of China's mobile payment market was just 8%, compared with Alibaba's 79%, according to research firm Analysys, and Alipay had over 500 million users at the end of last year. But in its third quarter 2015 financial statement, Tencent revealed 200 million users had connected bank cards to QQ Wallet and WeChat Pay..

For now, "Alibaba dominates e-commerce in China," acknowledges Chen of WalktheChat. "Tencent's historically been stronger in social media."

Still, that could change. For one thing, Alibaba has stumbled in mobile before. Its first mobile messaging app Laiwang was a failure, arriving in the fall of 2013 when WeChat had already become dominant. Laiwang failed to accumulate a large user base, while WeChat has only continued to grow.

Chen believes the vibrant ecosystem built around WeChat has been critical to its success. That ecosystem allows Tencent to leverage the resources of all the companies providing "off-the-shelf services" for its platform, enhancing the user experience, she says, adding: "This ecosystem is much more limited for Alibaba and Alipay, and growing at a much slower rate."

In early 2014, US-based LinkedIn, the world's largest professional social-networking platform, became WeChat's first major global partner in China. The partnership made it possible to access LinkedIn's job hunting and recruitment functions through the WeChat app, while LinkedIn gained direct access to China's preeminent social network.

The WeChat ecosystem is further expanding as the app moves to tap the emerging Internet of Things (IoT) through its open hardware platform. As of August, WeChat had granted free use of its public platform to over 2,400 manufacturers of intelligent hardware and many millions of individuals who use the app for social networking.

Given WeChat's ubiquity, exclusion from the platform could crimp the prospects of businesses in China—particularly those that rely on smartphones, analysts say. The US ride-hailing app Uber faces that predicament, after being banned from WeChat earlier this year following the merger of rival apps Didi Dache and Kuaidi Dache.

"WeChat's ban on Uber is likely to have a profound impact on Uber's growth in China, especially in the lower-end sector of the ride-hailing market," says Liu of MIC, adding that Didi Kuaidi already dominates that market with a combined share of more than a 90%. Uber's best bet, she reckons, is to target the high end of the market—especially foreign business people—where Didi Kuaidi is not as strong.

And despite its travails expanding internationally, WeChat's global profile is rising: Western messaging apps are now ironically borrowing some of its most innovative functions. "WeChat is influencing Western messaging apps, pushing them toward social commerce and platform integration," says WalktheChat's Chen. For instance, Facebook announced in August that it will implement some of the features WeChat pioneered in messaging apps in its own Facebook Messenger, including games, payment and permitting businesses to privately communicate with customers.

Those changes are overdue, Lin of AppWorks says, noting WeChat remains well ahead of its Western counterparts. Facebook's first stab at e-commerce, the ill-fated Gifts platform, failed to generate substantial revenue for the company and was shut down in July 2014 after less than two years of operation.

"Eventually, it's going to be possible to leave your wallet at home in China and pay for just about anything with WeChat on your smartphone," Lin says. "It's going to happen in China before it happens in the US."

Tencent, meanwhile, is set to become Asia's most powerful internet company on the back of rising adoption of the WeChat platform. HSBC reckons WeChat is worth approximately $83.6 billion, or half of Tencent's market capitalization.

To put it candidly, "without WeChat, Tencent would have become irrelevant by now," Lin says.

# The Party Planners

**Dating back to 1953, China's system of five-year plans has long been dismissed as anachronistic, but it remains crucial to guidance of the economy**

By Douglas Bulloch

Image by Wei Bingnan

China's state media aren't known as a source of viral internet content, but when *Xinhua* quietly released a video on Twitter purporting to explain the *Shisanwu*, or China's 13th Five-Year Plan (FYP), they managed to create just that, with the video quickly becoming the talk of both veteran China watchers and the general public alike.

For anyone unfamiliar with the video's cavalcade of cartoon images and quirky self-parody, the overall impression it creates is that of a diligent government applying expertise and deep public spiritedness to the full range of China's challenges. For completeness, the video features a diplodocus that looks only marginally less confused than most viewers must have been by the time it strolled into view. Perhaps no one pointed out to him that he was supposed to symbolize China's growth throughout the 12th FYP's cycle (see the chart on page 23).

In the more sober world of public policy, the video clearly tries to conjure public interest in China's exhaustive planning cycle, which reached an important milestone on October 26 to 29 when the National Development and Reform Commission presented the 'Consultative Draft' of China's 13th FYP to the 5th Plenary session of the 18th Central Committee of the Communist Party of China.

Somewhere between the pulsating tweeness of the video and the ever evolving bureaucracy it describes, the three-day meeting marked the point when the many layers of China's governing system came into alignment, and commenced an official process which will end, in March 2016, by producing the first full FYP issued under Xi Jinping's leadership, giving an important insight into the strategic thinking of the current administration.

Described in the *South China Morning Post* as a 'vestige of a bygone Soviet age', FYPs continue to occupy a central place in China's complex system of governance. For just as China's economy has reformed and adapted in the last 37 years, so too has their planning framework. Indeed, there are clear signs that planning will remain an indispensable component of Chinese economic and political development for many years to come.

> You have formulation of plans and you have implementation of plans and they don't always fit together
>
> Robert Ash
> Professor of Economics
> School of Oriental and African Studies

## Ideology Interrupted

Planning, it was once believed, would eliminate the inefficiencies of competition that supposedly characterizes free-market economies, making socialist economies comparatively more efficient and productive. It was this notion of greater productivity, and not imminent nuclear conflict, that prompted Nikita Khrushchev's famous *aperçu* "we will bury you" when referring to the capitalist West. And it is easy to forget that in the 1950s and 60s the Soviet Union grew at over 5% per year, compared with the US trend of nearer 2% over the same period.

The Soviet Union's eventual problems with inefficiencies and poor capital allocation ultimately contributed to their collapse and disintegration. Since when, the widespread belief has been that formerly socialist economies would 'transition' away from planning with the market leading the way towards an innovative future of vastly expanded consumer choice and happiness.

Until recently, this was believed to be the path China had taken since the era of Deng Xiaoping, who implied an ambivalence to socialist economics with his famous fable of different colored cats nevertheless both catching mice. But has the collapse of the Soviet Union given planning an unjustifiably bad press?

## Planning ≠ Socialism

Leslie Young, Professor of Economics at Cheung Kong Graduate School of Business, clearly thinks so. He makes the point that despite well-known problems during the pre-1978 period of administrative planning in China, between "1952-1978, China achieved a real growth rate per capita of 3% per annum, which is comparable [to] that of the US over the same period." He adds that, "central planning was the fastest way for China to mobilize capital and labor for industrialization."

Furthermore, he thinks that planning has latterly "provided a useful guidesheet for a complex transition, while allowing room for judgment by the leaders of enterprises and local governments." Young goes on to suggest that many of the problems experienced by the former Soviet Union in the 1990s resulted from an absence of sufficient planning.

"Russia's switch from central planning to a market economy in the 1990s was aborted by its failure to build … a tax system to extract revenue to fund the state, financial institutions to channel savings into investment, plus accounting and legal institutions to ensure good corporate governance," he says.

Given the Chinese leadership's known sensitivity to the fate of the Soviet Union, what becomes clear is that they see planning as a key element of any transition away from socialist economics, suggesting that the great mistake China watchers make is not to distinguish between the socialist economics of the past and the strategic direction of the future, or to realize that planning lies at the heart of both.

And that is a view elaborated by a Chinese International Relations academic in Shanghai, who declined to be named due to sensitivities of talking to the media, according to whom China "is so big with so many things happening, that although you can't always make things work exactly as planned, you have to have a plan."

### From *Jihua* to *Guihua*

Nor is planning simply a necessary feature of China's size. It is also a key aspect of its politics. One important characteristic of the Chinese state, and a reason why it is unlikely simply to replicate the development path of other Asian states, is the centrality of the Chinese Communist Party to its functioning. In most other countries, certainly in democratic states, political parties are distinct from the state and take control of existing institutions when they come to power. In China, however, the party provides the key strategic and institutional impulse.

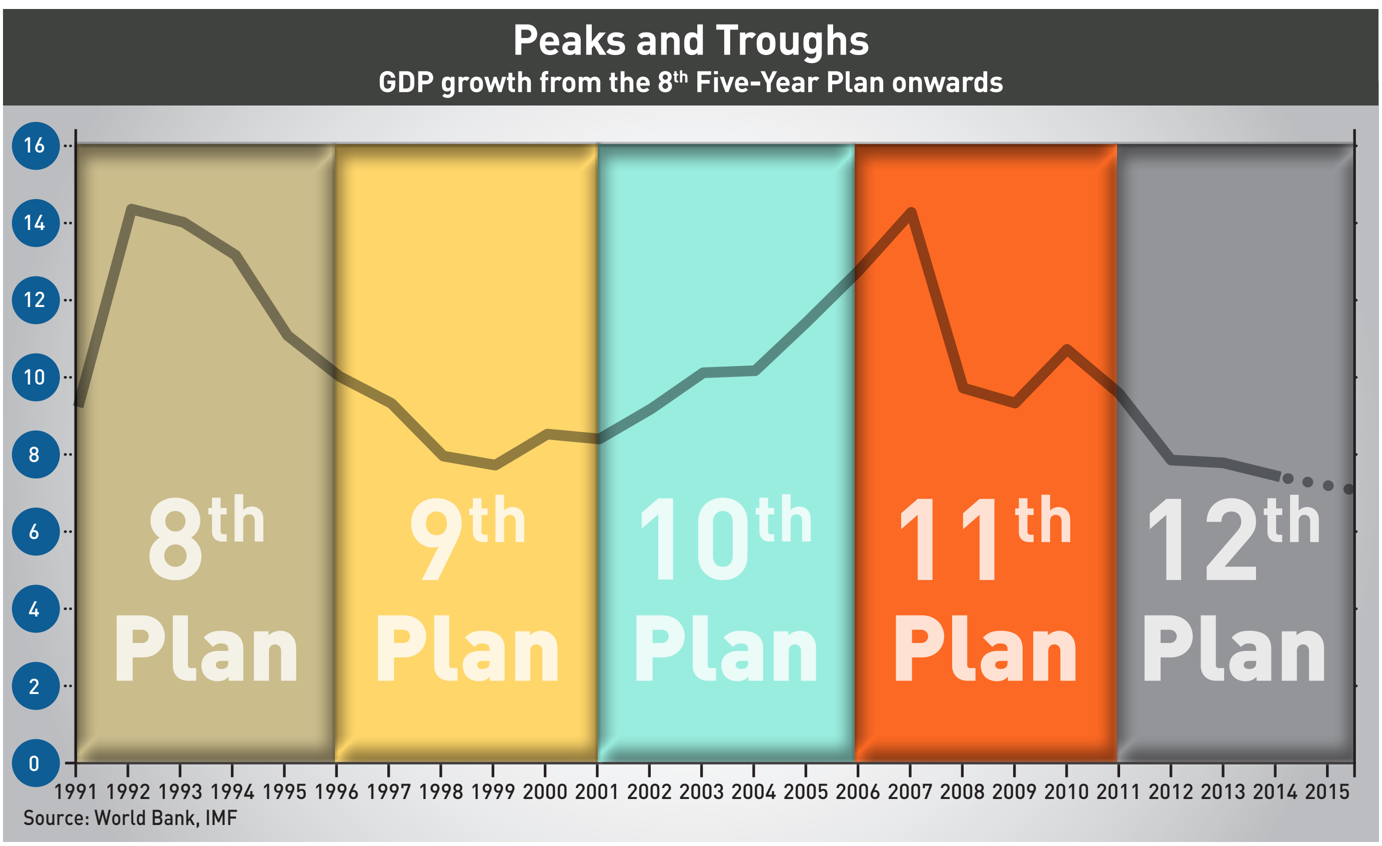
Robert Ash, Professor of Economics and Fellow of the China Institute at the School of Oriental and African Studies, University of London, says that "the formulation of FYPs is a reflection of the government's continuing determination to set long-term national, strategic priorities." And it is this strategic focus that allows us to gauge the evolution away from an old-fashioned concept of administrative planning towards a much looser template of objective setting and overall guidance.

Indeed, so familiar have we become with the idea of 'five-year plans' that the fact that they have been called 'Programs' rather than 'Plans' since the early 2000s is often overlooked. Not only this, but the Chinese word for plan was altered from '*jihua*' to '*guihua*' with the publication of the 11th Program in 2006. The latter word has a looser connotation more often translated as 'guideline' than plan.

This, according to Ash, is more than mere rhetoric. "Of course there is rhetoric, there is a lot of rhetoric, but there's a lot more than that. I say that because the change from *jihua* to *guihua* was a very definitive statement." A statement he believes strongly suggested that the CCP "really have abandoned administrative planning" and instead signaled the arrival of a "much more open, more transparent, less concealed and more consultative approach" to economic and wider policy formation.

Equally, the notion that plans might be eventually phased out meets with almost universal skepticism. The Shanghai academic says quite categorically that planning "has definitely not diminished. It has evolved." He further clarified that "it's one of those things you associate with the role of the government itself" going on to outline that "on the one hand it sets guidelines for what the government and the whole country should do, on the other hand it's really important as an indicator to tell people 'look we are still planning.'"

In this, the Shanghai academic makes a distinction between the symbolic and the functional aspects of planning, even going so far as suggesting the eventual realiza-



tion of planning objectives is less important than the symbolism of articulating them. "I don't think the plan actually always works" but "it is really symbolic for the central government to have these FYPs" showing that what "will definitely not change is how much the government wants to control what is going on."

Equally, the predominant view of planning as an aspect of socialist economics neglects the vital role planning played in the development of other key, non-socialist Asian economies. In Japan, the Ministry of International Trade and Industry (MITI) was until the 1980s one of the most powerful Japanese ministries. And both South Korea and Taiwan made extensive use of planning during their own periods of rapid industrialisation.

An important aspect of this Asian pattern of strong government leadership in economic development was that international capital markets were not liberalised until the 1980s, which meant that governments had a key role to play in the allocation of investment capital. Therefore China's ongoing plan to liberalize its capital markets carries implications for its planning framework given that capital allocation is one of the principal tools of economic control.

## Number 12

Ash offers a further observation about the 11th and 12th plans by highlighting "another semantic change or initiative, of introducing two kinds or categories of initiatives. So there were the binding targets, and there were a small number of those. But there were also a lot more 'predictive' targets." Describing these as the sort of thing the Central Government would "like … to happen but were not 100% confident … will happen or that … must happen."

And it is in this expanding range of 'predictive' measures that we see a natural evolution away from purely economic concerns, which in turn gives the biggest hint of all that these plans or programs are not simply a relic of Soviet-style economics, but a key instrument in the continuing operation of government.

> "The basic problem facing China's planning system today is macroeconomic rather than microeocnomic
>
> Leslie Young
> Professor of Economics
> CKGSB

For although much of each plan's focus remains economic, this may have less to do with old-fashioned socialist economics than the continuing centrality of economic development to China's strategic direction. In which case, it is only natural that planning should evolve if only as response to the shifting concerns of the Chinese population.

When examining the 12th FYP, it is possible to see that China has delivered on the headline quantitative measures such as growth rates and urbanization, but on other non-economic measures such as pollution-reduction initiatives, results have been disappointing. On some of the conceptual elements, it is hard to gauge whether growth was 'higher quality' or 'more inclusive', but to echo Ash, it is significant that such aspirations are outlined in the plan.

What is also clear is that China has embarked on some major economic initiatives since the accession of the new leadership in 2012, none of which were explicitly detailed in the 12th plan. In view of which it may be tempting to see the plan as ultimately irrelevant. It is, however, instructive to note how some key initiatives seem to be foreshadowed by the plan. In particular the 'One Belt, One Road' is quite obviously complementary to stated elements of the 12th FYP such as developing the Western Regions and 'moving production inland', not to mention facilitating the longer term goal of 'opening up' and searching for 'win-win cooperation' with regional partners.

All of which further reinforces the notion that FYPs have evolved in line with China's broader economic development. They are 'programs' not 'plans'; they offer 'guidance' rather than strict orders, and they constitute a clear strategic signpost both domestically and internationally, leaving room for even very significant changes of direction in pursuit of the overall aims.

Indeed, these changes are such that Sebastian Heilmann, Professor for the Political Economy of China at Trier University in Germany, rejected the idea that the plan is comparable to a 'blueprint' back in 2012, referring instead to FYPs as "a recurrent cycle of multi-year, cross-level policy coordination."

A 'cycle' which commences long before the plan is formerly published, and which precipitates what Oliver Melton, Senior Economic Analyst at the Bureau of Intelligence and Research, U.S. Department of State, calls a "cascade of plans" descending through the various regional and provincial levels of government, while being channeled nationally through the many 'Pillars of Industry'. Or as Ash puts it more succinctly "the planning for the next plan gets under way half way through the previous plan."

## Number 13

What has been revealed so far of the 13th FYP builds on many themes already apparent in Xi Jinping's tenure. There are no particularly surprising policy departures, with the 'One Belt, One Road' policy taking its place alongside the more general aspiration of a 'more balanced, inclusive and sustainable growth model.' Space is

## Hitting the Target

**Key targets of the 12th Five-Year Plan and actual performance so far**

| | Target | Actual Performance |
|---|---|---|
| Annual GDP growth | 7% | 8.1% (average) |
| Urbanization | Increase to 51.5% | 54% (2014) |
| Service sector's contribution to GDP | Increase to 47% | 48.2% (2014) |
| Research and development spending | Increase to 2.2% of GDP | 1.98% (2014) |
| Inflation | At or below 4% per year | 3.18% (average) 5.4% (2011) |

Source: KPMG, World Bank

made for Xi's 'China Dream' and a new emphasis on China's role in "actively participat[ing] in making international rules."

The one change that has captured the headlines is the shift to a 'Two Child Policy', although this move had been expected for some time. However, to incorporate this social policy shift in the FYP, despite its obvious economic implications, again highlights the extent to which the planning framework has become a catchall strategic statement rather than simply an economic plan.

There are many other aspects to the plan, but again, no dramatic deviations from current expectations. The proposed liberalization of the capital account confirmed for 2020; the restatement of the 'New Normal' consensus on growth rates (see our article on page 10); progress in military reforms already underway; and looming above all is the challenge of overcoming the middle-income trap and achieving domestic prosperity, an aspiration that will be central to verdicts of Xi's tenure whether it appears explicitly in the plan or not.

Two further changes also confirm political expectations with a reinforced commitment to Xi's anti-corruption campaign and an annual growth target of not less than 6.5%. In what had at first seemed like an oversight, there was no explicit mention of a growth target, but then on November 3 Xi Jinping announced on his own authority the forecast growth rate, a rate necessary to achieve the Party's "centenary goal" of per capita income levels doubling from their 2010 figure by 2020.

But even with the importance of that target, what becomes clear is both the extent to which Xi has placed himself, rather than the bureaucracy, at the center of events, inviting the frequent comparisons made between him and those other 'helmsmen', Deng and, inevitably, Mao.

### Drawbacks and Hurdles

The limitations of detailed administrative planning have been clear for decades and, indeed, China has its own painful experiences to draw upon. But the evolution of planning into a 'cycle of policy coordination' raises other issues. In the first place, as Ash says, "you have formulation of plans and you have implementation of plans and they don't always fit together."

That in part explains precisely why planning in China has evolved to the looser form of guidance that it comprises today. But beyond this there is also the international dimension. Young outlines that "the basic problem facing China's planning system today is macroeconomic rather than microeocnomic." He sees the key problems being that of falling international demand and the investment bubble bursting in Shanghai, the effects of which are understandably hard to plan for.

Interestingly, Young views the solution in terms of an extension of planning into the international realm via the new 'One Belt, One Road' initiative, which he sees as comparable to "the first era of central planning", and which requires "political leadership, central coordination of state enterprises and workers, and funding via state banks."

With this in mind, however, it is worth considering whether state banks and state-owned enterprises (SOEs) can remain central to the Chinese economy as capital controls are gradually lifted as planned. What is clear is that some sectors, such as the new technology sector, are not dominated by SOEs.

Baidu, Alibaba and Tencent are importantly not SOEs and all spring from the sort of innovation that planning simply cannot anticipate. Yet they did emerge, suggesting on the one hand that planning is at least no barrier to innovation, at least in this instance, and indeed that important and growing sectors of the Chinese economy are not centrally concerned with the planning cycle.

Another problem with the current planning cycle in China relates to its evolution beyond simple economic concerns, which directly implicates planning in the never-ending regional tensions that characterizes Chinese politics.

"If the local or provincial government is not in line with the central government—that's when the plans fail," says the Shanghai academic. And Ash concurs: "The big problem I see… is the tension within the system between the different levels of government and the different regions."

Unfortunately this is a problem that is exacerbated by the manner in which capital is currently allocated through state banks towards the big SOEs, precisely because the different regions have different economic profiles, some being dominated


**The text of the 13th five-year plan will remain unclear until it is approved at the National People's Congress in March**

by SOEs, and others, particularly in the southern Guangdong region, having far lower SOE activity.

It is worth noting that in the 1980s, after Japan liberalised capital controls, MITI's role of strategic economic guidance diminished sharply until it was eventually merged into the Ministry of Economy, Trade and Industry (METI), a government department with a much broader and more dispersed, role in 2001.

And lastly, in the non-economic arena, India's FYPs have long focussed on ameliorating the negative social and environmental consequences of rapid economic development. Priorities which form an increasing component of China's plans, highlighting the extent to which planning can also be seen as a formal calendar of overall strategic objective setting and reassessment, rather than a merely a blueprint for headline growth.

## Planning and Power

Arguably, China's penchant for planning predates the adoption of socialism—having always been governed by a centralized government bureaucracy—but the end of the Cold War and the rise of 'globalization' has persuaded too many people that planning will slowly be phased out. In fact, planning remains central to how China functions, raising the possibility that planning itself, long seen as merely an aspect of socialist economics, is better seen as an indispensable feature of Chinese political culture, whether the cat is 'black or white'.

The Chinese Ambassador to the UK, Liu Xiaoming, explained on UK television on October 15 that he didn't "think the definition of China as a communist state is the right one," going on to say that "the Communist Party provides strong leadership, and enjoys the people's support." That reinforces the idea that planning in China has no longer anything to do with socialist economics, but everything to do with strategic direction, and just the plain old exercise of power.

Equally the return of a 'helmsman' style of leadership may be a reflection of the scale and nature of the challenges China currently faces. And in this respect the plan is living up to expectations, particular if you assume that the whole affair is simply an opportunity to imprint Xi's authority on the Party and to therefore consolidate the Party's role within the state.

In the words of the Shanghai academic, planning is "not just about communist ideology, it's also about traditional hierarchy and very centralized power." A conclusion supported by Ash, who says planning "always come[s] back to the role of the party" which "therefore becomes a very political question."

# New Youth

## Unprecedented economic opportunities and growing pressures mean China's millennials stand apart from previous generations

By Chris Russell
Additional reporting by
Francesca Chiu

Image by Han Xiao

Exhibition centers aren't obvious places you might go when looking to take the pulse of a nation's youth, but in Shanghai in late September, this was the perfect place to be to understand the new cultural and economic power of China's millennial generation.

Indeed, the Yo'hood street fashion trade show, held in the ShanghaiMart trade hall in the west of the city, drew thousands of millennials over the course of a single weekend. The annual event put on by the high-end street fashion, media and e-commerce company Yoho!—which received $30 million in funding last year—is now in its third year and goes some way in assuaging fears over China's capacity to transition to consumption-driven growth, as well giving expression to one nascent, and well-moneyed, side of Chinese youth culture.

As attendees browsed through internationally renowned brands such as Hood By Air, Nike and Converse housed in eye-catching stalls, one of which was made to resemble a Brooklyn corner store, they could purchase items via Yoho!'s app as they walked along. In so doing these young people were showcasing China's millennials' penchant for exploring their myriad tastes and interests, often in ways previously unimaginable to their parents and grandparents. Just 20 years ago, Yo'hood would have been unthinkable.

Yet this is an increasingly complex demographic, who as well as enjoying the fruits of China's reform and opening up are also beset by all manner of societal and economic pressures, making them arguably much more different from their parents than their Western counterparts are from theirs.

From an ever tougher job market to unobtainable home prices, millennials have to navigate a world with less security than was enjoyed by previous generations, all amidst slowing economic growth, to boot. And the many companies looking to sell to this increasingly important generation of consumers will have to grapple with all these issues, too.

## Divided Generation

Millennials, the subject of so much discussion globally, are defined by the Pew Research Center as those born after 1980 and who came of age in the new millennium—in other words, those aged between 18 and 35. In China, this cohort represents 385 million people, or 28.4% of the population, according to the US Census International Database.

But while millennials are considered one wide demographic around the world, in China they are typically broken down into two distinct categories depending on the decade in which they were born—*balinghou* and *jiulinghou*, or post-80s and post-90s. Despite being born only a few years apart in some cases, the differences in the society they grew up in have been enough, generally speaking, to affect a different mentality between them, a gap largely attributable to increased internet access and a booming economy.

> "The post-90s are much more evolved in their individuality and the reason being is because they started [exploring their individuality] at a much earlier age
>
> Kevin Lee
> COO
> China Youthology

"Someone born in 1995 was born into an economy more than twice the size of someone born in 1985," notes Eric Fish, author of *China's Millennials: The Want Generation*. "And when that person born in 1995 turned 15, there was a 34% chance they already had internet access, as opposed to less than a 2% chance for the person born in 1985."

This increased wealth and access to information has greatly enhanced the capacity for post-90s youth to explore their individuality in a way that post-80s couldn't. "We consider them two ends of one spectrum," says Kevin Lee, COO of China Youthology, a research and consulting firm in Beijing. "The post-80s generation were really the pioneers of individuality in China…. The post-90s are different, the post-90s are much more evolved in their individuality and the reason being is because they started [exploring their individuality] at a much earlier age."

And this earlier exploration of their individuality has played into a noticeably different mentality between the two groups. "Post-90s tend to be more open-minded, rebellious, individualistic and willing to challenge authority than the post-80s," says Fish.

## Pressure and Prosperity

If there are differences within China's millennial cohort, they are nothing compared to the chasm in experiences and attitudes between them and their parents—and grandparents.

"If you compare [post-90s] to previous generations—post-60s, post-70s—there's no comparison. They are worlds and universes apart," says Lee.

In part, this is due to China's breakneck economic growth, which meant that millennials grew up without the scarcity that previous generations had come to know. They are also a generation that is much more familiar with the power and influence China now wields as a result of that growth, having experienced events such as the 2008 Beijing Olympics and the milestone of China becoming the world's largest economy by some measures during their formative years.

In addition, they have enjoyed freedoms that previous generations were mostly denied. Previously one's *danwei*, or work unit, would have been intimately involved in decisions regarding work, marriage, travel and children—as late as 2003 permission was required from *danwei* or other organs of the state for marriage, divorce and passport applications. Today, millennials are largely free to make these decisions without the interference of the state.

It's a freedom they've embraced. Outbound tourism has increased massively in recent years, with millennials being a key driver. According to a Bank of America Merrill Lynch report released in March, by 2019 25-34 year olds are expected to make up 35% of China's tourists, the largest segment. And millennials are increasingly heading overseas to study—459,800 people went to study abroad in 2014, an annual increase of 11.1%, according to the Ministry of Education.

That last statistic points to another important facet of China's millennials—similar to their Western counterparts, they are much better educated than previous generations. In 2015 there were 7.49 million graduates according to the Ministry of Human Resources and Social Security, an increase of 220,000 from 2014.

Then there is the impact of China's infamous so-called 'one-child policy' (in November it was announced it would become a 'two-child policy'). Although perhaps overstated—the policy had been primarily implemented in urban areas and exemptions have existed for ethnic minorities and those in rural areas—a significant number of millennials have grown up without siblings. In the popular imagination, this has resulted in a generation that is selfish and demanding, the stereotypical 'little emperors' spoilt and coddled by both their parents and two sets of grandparents. But the reality is perhaps not completely aligned with this characterization.

"It's definitely fair to say Chinese millennials are generally more demanding and have higher expectations (sometimes unreasonably high) than their parents when it comes to life, love and work, but is that so unique to China?" says Fish. "This concept also has a very urban middle-class bias and distracts from the huge number of young Chinese who are really struggling."

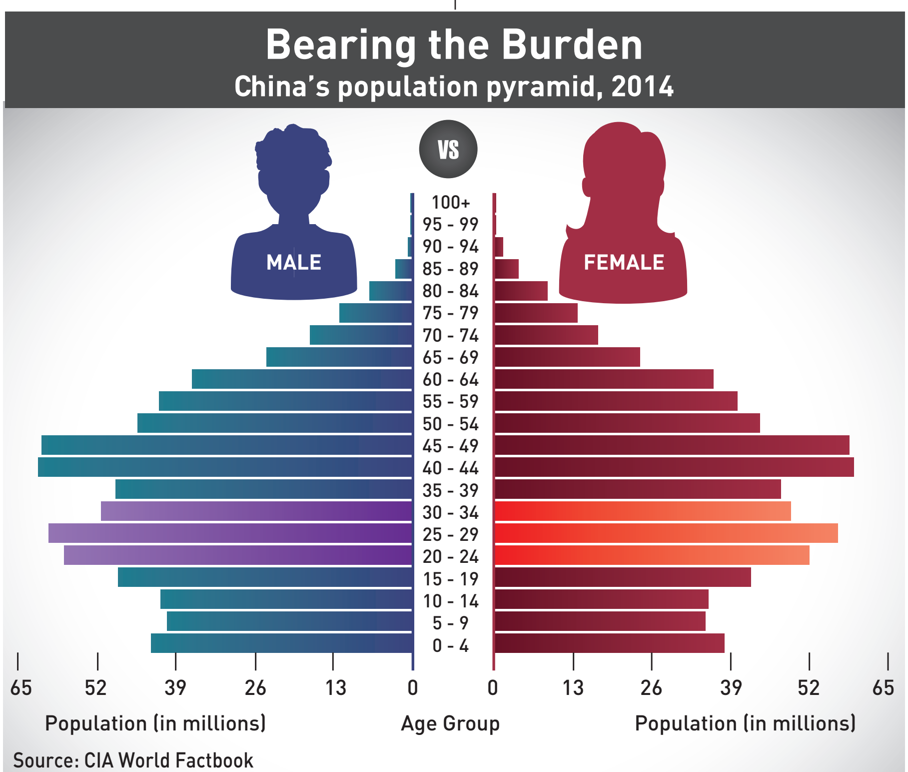
And for some, they really are struggling. Those high graduation numbers have led to a glut of graduates and not enough appropriate jobs for them at a time when China's rapid growth is beginning to taper off. According to a survey of millennials in China by J. Walter Thompson (JWT) in 2013, two years before stories of the country's economic slowdown really began to dominate headlines, 68% of respondents said they felt people their age were struggling to find a job, and 76% said they thought their generation had been dealt an unfair economic blow because of global economic uncertainty.

"Many young workers—both white and blue collar—complained to me about how much nepotism and corruption there is in the job market, and how if you don't come from a good family background or have connections, it's really tough to climb the ladder," says Fish. "There seems to be a widespread feeling that the prime period for wealth accumulation is in the past."

## Millennial Mindsets

These circumstances have given rise to a mindset that is at once both recognizable from millennials worldwide while also bearing its own Chinese characteristics centered on a new kind of individualism. "Our generation focuses more on concepts like individuality and freedom," says Alan Meng, a post-80s post-graduate student studying in the UK.

Lu Xiaoming, a 30-year-old web magazine editor for a live music promotions company in Shanghai, agrees: "With my generation, as we are mostly the single child in the family, kids are used to a materially sufficient life, but the downside to that is you don't really find a lot of peers to play with. That's why my generation can be individualistic sometimes, and also, since you already grew up in a materially sufficient life, you tend to chase the adventure and thrill of life a bit more as well."



This informs attitudes to work, even at a time when many find the job market difficult. Eighty-five percent of respondents to the JWT survey said their job should help them pursue their passion. There is also an entrepreneurial spirit amongst millennials—74% said they would just start their own business if they lost their job or struggled to find work. "Chinese millennials are more daring to try something and are more willing to change," says Derek Zhong, a post-90s corporate social responsibility associate.

But that is not to say that China's millennials have adopted Western notions of individualism wholesale, as traditions and notions of social responsibility such as filial piety still hold sway. According to JWT, 88% are proud of national traditions and customs, 91% think it important to hold on to family traditions and 75% believe that traditions hold society together.

"The collective is always the backdrop," says Lee. "Their parents are all collective and the society that we still live in, the media, the schooling—everything is still quite collective." But he points out that post-80s and post-90s approach this collective mindset in different ways. For the post-80s, it is about who they are in relation to other people and how they are seen—"a bridge mindset" compared to older generations, as Lee puts it. But post-90s are much less concerned with the perceptions of others beyond a select group, such as their friends.

But where China's millennials are much closer to those in the West is in their enthusiastic adoption of technology and the internet: 58% of internet users are millennials, according to a July report from Bank of America Merrill Lynch. China's millennials are also effectively mobile natives—a 2013 Telefonica and the *Financial Times* survey cited by *China Daily* showed 92% of Chinese 18-30 year olds owned a smartphone. "Information technology and social media in the last 15 years has really been a hallmark for this generation," says Lee.

## Making a Connection

For marketers, that naturally leads to a different approach when trying to reach millennials. "You're not going to reach them by buying TV commercials or full-page ads in glossy magazines—you will meet them through product placement on TV and film, you will reach them on social media, if handled the right way," says Michael Zakkour, Vice President, China/Asia Pacific of Tompkins International.

> "I don't think the vast majority of brands inside and outside of China have really gotten on board with the opportunity [presented by millennials] yet
>
> Michael Zakkour
> Vice President, China/Asia-Pacific
> Tompkins International

That is particularly true for Tencent's ubiquitous WeChat app (see our story on page 15), although Zakkour cautions against using it with a traditional media mindset: "Don't view it as a one-way conversation; it is a tool for social engagement, and you only need to look at the way Chinese millennials use WeChat in their everyday lives to better understand how to integrate your relationship with them and your brand."

To an extent that is about appreciating the possibilities created by interactions between the online and offline worlds—an 'omnichannel' approach that Zakkour says is about making sure all of these channels are coordinated and integrated. In doing so marketers provide millennial consumers with choice—something that appeals to their individualistic personalities and life experience of growing up in a wealthier China.

The connectedness between these two things is something that Lee also stresses. "Most of the best brand interactions are actually offline, but what they do is they create many opportunities for the consumers, the participants and then bring that experience back online." That is something Yoho! has done with their offline trade show, which then feeds back into their e-commerce and online media operations.

This interaction ties into what Lee calls "category culture" whereby brands create meaning and moments around their products or categories in order to drive engagement. "The questions is: how do we create our category and our category culture as something interesting enough… for consumers to talk about it and share about it," he says. Ultimately, that is about making something relatable to millennials and authentic to them—for post-90s in particular, he says, "a brand is not just a faceless organization."

Zakkour feels that an underappreciated approach is leveraging the rebelliousness of Chinese millennials. "What you can do through marketing, product and entertainment is tap into that rebellious spirit and let them wear and use those things in a subtle way that allows them to express their individuality and rebelliousness without breaking societal norms," says Zakkour. He points to Vans as an example of a brand that has done this—and they have also successfully used its all-day 'House of Vans' art and music events offline to drive interest in the brand and augment its existing subcultural associations.

But not every company has been as successful as Vans, and the list of those iden-


**China's millennials are increasingly expressing their individuality, posing a new challenge for the brands trying to reach them**

tified by experts and millennials as having been so is relatively short. Apple, naturally, is cited by many, while the tech company such as Xiaomi is known for its youthful following. Nike and Adidas are also pinpointed as having significant traction with millennials. Beyond these, examples are less clear cut.

## Bright Future?

China's millennials represent the future for both their country and many of the companies operating there, but it's a future with a few clouds on the horizon.

Change has been so rapid in the last few decades that certainty has been in short supply, but if the days of double-digit growth had come to be taken for granted, they aren't anymore. This so-called 'New Normal' (see our story on page 10) represents a new kind of economic and social uncertainty for China's millennials, particularly the post-90s generation, who will now have to contend with the effects of the slowdown.

"I won't say me or a lot of my peers are actually aware of the slowing economic growth, but the skyrocketing apartment prices and rent money definitely have a impact on all of us, which results in late marriage and a high divorce rate, and people can't really spend as much as they want on lifestyle choices," says Lu, the web magazine editor, although he notes that "most of them spend it anyway."

And then there is China's ageing population, another result of the low birthrate caused by the one-child policy. As well as leading to increased responsibility for millennials, this shift will also make older generations an important demographic for businesses to focus on.

Still, like their peers worldwide, China's millennials manage to find optimism and self-confidence even while harboring a degree of negativity about their situation. That speaks to the many nuances of this generation, a fact only enhanced by its post-80s and 90s subdivisions.

But as millennials become more and more influential and their purchasing power increases—as it surely will—brands will need to grapple with this complexity. They may find that reaching China's consumers is quickly becoming that much more complicated, not least because this is relatively uncharted territory for so many on both sides of the sales counter.

"I don't think the vast majority of brands inside and outside of China have really gotten on board with the opportunity yet," says Zakkour. "There's a limited number of success stories we can point to because not everybody has moved aggressively in addressing that demographic—and they need to."

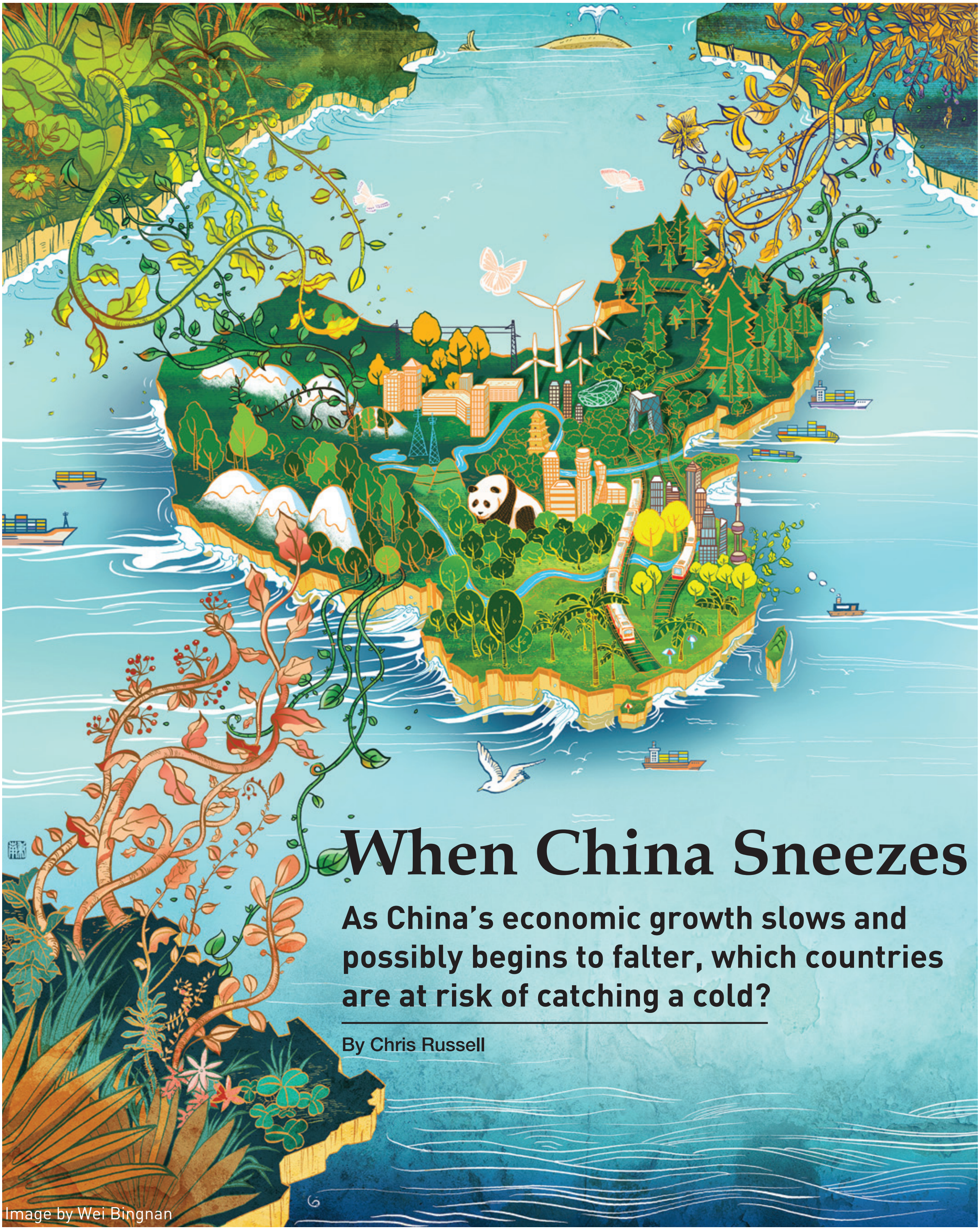


Image by Wei Bingnan

# When China Sneezes

## As China's economic growth slows and possibly begins to falter, which countries are at risk of catching a cold?

By Chris Russell

On a five-day tour to China in September, George Osborne, the UK's Chancellor of the Exchequer spoke in glowing terms about his hopes for the future of the countries' economic relationship, saying: "Our message to China is very clear: we want the UK to be China's best partner in the West." As part of his vision of a "golden decade" in UK-China relations, Osborne set out his aim to make China the UK's second-largest trading partner by 2025, displacing Germany.

Xi Jinping, for his part, seemed happy to recognize the UK's China love—in a written interview with *Reuters* ahead of a state visit to the UK in October, he described it as a "visionary and strategic choice", and a host of deals were signed during his time in the country, with British companies set to export satellite technology, liquid natural gas, jet engines and more. And that comes in addition to existing British exports to China, which include everything from Burberry jackets to pig semen, the latter as part of a £45 million-a-year ($69 million) deal.

But as Asia's heavyweight adjusts to the so-called 'New Normal' (see our story on page 10), the question arises of how countries such as the UK will deal with increased exposure to a China that is no longer posting the dizzying growth rates it once was, and which some experts feel is on the verge of a significant economic slump. While the UK is only now forging major economic links with China in earnest, others have been hitched to China's economic growth for years. So when China does sneeze, who catches a cold?

## Passed Around

China's economic boom, which chiefly involved marshaling massive amounts of resources in service of construction and manufacturing, required huge imports in order to maintain that momentum, and as such commodities and capital goods—those used in the production of other goods—have been its main imports from other countries. Yet as the country's investment and construction drive comes under pressure and low-end manufacturing enters into decline, demand for these imports is falling, with knock-on consequences for the countries that provided them.

"The ones who are most affected are the ones who benefited a lot from the commodity price surge, and they are also the ones who are most affected on the downslope," says Yukon Huang, Senior Associate at the Asia Program for the Carnegie Endowment for International Peace. "[Commodity exporters are] feeding into primarily the construction surge in China—the property market, industrial production—and that's essentially China's domestic market."

That includes countries such as Brazil, Australia, Russia, Mexico, Chile, South Africa, Malaysia and Indonesia. Unsurprisingly, some of these countries are also the most dependent on China as a share of their total exports—according to figures from UBS, for Australia this represents a whopping 33.7%. Australia and Malaysia are amongst the most economically exposed overall, with exports to China constituting 5.6% and 11.5% of GDP, respectively.

In terms of capital goods exporters, Germany and Japan are both sensitive to a slowdown in the Chinese economy, with capital goods exports from the former representing the bulk of its exports to China. Bulgaria and Finland also find themselves in a similar situation, but in general the EU would seem more than able to cope with China's slowdown and may even find it something of a mixed blessing.

Writing in a commentary for the Centre for European Policy Studies, Cinzia Alcidi and Mikkel Barslund, Head of the Economic Policy Unit and Research Fellow for the Brussels think tank, respectively, note that "since slower Chinese growth goes hand-in-hand with lower commodity prices, the latter is likely to provide EU countries with a strong offset for lower Chinese export demand … Furthermore, the burden of the slowdown is likely to fall on the EU's broadest shoulders and, in fact, may even contribute to a rebalancing within Europe."

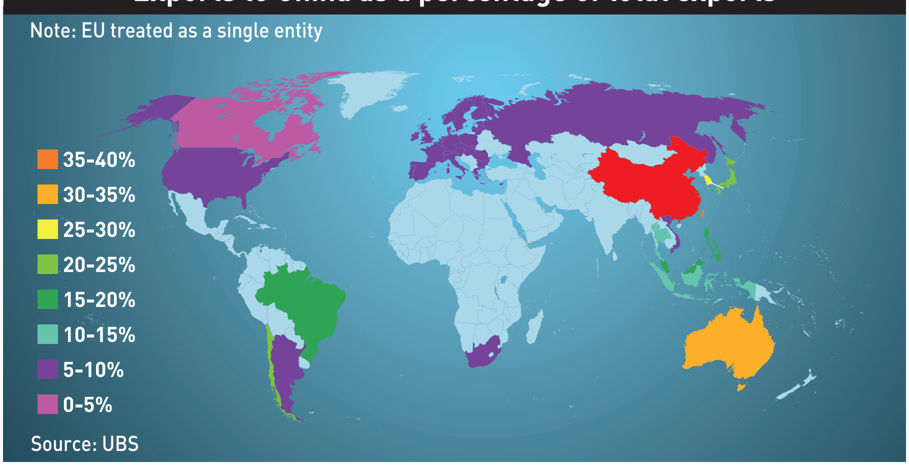
Meanwhile for Japan, the effect is felt much more strongly: China represents a much higher percentage of its exports compared to the EU—21.5% versus 9.6%—and those exports represent 3.2% of GDP. According to the OECD, a two-percentage point decline in Chinese growth for two years combined with financial turmoil could shave over half a percentage point off the Japan's already anemic growth.

But when looking at the headline figures, it is also important to distinguish between those exports that are intended for China's domestic market and those that are ultimately destined for other markets. In the latter case, goods are exported to China, where they are then processed or assembled before being exported to other countries, what Huang calls the "production sharing network". China's regional trading partners play a significant role here.

Despite ranking amongst China's top sources of imports, exports to China for

**All in it Together**

**Exports to China as a percentage of total exports**



domestic use only constitute 49.9%, 46.3% and 29.9% for Vietnam, South Korea and Taiwan, respectively, according to figures from UBS. Owing to its substantial exports of capital goods, the figure for Japan stands somewhat higher at 68.3%. Thus such exports won't be affected by a slowdown in China, although expanded Chinese productive capacity could dent these figures going forward.

What is more certain is the affect reduced trade as a result of China'a slowdown is having on the shipping industry—in September, Chinese imports fell for the eleventh month in a row and by 17.7% year-on-year. In October, A.P. Moller-Maersk—a bellwether for the industry—cut its full-year profit guidance, citing weaker global demand for container shipping.

## Strong Immunity

But when looking at countries with the greatest exposure to China, one is conspicuous by its absence—the US. Despite playing a leading role in the global economy, experts largely consider it to be insulated from any slowdown in Chinese growth.

"In terms of trade linkages, the US is indeed not very exposed to the slowdown in China. In fact, such impact may even be offset by the global disinflationary pressures, which could boost real income in the US, aiding consumer spending," says Michelle Lam, economist at Lombard Street Research, citing research from the firm's team of economists.

And Huang agrees: "The US is essentially not very much trade dependent, period. It's a country which is essentially not affected by global trade patterns, but people think it is. It's because it's self-contained and mainly because it's services-oriented." Indeed, exports to China only represent 0.8% of US GDP according to UBS, although those intended for China's domestic market stand at a relatively high 76.9%. Moreover, both Canada and Mexico remain more important trade partners for the US.

But the big picture overlooks some key nuances. Certain states are much more dependent on Chinese imports than others: according to a report by the US-China Business Council, Alaska, Oregon, South Carolina, South Dakota and Washington all had China as the top destination for their exports in 2014.

> "US exports are affected only a little bit [by a slowdown]"
>
> Yukon Huang
> Senior Associate, Asia Program
> Carnegie Endowment for International Peace

And certain sectors and companies are also much more reliant on China. According to the MSCI World with China Exposure Index, five US companies, including Qualcomm and Texas Instruments, are in the top 10—and these are primarily in the tech sector. In addition, Apple, Yum Brands and the US agriculture sector generally also have a high degree of exposure. Even so, there's is still a degree of resilience.

"[Agricultural products] are not as affected by a slowdown because food consumption doesn't tend to dive. It moderates a little bit but it doesn't fall as dramatically as commodities or machinery," says Huang, who is fairly sanguine on the overall effects. "US exports are affected only a little bit, but not very much. I would say it's the last one to be really affected."

Meanwhile US Treasuries, which China has been a long-standing and significant holder of, have largely been unaffected by China's slowing economy. That's in spite of China paring back its stake and is due to US domestic demand being stronger than it has been in years. However, China's interest rate cut in late October was enough to spark a significant sell off, indicating the impact the country can still have on the US government debt market.

## Varied Vectors

But trade isn't the only way in which China's economy can have implications for other countries, and various macroeconomic events and policy decisions can, to varying degrees, reverberate around the world.

In terms of China's financial sector, the country's build up of debt has been a persistent source of worry for economists, and a debt crisis, although widely considered to be manageable, would nonetheless dent Chinese economic performance. Yet the immediate effects beyond China's shores would be fairly limited. "China has limited external debt so financial distress should have limited implications for the rest of the world (apart from Hong Kong and Taiwan)," says Lam.

That said, some countries have greater exposure than others. According to Fitch, UK banks had $92 billion of assets exposed to mainland China at the end of 2014, and that didn't include HSBC or Standard Chartered, two banks with a heavy focus on Asia. That total wasn't far off the amount for North America, which had $116 billion of assets exposed to the mainland. Unsurprisingly, Hong Kong came out on top with a figure of $869 billion.

Exposure to China's debt could increase further, with Li-Gang Liu, Chief Economist for Greater China at ANZ, noting that "foreign capital and foreign financial institutions could be part of the solution in solving China's debt problems." That could happen if there were further listings by big state-owned enterprises on the Hong Kong or Shanghai stock exchanges, he says.

The latter exchange and its Shenzhen counterpart have been a source of concern for global investors, especially since their fall in the summer. But despite innovations such as the Hong Kong-Shanghai Stock Connect, which launched in 2014 and increased access of foreign investors to mainland markets, mainland bourses have little relevance for those offshore (although that could also change—Osborne proposed the creation of a London-Shanghai stock connect during his China trip).

Moreover, they have very little relation to the overall health of the Chinese economy. Global markets went into a brief meltdown after the Shanghai and Shenzhen exchanges tanked over the summer, but Huang points out that this was a psychological reaction based on China's sheer economic size rather than the result of any direct connection to global markets.

That in turn caused the US Federal Reserve to delay a long-anticipated interest rate rise until 2016, with chair Janet Yellen citing China's economic slowdown as part of its reasoning. But Huang suggests this is more to do with the aforementioned flawed perceptions than it is about actual economic implications. "[If] companies and banks believe that [China] is collapsing, then you can't change your interest rate because you're going to make the situation worse. So this is a very interesting case of a false perception affecting policies in the US."

But the most important area for other countries, and the one with the most visceral effects, is the valuation of the renminbi, which was devalued in August upon a revision to its valuation scheme.

"While the euro area, Japan and ASEAN countries are likely to be affected by yuan devaluation, we have long argued that the yuan is overvalued, and yuan weakness will indeed help China's rebalancing from investment to consumption—this is beneficial for the rest of the world," says Lam. "But of course, it is only if the rest of the world are prepared to accept such adjustment."

With central banks set to continue programs of quantitative easing, in the future there may be successive rounds of currency devaluations, from which Lam says "no one will gain".

## Closer Contact

As its domestic market continues to grow, the effect on the value of exports to China will depend on a number of factors that will differ from country to country.

In part, it depends on how trade linkages evolve globally, and in this respect the Trans-Pacific Partnership (TPP)—which does not include China—has the potential to be particularly important. With the reductions or elimination of tariffs and the harmonizing of standards, participating countries such as the US, Australia and Japan will all have new trade incentives.

> "China has limited external debt so financial distress should have limited implications
>
> Michelle Lam
> Economist
> Lombard Street Research

Then there is the evolving nature of the Chinese economy as it moves away from being investment-oriented, something that Huang thinks could make its market less important for current trading partners.

"Consumption tends to be less import intensive, investment is more import intensive, so a more consumption-driven Chinese economy, as opposed to investment-driven essentially requires less imports from overseas," he says. "That's one reason why China's imports have slowed a lot—its consumption has held up reasonably well but its investment has not... In some ways the world is better off if China actually continued to invest, if it were sensible to do so."

That is partly due to the fact that China's economy is still not as open as it could be, with foreign participation still closed or limited in many sectors. That's particularly true of services, where advanced economies are strongest—OECD statistics show services represented 30% of the US's gross exports in 2014. According to the OECD's Service Trade Restrictiveness Index, China has above average restrictions in all recorded sectors except architecture—and these include important areas such as banking, shipping, telecoms and insurance.

That could change with the signing of trade agreements such as the US-China Bilateral Investment Treaty (BIT), which would see China move to a 'negative list' of sectors not open to US participation. Other deals could include an EU-China free trade agreement, with Xi and UK Prime Minister David Cameron calling for the launch of a feasibility study during the former's state visit, and even Chinese involvement in the TPP has been mooted by analysts and Chinese state media. But all that remains hypothetical, and there were no substantial breakthroughs in BIT negotiations during Xi's US state visit in September.

Greater openness could still come through China opening up its capital account as part of its bid to join the IMF's Special Drawing Rights, and that will benefit economies with a sophisticated financial services industry, says Li-Gang Liu. Combined with a continued or steeper slowdown, that could see less capital going into China and more going out.

"This means that certain Chinese capital will flow to financial centers such as Hong Kong and Singapore, and ASEAN economies could get a bigger share of capital flow from OECD economies, so in that sense I think [a slowdown] might not be a bad thing for ASEAN economies," he says.

In any case, China is now one of key drivers of global growth, particularly since the financial crisis, and any slowdown will have global ramifications with knock-on effects for everyone irrespective of their direct exposure. That said, many of the world's advanced economies can take heart from the fact that the direct impacts are nonetheless limited and the alarmist headlines following China's turbulent summer can be taken with a pinch of salt. When China catches a cold, the main country that suffers is itself.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# Together as One

## Plans to integrate Beijing, Tianjin and Hebei face obstacles central to China's future growth

By Hudson Lockett


Image by Han Xiao

When the dawn of post-imperial China broke the horizon in 1911, the grandest building in Beijing was still the Forbidden City's 35-meter-tall Hall of Supreme Harmony, and Beijing, Tianjin and Hebei were still a single province.

Just over a century later the gleaming glass of the China World Trade Center's Tower III stands at 330 meters in the capital's Central Business District. But all too often its top floors are obscured by impenetrable haze. On a rare blue-sky day the view from the top affords a vista of gridlocked ring roads radiating out toward a seventh ring of garbage dumps and onward to a far less prosperous periphery.

Hence the drive to decongest the capital's core by pushing the municipal government's headquarters out to Tongzhou district, bordering the municipality of Tianjin and the push for greater public transportation links with surrounding Hebei province, along with calls for more specialized, coordinated development and environmental protection by the three. It's all part of the ambitious "Jing-Jin-Ji" plan to integrate Beijing, Tianjin and Hebei into a single, massive urban corridor.

The project has backing from President Xi Jinping himself, and a regional approach will undoubtedly be necessary to address the mounting industrialization-based ills of Beijing and its neighbors. Yet differences in economic structure, political realities and the tall walls of bureaucracy could stall grand plans meant to deal with difficulties at the local level that are now also facing China as a whole.

"The thing is, when you look at the flow of resources, the money follows power, people follow the money and pollution follows people," says Qi Ye, Director of the Brookings-Tsinghua Center. Ye notes that unlike China's other urban corridors in the Yangtze River and Pearl River deltas, both political and economic power in the Jing-Jin-Ji area are tremendously unbalanced. "It's no wonder you see so much pollution concentrated in a small area like in Beijing."

But if policymakers can't overcome such issues writ small within the region, it's unclear how they could hope to handle economic rebalancing on a national scale. As goes Jing-Jin-Ji, so, too, may go China.

> "China... doesn't really do collaboration well across different municipality lines
>
> Daniel Hedglin
> Co-Founder
> China Urban Development Blog

### Historic (Ab)normality

The history of Jing-Jin-Ji hearkens back to the Ming and Qing dynasties, under which Beijing, Tianjin and Hebei were known as a single province ("Zhili", meaning "directly ruled" by the imperial state) having roughly analogous borders. But in 1928 the Republic of China designated Beijing and Tianjin as special municipalities, with most of the surrounding territory reconstituted into the province of Hebei.

And while Jing-Jin-Ji now enjoys the policy planning spotlight, the concept is over a decade old. The phrase—which refers to the respective administrative abbreviations of Beijing, Tianjin and Hebei—had entered the state media lexicon by as early as March 2004, when a report from the overseas edition of the *People's Daily*, the newspaper of the Chinese Communist Party, asserted the central government's powerful National Development and Reform Commission had convened a joint meeting on the topic with leaders from all three administrative districts.

But it was only in February of 2014 that the plan was revived by Xi Jinping's call for integrated development of the region during a symposium in Beijing. By March the state-run paper *China Daily* was reporting on a "new plan" for integration "expected to ease the air, water and transportation problems" of Beijing and Tianjin. The former would also "relocate less important industries and divert population to neighboring cities in Hebei, to ease population pressure in the capital and beef up the competitiveness of its surrounding areas."

### Structural Integrity

Such bulking up is urgently needed: Beijing and Tianjin both had nominal gross domestic product (GDP) growth above 7.5% in the first half of 2015, but Hebei saw growth fall to less than 2% for the period—low enough for Andrew Batson and Chen Long of research firm Gavekal Dragonomics to write that it and five other northern provinces "are unarguably in recession".

The divergence stems in part from economic structure: nearly 80% of Beijing's growth comes from the services sector; Tianjin's is split roughly in equal measure between services and high-end manufacturing. But Hebei relies on manufacturing for over half of its growth, much of it heavy industry, and in 2014 over 11% of its GDP still came from the primary sector, namely grain farms and coal mines.

Wang Jinmin, an assistant professor at the University of Nottingham's School of Contemporary Chinese Studies whose research focus includes industrial clusters in China, says that this traditional heavy industrial base sets Jing-Jin-Ji apart from the river delta economies.

But China is now transitioning away from heavy industry and exports and toward a consumption and services-based economy. Thus, in Hebei, Wang says, "the government intends to push for industrial upgrades in the area to stimulate structural change," hopefully spurring more rapid development of the private sector.

Yet while its economy is already larger than those of Beijing and Tianjin in absolute terms, Hebei's per capita GDP lags the national average and trails woefully behind its neighbors'. That's because its residents account for two-thirds of Jing-Jin-Ji's total population of 110 million people, and 40% of the province's population live in areas that are officially designated as rural.

### Polycentric Thinking

That distribution puts the lie to claims in anglophone media that Jing-Jin-Ji will soon constitute a massive, unified "megacity" of unprecedented scale. But this potential for increased urbanization and Hebei's many million-plus population municipalities—relatively small, for China—may open the door for the region to move beyond its Beijing-facing monocentricity, says Daniel Hedglin, an urban planner with experience in Shanghai and co-founder of the China Urban Development Blog.

"They're looking to think about the region in polycentric centers that are a little bit larger and much more specialized," Hedglin says. Which might be harder than it sounds .

"China, in general, from a planning perspective doesn't really do collaboration well across different municipality lines," Hedglin says. With few exceptions, regional integration requires a level of cooperation anathema to most mainland cities whose officials' chief concerned is competing for economic opportunities.

Based on official announcements thus far, coordination under the Jing-Jin-Ji rubric would mean a continued focus on technology and cultural industries for Beijing, while Tianjin would ratchet up its research and high-value-added manufacturing sectors in addition to its role as a major port.

While state media reports have made vague references to new infrastructure, residential developments and light manufacturing in the province, Hedglin says that "to this point it's still a bit mysterious how Hebei plays into the Jing-Jin-Ji region."

### Known Knowns

There are, however, a few firm details, mostly about the "Jing" of the eponymous plan.

Current plans demand that Beijing's population growth be capped at only 1 million more residents, with its central districts to be depopulated by 15%. Municipal governance will move to the outer district of Tongzhou, near Tianjin, aided by a broader transport infrastructure overhaul.

Details on that initiative arrived in July, when Beijing's municipal transport commission laid out a hypothetical 1,000 kilometers of track for an expanded subway, train and high-speed rail system reaching as far as the city of Baoding, about as far southwest of the capital as Tianjin is to its southeast. *Xinhua* framed the expansion as a first step in spreading out Beijing's intensely dense population.

Wang points out that such expansion could also boost the proximity benefits for Hebei, which he expects could see an inflow of other industries that crowd the capital, such as hospitals and other medical sector businesses. He also believes Beijing could encourage further expansion of its top-tier higher education institutions in Hebei, which in turn could attract attention (and hopefully investment) from the tech industry.

But there will likely be limits on what can escape Beijing's gravitational pull: in July Chinese business magazine *Caijing* reported that the city of Baoding would become China's auxiliary political capital—a claim officials and state media promptly and strenuously denied as property prices rose regardless.

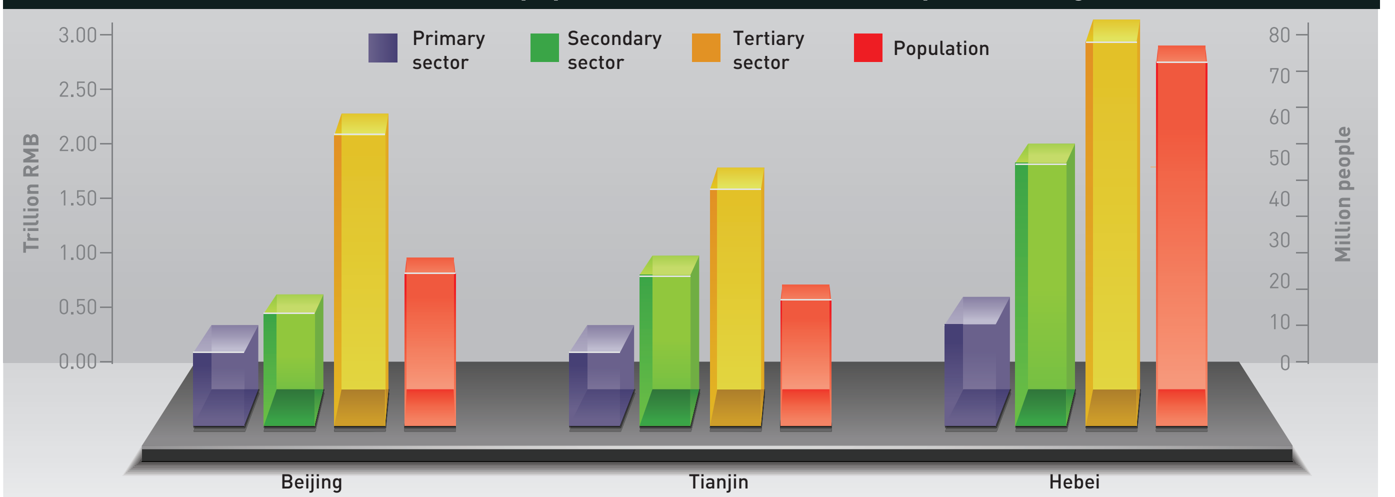
Even the most recent official pronouncements on Hebei's role have been remarkably vague. In August *Xinhua* cited a document issued by a leading group for coordinated development of the Jing-Jin-Ji region as stating that Hebei would be an "important national base for trade and logistics" (it already is) and "an experimental area for industrial transition and upgrading".

### Daunting Difficulties

Such grandiose description may resonate with the ambitious idea of a third economic corridor in China's northeast, but coastal cites in the region are vulnerable to sea lev-

## Matching Up

**Breakdown of GDP and population for the constituent parts of Jing-Jin-Ji**




Source: National Bureau of Statistics

el rises spurred by climate change—Tianjin especially. A mere three-meter rise—possible within the next 50 years according to one recent climatological study—could put much of the city's center and all of its new coastal development projects underwater.

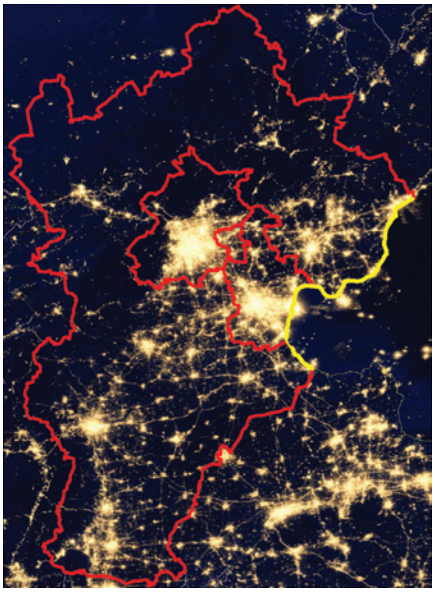
Yet, somewhat ironically, Beijing, Hebei and Tianjin are also among the seven of China's administrative districts that run a water deficit, in which water withdrawals exceed renewable resources, according to China Water Risk. In fact, the groundwater level of the North China Plain has fallen by nearly two-thirds since the 1970s, when economic reforms began. Even what's left is often unusable thanks to pollution: a 2013 survey by the Ministry of Land Resources showed more that 70% of the plain's groundwater wasn't fit for human contact. Hedglin is skeptical of the idea that pushing unwanted industries out of Beijing and into Hebei will bring ecological and economic gains.

"I get a little nervous that what they're talking about by moving the factories out of Beijing isn't necessarily trying to just spread economic growth across the region," Hedglin says, "that it's trying to move it away from the city center so that it's less embarrassing that Beijing has these pollution problems."

That seems to be how officials in Hebei see things. In April 2014 one district official from the city of Chengde told the state-run newspaper *China Real Estate Business* that the first wave of companies leaving Beijing for Hebei and Tianjin were all heavy polluting and high-energy consuming: "That kind of company will be a burden no matter where they end up, so right now neither Hebei nor Tianjin is eager to take them in."

While simply making more land accessible for use outside of Beijing through better transport infrastructure may provide some short-term relief, Hedglin also worries that those same channels could eventually enable inflows to the capital's urban core by suburban commuters who eventually decide that the next step of success is life in Beijing.

Ye, at the Brookings-Tsinghua Center, is likewise skeptical of the idea that Hebei's workforce can transition to light manufacturing as easily as has been suggested. "It's not realistic to expect steel mill factory workers will go to a high tech company, a high-tech industry," he says.



**The Jing-Jin-Ji region at night**

## Green Shoots?

Instead, Ye recommends a counterintuitive path forward for a province known chiefly in China for pollution and low wages—going back to the farm.

"I think there's a really great opportunity for developing high quality and high-tech agriculture in this region," he says—and not just the grains it already grows. With the support of complementary tech and research and development from Beijing and Tianjin, respectively, Hebei's miners and steelworkers could engage in large-scale farming of vegetables and other produce, bringing in far higher returns on investment than government-subsidized corn.

"This is an area with huge demand for high-quality food, and these kinds of gaps tend to be filled by products from other regions," Ye says. "Why not Hebei?"

But whatever sectors form Hebei's new economic bedrock, its provincial government's policies will play a key role in facilitating growth. Nottingham's Wang suggested Hebei should take its cues from the enterprise booms that are still echoing through China's southern river deltas, enacting policies that attract more foreign direct investment with the aim of kick-starting potentially disruptive (and lucrative) entrepreneurial ventures.

## Micro as Macro

In fact the Pearl River Delta, which had developed organically, faces the opposite problem in its own efforts to better plan development among its nine-city cluster in Guangdong province. Peter T.Y. Cheung, an associate professor at Hong Kong University's Department of Politics and Public Administration who has studied the delta's development extensively, says that decentralization and an embrace of reforms empowered cities in the cluster, including Shenzhen and Guangzhou, "so it's difficult for the provincial government to coordinate them after two decades of reform."

But he said plans in both regions were responding to a problem of how officials have long been competitively evaluated for promotion based on economic growth, a game in which political positioning is key. A study of administrative hierarchy in China, published in the April edition of the *Chinese Journal of Urban and Environmental Studies*, found that after examining hundreds of cities and thousands of towns that the higher a city's rank, the faster its growth. In other words, the developmental inequality Jing-Jin-Ji seeks to address is a microcosm of a broader national issue.

Indeed, no district ranks higher than Beijing, and few lie lower than Hebei. But Cheung also points out that in 2014 the State Council set up a team to promote regional integration and appointed Zhang Gaoli, China's vice premier and a member of the party politburo's powerful standing committee, to lead it.

That clout could prove vital to the success of Jing-Jin-Ji—though coordination will still require a new approach and unprecedented level of cooperation that won't likely come easy, regardless of who is in charge. Most vitally, if Hebei is only ever a dumping ground for unwanted industries from Beijing there can be little hope of real and sustainable integration. But while the obstacles are legion, the Jing-Jin-Ji integration plan has at least recognized one key truth: the region will rise, or fall, together.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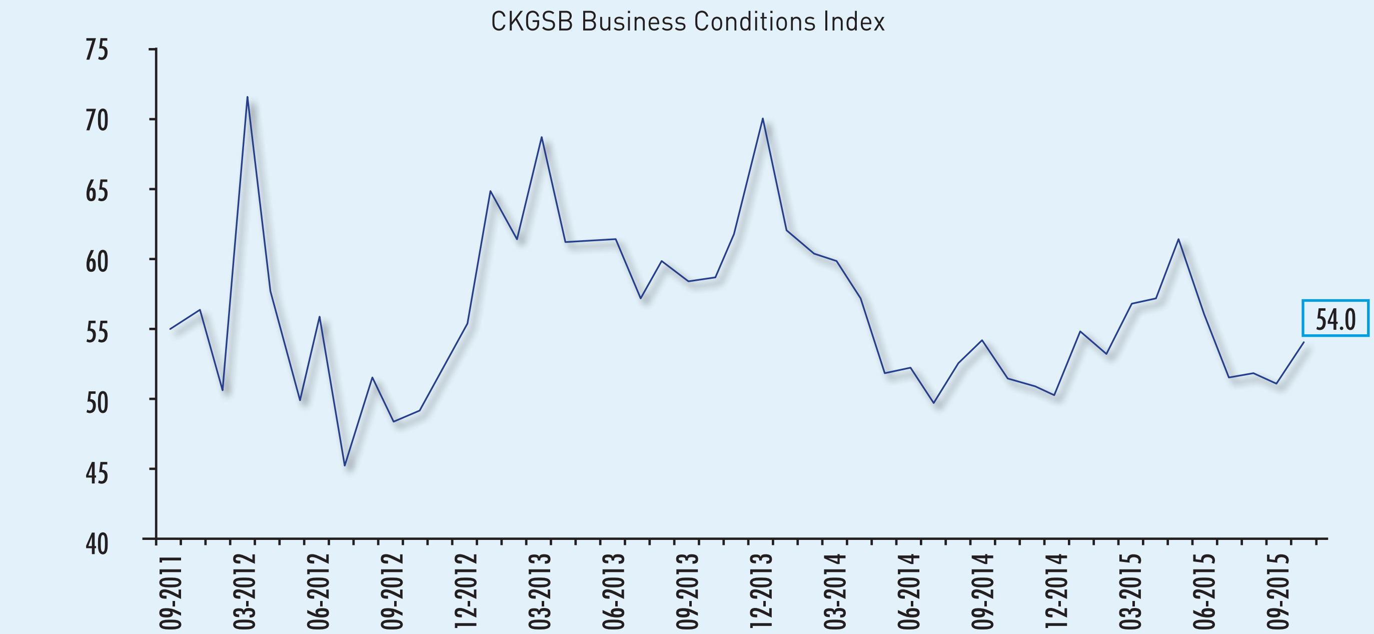
# Cautious Optimism

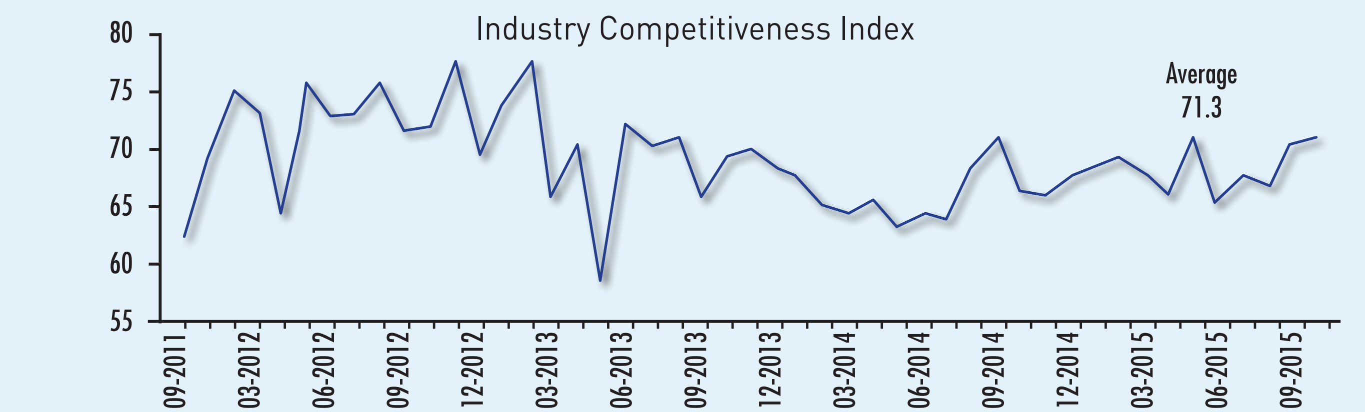
## Businesses remain confident, but it remains unclear if they will continue to

In October 2015, the CKGSB Business Conditions Index (BCI) posted a figure of 54.0, a mild rise over the previous monthly reading of 51.1 and slightly above the confidence threshold of 50. The BCI hit a 14-month high of 61.3 in May 2015 before sliding steadily, with readings from July to September hovering above 50, indicating that the sample firms became less optimistic about business conditions with regard to the following six months. Despite a moderate rally this month, it is still unclear whether or not the ongoing momentum will hold. As a result, we need to maintain cautious optimism with regard to these short-term economic trends. The BCI, directed by Li Wei, Professor of Economics at the Cheung Kong Graduate School of Business, asks respondents to indicate whether their firm is more, the same, or less competitive than the industry average (50), and from this we derive a sample competitiveness index (see Industry Competitiveness Index). As our sample firms are in a relatively strong competitive position in their respective industries, the CKGSB BCI indices tend to be higher than government and industry PMI indices.

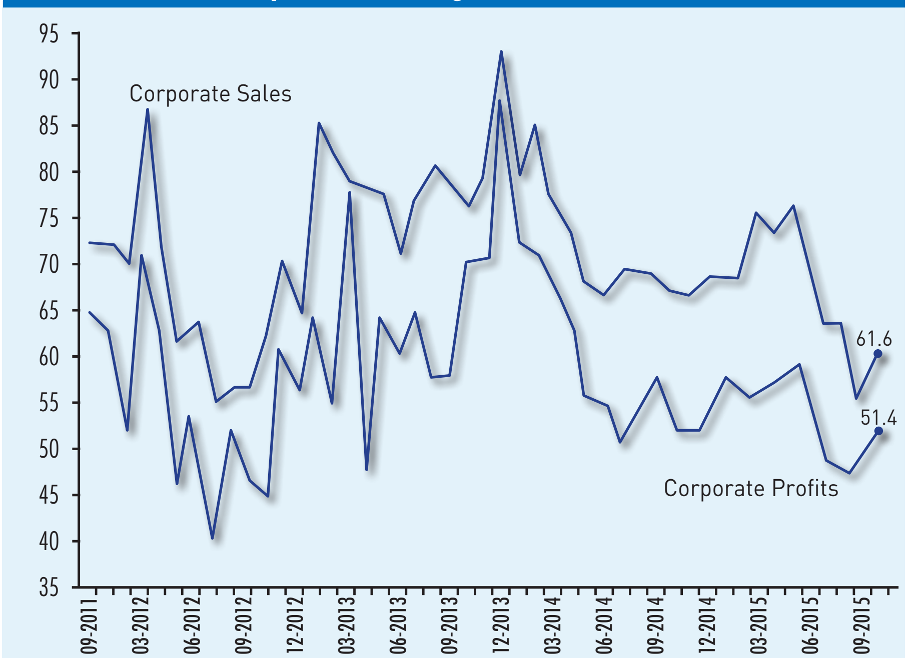
### Business confidence edges up after a fall...



## ...and firms feel more competitive

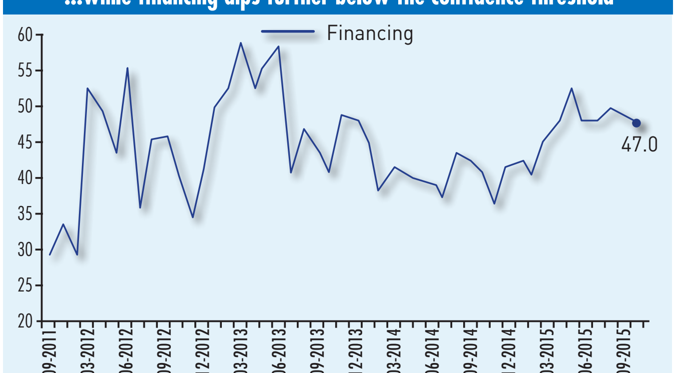



## Both sales and profits make slight recoveries from recent falls

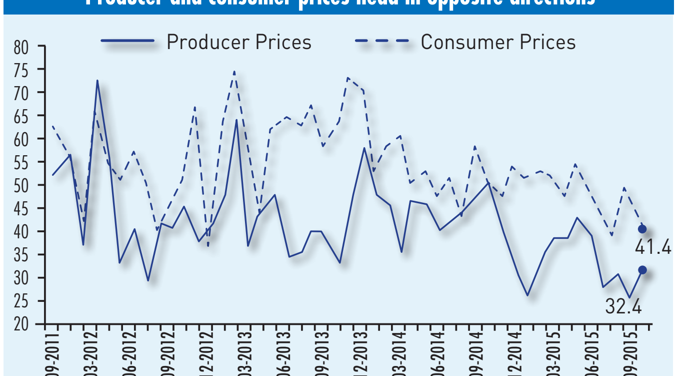



The sales index posted relatively strong growth, up to 61.6 from 56.6, while the profits index also witnessed a mild rise this month to 51.4 from 48.7, bouncing back over the mark of 50. The trend reversal isn't that impressive, indicating that firms still have limited confidence in their profit prospects in the near future. The financing index edged down to 47.0 in October from 48.4 in the previous month—the index has long stayed below the mark of 50, suggesting a tough financing environment in which the sample firms operate. The consumer price index plummeted once again, down to 41.4 from 50.0—it has truly had a rollercoaster ride over the years. Meanwhile, the product price index edged up from 27.7 to 32.4, yet remained in extremely low territory. In general, all the price-related indices have stayed weak since January 2014.

## ...while financing dips further below the confidence threshold




## Producer and consumer prices head in opposite directions



# LOSING SIGNAL

## How will vendors adapt as China's massive smartphone market cools?

By Matthew Fulco

Image by Han Xiao

Companies that have spent months being feted by the media don't tend to revise down their sales target, but in March Chinese smartphone maker Xiaomi did just that—from 100 million units set in December 2014 to 80-100 million. And even that doesn't truly reflect the company's ailing growth: rival Chinese brand Huawei overtook Xiaomi in the third quarter as China's top smartphone vendor.

Analysts are bearish. The Taiwanese research firm TrendForce forecasts Xiaomi will ship 70 million handsets this year. Singapore-based Canalys reckons Xiaomi's sales fell year-on-year from July to September—the first time the company has experienced such a contraction.

It's a reality check for the upstart vendor, which soared to fame and a $45 billion valuation in less than five years as China's first-time smartphone buyers snapped up handsets at a furious rate. From 2012 to 2014, smartphone sales in China doubled, comprising nearly one-third of the global total of 1.27 billion, according to Bernstein Research. By early 2013, mainland China had surpassed the United States to become the world's largest handset market.

But smartphone sales in China are now flagging. Shipments are forecast to increase just 1.2% on an annual basis this year, down from 19.7% in 2014, according to the research firm IDC.

"The market has reached saturation," says Nicole Peng, APAC Research Director at Canalys in Shanghai. Cheap Android devices will no longer drive growth as Chinese consumers upgrade to mid-range and high-end handsets, she says.

That augurs ill for companies like Beijing-based Xiaomi and Lenovo, the fifth-largest smartphone brand globally, both of whose growth has been fueled by sales of low-end devices in China. With their home market slowing, they and other Chinese vendors are ramping up overseas expansion from Latin America and Africa to India and Southeast Asia. But in those hotly contested emerging markets Chinese vendors face entrenched local competitors.

At the same time, more Chinese companies are trying their hand at low-end smartphones, buoyed by the Android segment's low barrier to entry. Alibaba-backed Meizu is one of the top performers among the new wave of Chinese handset vendors. Others, like the video-streaming service LeTV, are using smartphones to promote their other business lines.

> "
> The market has reached saturation
>
> Nicole Peng
> APAC Research Director
> Canalys

One thing is for certain: the world's largest smartphone market has never been more competitive.

### Commoditization Struggles

When smartphone penetration was low in China, it was possible for both upstarts and more established vendors to grow rapidly. But now that the market is flooded with lookalike Android phones, some of the most successful Chinese brands face an unprecedented challenge.

In the case of Xiaomi, the problem is not evident at first glance. After all, the company shipped 17.9 million handsets in the second quarter, up 29.4% year-on-year, according to IDC. Over that same period, Xiaomi's share of the global smartphone market increased from 4.6% to 5.3%.

The trouble for Xiaomi is that the company is accustomed to growing much faster. "There's no doubt sales will surpass RMB 100 billion this year, and growth will be more than 50%," founder and CEO Lei Jun told reporters at China's National People's Congress in March.

That's looking unlikely now. In the first half of the year, Xiaomi sold 34.7 million units, less than half its full-year target.

"Xiaomi's growth as a smartphone vendor has peaked," says James Yan, an analyst at IDC in Beijing.

That means the company will need to rethink its strategy of selling cheap handsets in huge volume, says Jade Chang, a smartphone analyst at the Taipei-based Market Intelligence & Consulting Institute (MIC). That business model, with its wafer-thin margins, only works when the market is growing at breakneck speed, she says.

For its part, Lenovo is struggling to manage the acquisition of Motorola. Those travails are hurting Lenovo's growth, which has already taken a hit from the slowing smartphone market. In the second quarter, the company's net profit declined 51% from a year earlier to reach $105 million.

In a bid to reduce costs, Lenovo announced in August it would slash its employee headcount of 60,000 by 5%. The company is also restructuring its mobile business group as it aims to streamline its portfolio of smartphone models.

Meanwhile, Samsung is faring even worse. IDC says the South Korean electronics giant remained the top smartphone producer globally in the second quarter. But in China, Samsung tied for fifth place with local brand Oppo. That's a big drop from two years ago, when Samsung was the top handset maker in China.

"Samsung is still seen as a high-end brand in China, but it doesn't have a lot of time to reverse its decline," says Peng of Canalys. "It needs to create a unique experience for users in the growing premium segment."

### It Pays to Go Upmarket

As Chinese consumers discard their Samsung handsets, they are flocking to Apple. The US tech giant has surged in popularity in China since December 2013, when it signed an agreement to sell iPhones through China Mobile, the largest wireless network in the world with over 800 million subscribers. Within a year of the China Mobile deal, Apple rose from China's No. 6 smartphone vendor to No. 1, surpassing Samsung, Huawei, Lenovo and Xiaomi.

Apple has continued to enjoy brisk China sales this year. In the first quarter, shipments rose 72% from a year earlier, beating iPhone sales in Apple's home market of the US for the first time, the company said. In the quarter ending June, iPhone sales in China grew 68% year-on-year to 11.9 million units, according to Gartner.

Fu Cong, a Shanghai-based communications consultant, says his wife—a senior manager in a retail bank—loves her iPhone 6 Plus for its functionality and brand cache. "It's easy to use and everyone knows it's expensive," he says. "It's a status symbol."

"The segment that Apple targets [in China] is the most lucrative one," says Teng Bingsheng, Associate Professor of Strategic Management at the Cheung Kong Graduate School of Business in Beijing. "These people are less sensitive in general to price. As long as Apple continues to introduce good products, I think these people will be rather loyal to Apple."

Among Android vendors, only Huawei is performing as well as Apple. In fact, in the second quarter, the Shenzhen-based telecom giant did even better, posting 48.1% annual growth—compared with Apple's 34.9%—as it shipped 29.9 million handsets, IDC says. Those stellar numbers have helped Huawei become the world's third-largest smartphone maker behind Samsung and Apple.

Huawei's success derives from its technological advances over the past decade, which have made it capable of producing high-quality mid-range handsets. The company has drawn upon its resources as a telecom giant and invested heavily in research and development (R&D) for smartphone chipsets, says Yan of IDC.

Huawei formerly served as an original equipment manufacturer (OEM), producing handsets for other brands, observes CKGSB's Teng. "But Huawei realized the value of its own brand would be its most important asset, so it invested a lot more into its own brand name. It is no surprise that is rapidly gaining market share."

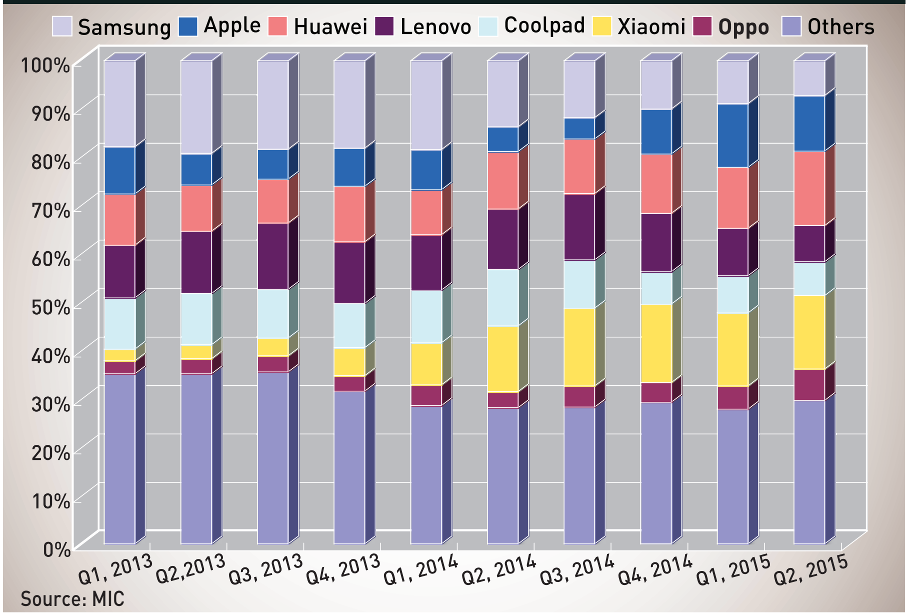
As a result, Huawei now has legions of dedicated fans of its mid-range Honor sub-brand, Yan notes.

## Long-Distance Growth

With its massive global network, Huawei is the top-selling Chinese vendor overseas and well positioned to compete in emerging markets, an area other Chinese handset vendors are now tapping in a bid to offset slowing growth at home.

Stealing Share

Smartphone brand market share




Source: MIC

In the developing world, Huawei has a head start on many of its competitors. It entered India in 1999 as a telecom equipment provider and began selling mobile phones to Indian consumers in 2010. In 2013, the telecom giant became the first Chinese brand to produce smartphones in Brazil. By 2014, Huawei was the No. 2 handset vendor behind Samsung in Africa's market of 1 billion consumers.

Southeast Asian consumers are snapping up Huawei handsets too. The telecom giant forecasts shipment growth there to rise 160% to 8 million units this year on the back of robust demand in Myanmar.

In Indonesia, Southeast Asia's largest smartphone market, Oppo is the market leader. For the last four quarters, its handset sales have been the best among the 12 major Chinese smartphone vendors in the country, according to Counterpoint Research. Mid-range smartphones like the R5, which retails for about $450, are Oppo's best-selling products, the company says.

"Oppo's smartphones are excellent quality and the company is effective in using localized marketing campaigns to drive sales," says Yan of IDC.

Southeast Asia, with its geographic proximity to China and cultural similarities, may offer the best opportunities for Chinese smartphone makers, says Chang of MIC. Conversely, the Brazilian market is far away, and the country's high import duties on smartphones necessitate huge capital investment in production facilities in the country, she says.

In July, Xiaomi made its first foray outside Asia with the Brazil launch of its Redmi 2 handset. Xiaomi will assemble the phones in Brazil, while importing some parts and manufacturing others locally. Yet it is likely that Xiaomi will struggle to keep prices low given the high costs of energy, labor and logistics in Brazil.

Meanwhile, it is in India—the world's No. 3 smartphone market and its fastest growing—where Chinese vendors are vying most fiercely for market share. India's fragmented telecom industry, prevalence of retail-driven sales and consumer preference for pre-paid plans make the barrier to entry low in the smartphone market, experts say.

While Huawei enjoys an early mover's advantage, competition is intensifying fast as vendors move production to the subcontinent to avoid paying higher import taxes: the Indian government recently hiked duties on imported smartphones to attract more local manufacturing.

The number of Chinese smartphone brands sold in India has risen from 12 to 57 since 2013, according to Counterpoint Research. In August, Lenovo announced it would use contract manufacturer Flex's factory outside of Chennai to produce its Lenovo and Motorola brands. Both Oppo and Vivo have pledged to begin production in India by the end of the year.

Taiwan's Foxconn Technology Group, the world's largest contract electronics manufacturer, began producing smartphones in India for Xiaomi and OnePlus this year. Guangdong-based Meizu, which is backed by Alibaba, also plans to cooperate with the Taiwanese original design manufacturer (ODM) to make handsets in India.

A former Foxconn executive, who spoke on condition of anonymity, urges Chinese vendors to proceed cautiously. "We can't take Foxconn at its word," the person says. The Taiwanese ODM's record outside of China is spotty, the person observes, pointing out its Brazil plant plagued by logistics and labor problems, and the massive production facility promised in Indonesia last year that failed to materialize.

The person adds: "India has serious infrastructure and supply chain deficiencies. I'm not sure Foxconn will be able to build a manufacturing facility there that meets its standards."

Competition in India is also ferocious. The subcontinent has a number of established domestic mobile phone brands like Micromax, Lava, Intex and Karbonn. These brands are well known among Indian consumers and have strong relationships with retail outlets, which could give them an advantage over foreign vendors new to the market, says Ganesh Ramamoorthy, Vice President of Research at Gartner in India.

## No Place Like Home

Back in China, the sheer size of the smartphone market means that opportunity remains, but vendors will need to do more to attract the attention of consumers.

> Huawei realized the value of its own brand would be its most important asset
>
> Teng Bingsheng
> Associate Professor of Strategic Management
> CKGSB

Xiaomi is doing that by broadening its product portfolio, observes Helen Chiang, an associate director at IDC in Taipei. The Xiaomi ecosystem is the envy of China's other Android vendors, she says, noting the company's foray into television with the Mi TV and Mi set-top box, as well as connected devices beyond smartphones—the Mi Band fitness tracker, a Wi-Fi router-range and an air purifier. The company is even expanding into notebook computers and mobile-operator services.

But Chang is less sanguine about Xiaomi: "Attempts to diversify products and services may dilute what they focused on in the first place and strain resources."

She continues: "Most importantly, Xiaomi is likely to fall into a fierce patent war," which could constrain its expansion efforts. Xiaomi's patent deployment is relatively weak compared to other Chinese brands such as Huawei, she says.

The key for Lenovo regaining its footing in China will be resolving its cultural differences with Motorola, says Peng. "Motorola is focused on product, while Lenovo is successful on supply chain and costs and is not so good on profitability."

In the short term, "the Motorola brand, which has a good reputation, can be a way for Lenovo to quickly move into the mid and high-range segments in China," she says. "The Lenovo brand will be used in the lower end." In the long run, however, Lenovo needs to figure out how to bring its own brand upmarket to ensure sustainable growth, she adds.

Among newer entrants to China's smartphone market, Meizu is a stand-out, says Yan of IDC. "Their R&D is superb, and now thanks to the big investment from Alibaba [$590 million] they have plenty of cash to use for expansion," he says.

Some companies in other sectors are adding smartphone business lines, such as paid TV provider LeTV and internet security company Qihoo 360. In the case of LeTV, the company is not aiming to sell handsets in high volume, but to use them to push its core paid TV business, says Peng of Canalys. By contrast, Qihoo is simply aiming to tap the low-cost smartphone market, which remains considerable as millions of Chinese consumers upgrade from older feature phones, market insiders say.

As more brands flood the market with cheap devices, the level of fragmentation will peak in the next year or two, Chang reckons. Companies with small economies of scale who are unable to expand internationally or focus on niche markets [such as tier 5 or tier 6 cities where a large distribution network and marketing budget are not required] will be forced out of the Chinese market during that period, she predicts.

Still, opportunity remains for some aspiring entrants to the low-end market to succeed. Since Xiaomi established the business model of selling cheap handsets largely online, "there is room for a couple of copycats using the same strategy," says Teng of CKGSB.

"There are a lot of people in China who still have limited income, such as students and retirees," says Peng. While the low-end market segment will be hyper-competitive, "it will not go away," she says.

# New Threads

## Uniqlo has ambitions to be the world's largest retailer, and it is betting on China to get it there

By Helen Roxburgh

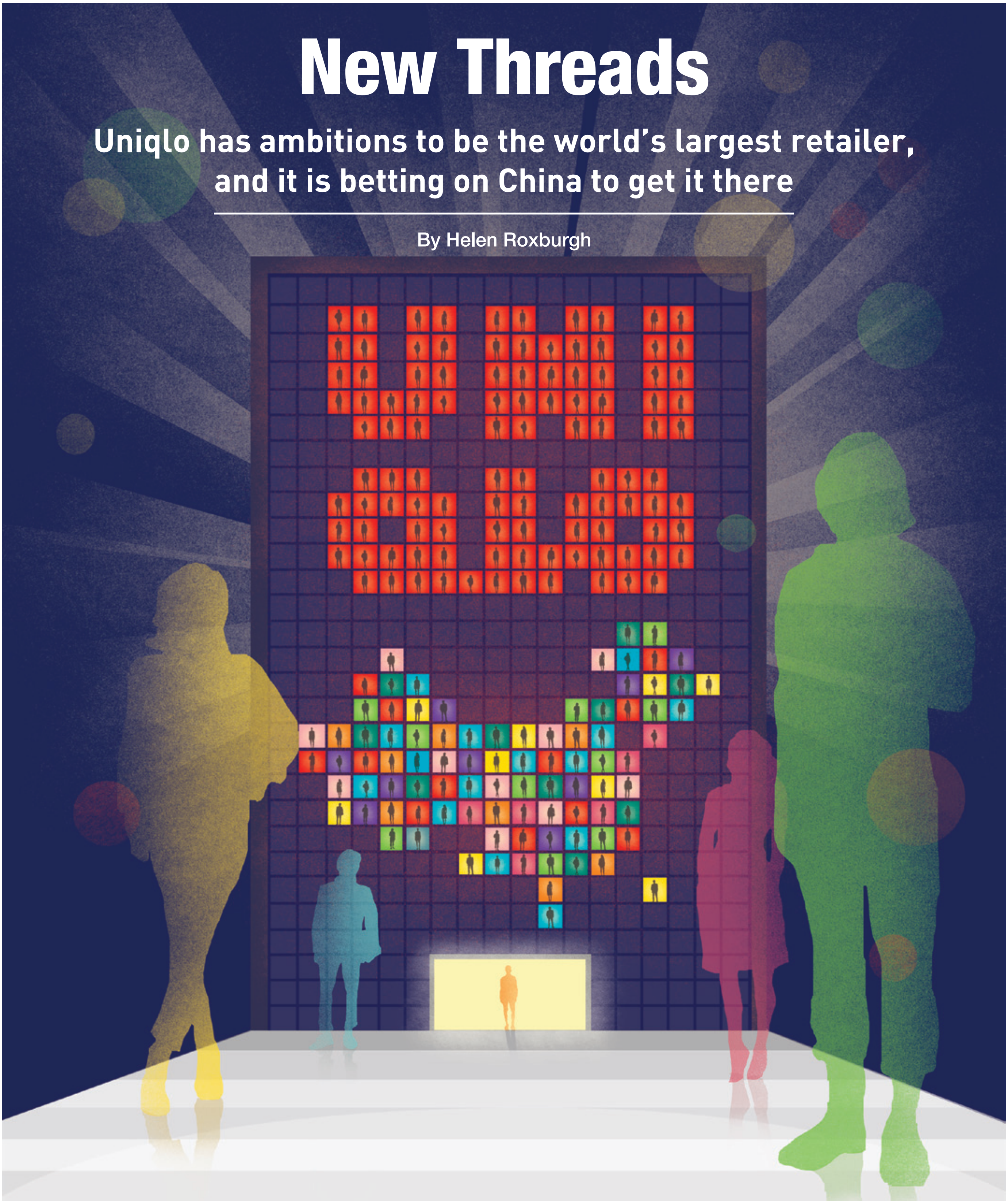


Image by Beibei Nie

On a Saturday afternoon in late September, Uniqlo's central Shanghai store is packed with excited shoppers. But this is not just normal weekend sales; this particular Saturday is the launch of a new partnership for Uniqlo—its tie-up with one of the biggest names in entertainment, Walt Disney. Introducing a range of branded goods to China, the 'Magic For All' launch brought an enthusiastic crowd of shoppers, with a queue of more than 1,000 waiting before the store even opened.

The fifth floor of the giant Uniqlo shop on central Huaihai Road was turned over to the new Uniqlo-Disney range and included a life-sized Mickey Mouse model, five areas featuring different selections of clothes emblazoned with Disney characters and an area that allowed shoppers to create their own Disney character shirts. And it seemed to be going down well with the shop's fans.

"I love Uniqlo's stuff," said Wang Yining, who was leaving the store with two friends, all clutching shopping bags. "Uniqlo always offers something different and it's fun to come here. Also, it's not too expensive for me to buy things."

"It's easy to find things in colors I like," agrees Gabriel Fu, a student from Hong Kong, also holding bags of Disney-Uniqlo goods. "And they're very comfortable. I always buy clothes here."

Built around an ethos of high quality at affordable prices, Uniqlo quickly found huge popularity in China for accessible basics and mix-and-match designs. As a result, the Japanese retailer has been steadily building its presence in China over the last decade, and now has ambitious plans to accelerate its growth, most notably through a bold expansion in its number of shops.

That might seem sensible given its growing popularity—revenue soared by 21% between August 2014 and 2015 across Uniqlo globally, largely driven by an increase in Greater China revenues of 46% and operating profit of 66%. But is it now at risk of over-reaching itself, particularly given the slowing Chinese economy?

## Fast Forward

Uniqlo, the primary subsidiary of Japanese retail holding company Fast Retailing, first appeared as a brand in Hiroshima in 1984—reportedly, the name came about due to an error in registering the spelling of 'unique clothing'. The Uniqlo brand spread across Japan, and by 1994 there were 100 Uniqlo stores in its home country. However, it wasn't until almost a decade later that the company decided to venture into overseas markets. In 2002, the brand opened four overseas stores in London, and one in Shanghai. It opened two more in its first year in China, but expanded far more rapidly in the UK. But there the brand initially struggled, closing 16 of its 21 stores in the UK only a year later having failed to connect with its target consumers.

> "Retailers like Uniqlo tend to do their flagships extremely well
>
> Joel Stephen
> Head of Retailer Representations
> CBRE

But Uniqlo quickly learned from its mistakes, enlisting a host of popular celebrities, high-profile photographers and popular DJs to feature in a high-profile advertising campaign, and re-launched the brand in the UK three years later. Launch day sales reportedly exceeding any other store launch figures at the time in just three hours.

"Uniqlo are consistent in who they appeal to around the globe—the 'youngish' fun-loving consumer who enjoys the range of colors and the materials and fabric used," says retail consultant Chris Igwe. "The store itself is fun, colorful, but tastefully done. The merchandising is incredibly well-managed on the shop floor—you always have this image of a calm structure in a Uniqlo store."

"What it has achieved is being truly global in their offer, style and customer approach," he adds. "They are appealing to the young person as well as the young professional."

But burned by its experience in the UK, Uniqlo grew fairly slowly after its initial launch in China, reaching 189 stores in 2010. However in May of that year, Uniqlo opened its largest-ever store at the time on West Nanjing Road in Shanghai, its China flagship.

## Digital Runway

But sales really began to rocket once Uniqlo embraced the power of digital in China. The company was among the first international brands to heavily invest in Chinese social media, building accounts and followers on Weibo, RenRen, WeChat, Douban and Youku. The brand quickly appreciated the power of digital campaigns on social media, with one of its early successes a RenRen campaign in 2010 called 'Lucky Line', where users could stand in a virtual line to win iPhones, iPads and coupons. Their place in the 'queue' was then posted on the user's page.

But they've moved with the times as WeChat has ascended to the top of China's social media pile. The brand's successful 'Style Your Life' campaign, for example, allowed customers to try clothes on in front of backdrops to various cities, which they then shared on the app. This campaign helped Uniqlo more than double its number of followers. Numbers rocketed from 400,000 when the campaign launched last year to 1 million when it finished six months later, according to an *Advertising Age* interview with Jalin Wu, Uniqlo's Chief Marketing Officer for Greater China. Since then, numbers have doubled again and Uniqlo now has over two million followers on WeChat.

And since 2009, Uniqlo has also been selling successfully through Alibaba's Tmall platform. During Alibaba's Singles

Day sales event in November 2014, the biggest shopping day in the Chinese calendar, Uniqlo was the top apparel brand in terms of sales, and fifth overall.

Despite Tmall success, in July the retailer closed its online store on China's popular JD.com site, just three months after it launched, saying, "based on the results of the trial run", the retailer had decided to "take a step back" as it was "not in line with the company's China e-commerce strategy". In an interview with *Reuters*, a JD.com spokesperson said that the decision was not due to the store's performance as it had exceed sales targets in its first month.

Nonetheless, strong sales in China as a whole prompted Fast Retailing to raise its full-year earnings forecasts for the year, and the management remain confident despite a slowing economy.

"Uniqlo have done well in China, because they spotted early on the yawning gap between cheap and cheerless clothing and the high-end just as the Chinese middle class of white collar office workers was really beginning to emerge and find they had money to spend," says Matthew Crabbe, Director of Research, Asia-Pacific at Mintel. "Their clothes were affordable, but of good enough quality. This was an innovation in China at the time, and it is innovation that has kept Uniqlo in the minds of consumers."

And Crabbe points out that their success was also down to how they presented their products to consumers. "They were one of the first retailers to train staff to help customers by suggesting item matching, and were one of the first clothing brands to embrace Tmall, rather than try to compete with it," he says.

## Fragmented Fashion

Overseas growth—in China in particular—is key to Uniqlo's goal of becoming the world's top apparel retailer by 2020. In April Chief Executive Tadashi Yanai said Fast Retailing planned to have more Uniqlo outlets overseas than in Japan by the end of autumn, and that in five years there would be 1,000 in China (at the end of September there were 396). Eventually, Yanai wants 3,000 stores in China, with most of that growth in second and third-tier cities.

"Having established a firm framework for personnel training and store development, Uniqlo China is now embarking on a period of dramatic development and mass store openings with 91 new stores opening for business in fiscal 2015 alone," the company said in a statement, adding, "The success of our Shanghai global flagship store has boosted Uniqlo's brand appeal dramatically in China."

"Retailers like Uniqlo tend to do their flagships extremely well; they go big, they are the face of the brand but they are also very commercially successful," says Joel Stephen, Head of Retailer Representation at CBRE. "As they tend to open smaller stores in secondary locations, they avoid cannibalizing their other stores and thrive just on local catchments with those stores. With that price point and store strategy in this market, these retailers could open a thousand stores without becoming saturated."

Uniqlo currently holds 1.6% of the market for specialist apparel and footwear retailers according to Euromonitor, a share that has been steadily increasing up from 0.8% in 2010. That might not sound like a great deal, but China's apparel and footwear market is still highly fragmented and its consumer market is huge. One of the market leaders is Danish company Bestseller Fashion Group China, holding a 2.3% market share. Bestseller, which operates brands like Only, Jack & Jones and Vero Moda, has benefited from being one of the early retail chains in the Chinese market, opening the first Only store in 1996.

Zara's parent company Inditex ranks third with 2.2%, but the brand has reportedly said they will slow their store openings in China, having built a network of 500 stores. And rival fast fashion brand H&M holds 1.3% of the market, although it is also on

## Style Icons

**Brand market share of specialized retailers in China as a percentage of retail value**

| | UNIQLO | ZARA | BeLLE* | H&M | Meters/bonwe 美特斯·邦威 | JACK & JONES | DAPHNE 达芙妮 | teenmix* 天美意 | Tata* | Semir 森马 |
|---|---|---|---|---|---|---|---|---|---|---|
| 2011 | 1 | 1.2 | 1.9 | 0.9 | 2.6 | 1.2 | 1.3 | 1.1 | 0.9 | 1.5 |
| 2012 | 1.3 | 1.3 | 1.8 | 1 | 1.9 | 1.1 | 1.3 | 1 | 0.9 | 1 |
| 2013 | 1.5 | 1.4 | 1.6 | 1.1 | 1.4 | 1 | 1.1 | 0.9 | 0.8 | 0.9 |
| 2014 | 1.6 | 1.5 | 1.5 | 1.2 | 1.1 | 1 | 0.9 | 0.8 | 0.8 | 0.7 |

*Owned by Belle International
Source: Euromonitor

an expansion path in China, aiming to open 70 stores this fiscal year.

For Uniqlo, innovation and market awareness have been central to the company's attempts to grow its market share and insulate itself from its competitors. The company maintains that their products cannot be copied or replicated, due to its research and development and fabric innovation, such as heat-generating clothing HeatTech. And the tie-up with Disney is another way in which Uniqlo has shown themselves as savvy marketers. Disney is shortly going to open its first Disneyland in China; a $5.5 billion theme park near Shanghai, and the company's biggest ever foreign investment.

### Fashion Faux Pas

It remains to be seen whether the ambitious growth plans in China will pay off—particularly at a time when China's growth has slowed to the weakest level in 24 years, and many other retailers are more cautious, slowing store openings or closing shops.

But competitive pricing and offerings that sit well with the needs of consumers can help retailers prosper in spite of this. "The best-in-class retailers maintain a fairly aligned and competitive price structure in their stores globally; they don't put up prices to cover higher taxes in China. It helps access tens of millions more consumers who are growing into the lower entry price point," says Stephen. "And one thing the best of these retailers do well is basics. As the China market matures, people are keen to mix designer brands with stylish good quality basics. Successful retailers in this sector like Uniqlo do this very well."

Nonetheless, others warn of the risks of opening too many large stores too quickly.

"I think times have changed," says Crabbe. "The growth in online retail and [mobile]-commerce have increasingly meant that retailers no longer need to have so many stores to reach more consumers, just a better offering and visibility online. Uniqlo would do better to—as well as opening big flagship stores in key new cities—open dressing rooms in some places, rather than full stores, where people can try on the clothes and buy online."

> "Uniqlo would do better to open dressing rooms... rather than full stores
>
> Matthew Crabbe
> Director of Research, Asia-Pacific
> Mintel

And it hasn't all been smooth sailing in China. In July, a video of a couple having sex in a Uniqlo changing room went viral, leading to the arrest of at least five people. Uniqlo declared it was not a marketing stunt, but media reports said the government was investigating if there was a publicity angle to the scandal. The *China Daily* reported that Uniqlo could face a fine of between RMB 200,000 and 1 million, and even see its licence revoked if the government decided it was complicit.

Involvement, or lack thereof, aside, implications for the brand's image aren't clear cut. According to a consumer survey by YouGov, a quarter of men surveyed said the incident increased their purchase intent, while for a third of women, intent levels dropped. About 11% of men and 8% of women said the steamy video "enhanced their perception of the brand as a young and energetic brand," while nearly a quarter of men said it made them want to visit the shop. In any case, the incident has been clearly and indelibly linked with the store.

Adding to the negative publicity was an attack on a woman and a man with a samurai sword outside a central Beijing Uniqlo store in August in which the woman later died. While there was no Uniqlo connection with the event, it was another front-page controversy with the brand's logo squarely featured in many photos.

However, most experts believe Uniqlo has built a strong enough brand not to be damaged by such incidents. "The recent negative press for Uniqlo in China demonstrates the fragility of any organization's ability to manage all aspects of the brand positioning," says Toby Hemming, Director at media relations specialist Bold Media. "Whilst these incidents are of course highly regrettable, ultimately the public's perception of Uniqlo as a brand will be based on a far wider set of factors including brand equity, customer service and quality of product."

"Sensitive and timely handling of any negative press is crucial to the long-term commercial prospects of any organization," he continues. "Judging against this criteria, I don't think Uniqlo will suffer any long-term damage from two isolated incidents."

### A Solid Footing

However popular Uniqlo is with shoppers, the store will still have to navigate the fallout from various controversies as it continues its China growth. It could be a tough year ahead if the government concludes it had any part in the infamous 'sex video', and implements serious reprimands.

But even as growth slows, in the main Uniqlo sees itself as nicely positioned to weather the storm—adaptable, affordable clothing is always popular in tougher economic times, and it has based itself at the forefront of China's social media marketing.

"Value fashion retail is the strongest sector to be in," concludes CBRE's Stephen. "In China, there is a demographic growing into this sector, but there's also an existing demographic, some of whom are very wealthy [yet] who buy the product. There are also consumers trading down from the mid-range sector as the market slows, so there are three different consumer groups driving performance."

With so many consumers driving demand in China, Uniqlo's bid to be the largest clothes retailer in the world might not be impossible after all.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# Chasing First

## Colin Currie, Managing Director of Adidas Group Greater China, on the company's strategy for topping the league table

By Chris Russell

When you think of sports brands, there's pretty much a 50% chance that it's Adidas that comes to mind. This, after all, is the company that has provided the match ball for the FIFA World Cups, whose final is the most watched sporting event in the world, since 1970. But for all that, success in China hasn't been a given, and at the turn of the decade Adidas found itself languishing in fourth place behind the likes of Nike and Li-Ning.

Determined to get back to the top of the league table, the company instituted its Route 2015 strategy based around 15 "modules" focused on key growth categories such as football, running, basketball and Adidas's Originals and Neo brands. Steering them through this period has been Colin Currie, Managing Director of Adidas Group Greater China, and the work has paid off.

"I'm happy to report that we will achieve all our objectives that we set out and we will be back neck on neck with our competitor in terms of being a leading sports brand in China," says Currie. It shows in the numbers, too—Adidas's net sales for the first nine months of 2015 in Greater China hit €1.85 billion ($1.97 billion), an increase of 18% on the same period in 2014.

With Route 2015 almost out the way, the company is now looking ahead, and Currie feels confident in their position. "We know we're one of the hottest brands in China, that our sell-through and revenues are growing and doing well, that our net promoter score is very strong with Chinese consumers, that we have a great foundation to be able to move into the next five years and be able to grow with the market."

In this interview, Currie tells us about their journey in the last five years and what the company has further down the track.

*Q. Going beyond the first-tier cities was a big part of Adidas's strategy, so in what way was the approach different in these lower-tier cities and what were the kinds of considerations you needed to have?*

A. The first thing that we did was we continuously tried to understand the consumer in the different cities and what that city was made out of in terms of demographics and economics. When I first came in, we worked with our consultant partners to be able to put a stake in the ground and at least get the fact base because prior to that, that knowledge was not really well socialized—we had the census at that point of time, which was quite aged. So we had to go out and do our own scientific approach to understand how cities were evolving and what was the percentage of that population within a city that we believed was considered a MAC (middle-class and affluent consumer) population—a MAC to us is middle-class income, consumers who earn over RMB 80,000 on an annual basis. We would consider that segment and we would then populate that, [the] various dynamics, and be able to then tier the cities, because as you know not all cities are tiered equally across the businesses. Having got that understanding, we then essentially laid out the priority in terms of when would we enter those cities, and we would divvy that up between the regions—the east, the west, the north and the south. Once we'd done that fact base, every year we update our 50 key cities within Greater China and we update the data, and then rank the various cities differently depending on what they're going through in the year, and we also update on an annual basis the lower-tier cities as well.

We want Adidas products to be available 24/7 and we want our e-commerce website and online store to be fully integrated and connected to our physical retail

*Q. These stores, how do they fit into the broader strategy and what are the plans for growing the number of stores? How does the bricks-and-mortar retail fit together with e-commerce?*

A. The first question we wanted to ask is actually who is buying online? Is it necessary to go into a lower-tier city if the person in the lower-tier city actually is going to go online and buy the product? Is it more convenient for them to do that? Our findings were actually that people who are going online more are in the higher-tier cities and actually in the lower-tier cities what consumers want to do is to go to the provincial capital from their homes and actually go and shop and visit the provincial capital and have that experience rather than go online and buy that product because it wasn't available [in their hometown].

So having understood the consumer behavior there we're able to then say, okay, what is our strategy to be able to ensure we can tap into the growing opportunity of consumers who want to purchase online, more in the higher-tier cities, and also their wish to buy from physical bricks-and-mortar, and our strategy is simple—we want Adidas products to be available 24/7 and we want our e-comm[erce] website and online store to be fully integrated and connected to our physical retail, so that if you actually want to buy online and go and visit a store the next day [to collect] you can, and vice-versa. We're piloting this. The complexity of actually getting this out is we also have our franchisees, so we have to be able to work with them to ensure that we can deliver this seamless brand experience to the consumer through a third party, because only 10-12% of our stores are actually controlled by ourselves. So it's quite a big project but that is really the opportunity that we see, especially in the next five years physical retail space will essentially for sporting goods be single-digit growth, but our e-comm business will be growing at a very high double-digit, obviously from a smaller base.

*Q. How successful has Adidas's Tmall store been and how have you found the experience of using Tmall as a platform?*

A. Tmall to us is like a shopping mall, a marketplace. They are investing in driving traffic and consumers to the shopping mall and we have a shop on this virtual shopping mall. We all know the achievements of Singles Day, and how they've actually made a culture out of this…, and we work very closely with them. We've found that the e-comm marketplace in the past has been more of a value channel for sporting goods rather than a full-price channel. People who [shopped] online in the last two years have gone there for, okay, maybe I can get it at a discounted price. We've found over at least the last 12 months that Tmall is upgrading this and actually people are tending to now buy much more in-season product and full-price product and wanting to have a brand experience on there, which is right in line with our strategy. So we will work closely with Tmall, but we also have our own official site as well where we will position our brand on this site to really be the house of Adidas where you can find all products that you may not find on Tmall or you may not find in the physical store. So that's our strategy there between really the marketplace, which is probably a much more commercial channel with Tmall, and then our own online store, which is much more a brand experience.

*Q. How does the process of urbanization affect the products that you offer and the way that you market them? Do you see an influence in terms of this urbanization affecting what's popular and how you're presenting it to consumers?*

A. The parallel I draw from urbanization and when we talk about the evolution of a city and consumer segments within the cities is to do with the sophistication of the consumer within the various cities and how quick their behaviors and their needs are changing. So when we talk about our range, a one-size-fits-all approach across a tier-one to tier-six city will not work. Price has a big part to play in affordability when we talk about consumers in different cities and also how they're going through the evolution of their life in terms of the sports that they play. So down in the lower-tier cities we know that a sport such as running is very popular, or sport related to Chinese culture, so more martial arts, etc. As you get into the higher-tier cities, despite there being a big running boom anyway across multiple cities, playing soccer or playing basketball [are popular]—there's a wider choice of sports. So we understand that different sports are played in different cities based on, I would say, the evolution and the sophistication of the consumer, which is linked to urbanization as urbanization is one of the key drivers [of that sophistication].

When we look at our assortment therefore, in a lower-tier city generally speaking a consumer may only be able to afford a set of footwear on a periodic basis, or apparel, and they would use that for different occasions, be it playing sport, doing recreational sport or even going to work or going to a wedding. Whereas in Shanghai now that there is so much choice as well with different brands, so we're finding consumers are buying different sets of apparel and footwear for different occasions and they're much more buying our product for sport only or for recreational sport. Which would therefore mean when you go to market, in a store what you would offer would be quite a wide range of categories for a higher-tier city, whereas in a lower-tier city we would be much more focused maybe on running and training and not offering a high-price point football product or basketball product. We would still have an offer of those categories, but they wouldn't be the extensive range you'd find in the higher-tier cities.

> When we talk about our range, a one-size-fits-all approach across a tier-one to tier-six city will not work

So this is essentially how we carve it out, and you would ask, how do you know? Essentially, we look at the sales stream data, and we are connected to [around] 6,000 stores on a daily basis—we get the sell-through data and we can actually look at a store and say, okay, this product is selling faster than this product, the reasons why so we can tailor product better for future seasons to be able to be much more focused.

*Q. Adidas has pinpointed six influential global cities and Shanghai is one of them, so how does Shanghai feed into Adidas's work?*

A. The six cities strategy is about picking six key influential cities around the world that will drive the trends and create the halo of the brand into their geographical areas. And here in China we believe that Shanghai is the leader in culture. It's a financial hub, it has great universities, it has a great pool of youth, and therefore out of all the cities that we have here—and we talked about the top 50 cities, we also tailor that down and focus on top 23 cities as well which are essentially tier one, tier two—Shanghai is the metropolis we believe that consumers aspire to, will visit and therefore whatever we can do in Shanghai will be the window to the rest of China. So we will execute the best store formats or concepts firstly in Shanghai and then we will roll it out. If we have an activation nationwide, we will have the finals of it, or the closing of it in Shanghai. We really want Shanghai to be that window into China for the rest of the country, and also to be our model city so that we can actually plan our distribution here, plan how our brand is seen and own this city and then scale into the next set of cities, which will be for us in Greater China: Beijing, Guangzhou, Hong Kong, and then tier it down into the Chengdus, the Wuhans, etc. And strategy in the end for us in China would be how do we own these top 23 cities through distribution, through brand activation and through really connecting to consumers.

*Q. How has Adidas made use of sponsorship?*

A. Sponsorship is a key part of our marketing strategy. Partnering with teams or key assets is an important strategy for us, so we have a host of assets and teams that we sponsor, most notably the CVA, the China volleyball women's team that just won gold in the volleyball championship this year. We partner with Liu Hong, who won gold in walking at the IAAF (International Association of Athletics Federations) [World Championships], we sponsor some up-and-coming tennis stars, amongst others. It's important that we're associating our brand with who we believe are the athletes who we can support to perform better on the court.

The other part of our strategy is investing in grassroots. The government is investing heavily in sport—RMB 1 trillion ($157 billion) by 2025—and really driving that kids are given an opportunity to do sport as part of their curriculum, and we believe that this is a really important aspect and channel of our sponsorship strategy or marketing strategy. We just launched a couple months ago a partnership with the Ministry of Education—we will reach 20,000 schools and give kids the opportunity to play football.

Part of that deal was launching an app that has virtual football coaching that kids can go into free and learn about the basics of playing football in order to advance skills. This is for us to connect with kids for the future, but also about us giving back to the community—we've had a long history here in China, we've been able to grow here, and being a responsible, good corporate citizen is an important aspect to also be able to give back to the Chinese community.

*Q. Away from the more performance-related products and into the recreational sportswear, casual sportswear like Adidas Originals, what is their place in the overall plan? How does it need to be approached differently?*

A. First and foremost, sport is the core to our business—it is over 75% of our business, it will always remain the core of our business, especially as we now see that more and more consumers are starting to participate in sport. So sport is and will always be the core of our business and the core of our strategy moving forward.

Now on the recreational sport, lifestyle area this has been in the last five years probably something that the Chinese consumer has been more interested in because sport wasn't top of their mind five years ago, or participating in sports—following sports is different, all Chinese consumers will follow the finals of the 100 meters—but actually [a far lower percentage were] participating in sports. Therefore, the opportunity to offer our products, footwear and apparel to people who were doing recreational sport like jogging or walking, etc. has been there and we have two brands Originals and Neo (a mid-market sports casual brand) and together with our sports performance core brand this is a competitive advantage versus any other brand offering. And we say, actually Adidas has the breadth of footwear and apparel that can meet an athlete's needs or a kid's needs on court, but we also provide products, footwear and apparel for their off court needs. So we actually want to own that whole 24-hour life of a person who wants to do sport.

> We're evolving our strategy to be much more focused on the segments that we believe will grow in China

*Q. How do the other parts of the Adidas Group, such as Reebok, sit in relation to the core Adidas offering?*

A. We have been running [Reebok] in line with the global positioning of a fitness brand. The business is smaller than the Adidas business, but we focus it on more of the niche segment, which is focused on real tough fitness, and also women who want to go to the gym. And if you look at what the Reebok brand is doing globally it's involved in a lot of team activities like Spartan Race or CrossFit or some aspects of Boot Camp. Now those activities are not yet here on a mass scale, but they will come here one day and there will also be a movement like with running here. We believe in this sort of sport and when it is here we will be able to employ our Reebok business on a much far wider scale to tap into that. We want to keep the Reebok brand focused on tough fitness, but there's another side of the brand that is doing well here, which is our Classics, because obviously Reebok has a heritage as well and at the moment that side of the business is doing really well.

*Q. We talked about the Route 2015 and you say you've matched your goals there. So what's next for Adidas in China?*

A. At the end of 2013 we did another big study, which went on for a good part of six months, and then developed our 2020 strategy, which was completed at the end of 2014. We're now in the middle of that transition to our 2020 strategy, which I think we will talk about in the months to come, but essentially it's an evolution of our 2015 plan—it's not a revolution. We're evolving our strategy to be much more focused on the segments that we believe will grow in China and one of them is kids. So in the last five years kids hasn't been a big focus for us, but in the next five years kids will be a big growth driver for us. As I explained, the schools start to do sport, the investment, so this will be a big growth driver. So we've got our 2020 plan and we have our vision and our vision simply is also to win the hearts and minds of our consumer and be the best sports brand in Greater China, so we want to really concentrate on that emotional connection with our consumers in the next five years, which requires different sorts of competencies again in terms of ensuring that the consumer has a great brand experience every time they engage with us and they're actually an advocate for us and not a detractor. So that will be our focus and we continue to strive to obviously stay at the top of the market.

# A New Lens

## Rachel Botsman, co-author of *What's Mine is Yours*, tell us where the collaborative economy is heading and why it requires a fundamental shift in understanding

By Chris Russell

In the last year or so, the sharing economy has gone from being a niche idea most familiar to Silicon Valley insiders to one that has reshaped our lives—these days, you'd be hard pressed to find a city dweller who hasn't at least taken an Uber or stayed in an Airbnb. But for all that expansion, the ideas underpinning it are not so well understood, a fact routinely demonstrated in the often fraught debates concerning what the sharing economy means for workers' rights, traditional incumbents and the role of regulation.

Help is on hand, however. Since 2010, Rachel Botsman, co-author of *What's Mine is Yours: How Collaborative Consumption is Changing the Way We Live* and recent winner of the 2015 Thinkers50 Breakthrough Idea Award, has been dedicated to exploring the intricacies of the sharing economy, or collaborative economy as it is also often called, and what it means for our lives and businesses. From her TED talks that have been viewed over 2 million times, to the MBA course she designed and taught at Oxford University's Saïd Business School—the first ever on the collaborative economy—Botsman has been at the forefront of explaining the details and significance of this still nascent phenomenon.

In this interview, she shares her thoughts on where it's heading next and how it retains its capacity for empowerment. Excerpts:

*Q. There are a lot of different terms that exist in this space like the sharing economy, the collaborative economy, the gig economy, and so on, so to begin with can you* *delineate the differences between some of the terminology?*

A. It's really confusing because any idea that somehow uses the internet to match supply and demand is being thrown under the umbrella of these terms, and they do have distinct differences. So let's just look at the main ones that are used.

On-demand is the easiest to distinguish and why it's different. When I click an app on my phone through Washio, DeskBeer or Amazon Prime and something is delivered to my home or my office in under an hour, that is nothing to do with the collaborative or sharing economy, that is just technology creating a more efficient way to deliver goods and services. The reason why it gets confusing is because there is an on-demand component in many of these services, particularly Uber.

The sharing and the collaborative economy are closely related in that if you look at the structural shift that sits under these things, you move from a top-down, centralized institution to a network or a marketplace where people exchange goods and services directly with one another in ways that bypass traditional institutions. And in both of these systems one of the key ingredients is that they make different use of assets, so they unlock the wealth of assets in different ways.

For me though, the sharing economy has to really be about sharing, whether it's the asset itself that is being shared or whether the behavior is sharing. So when an Airbnb host is home and they're sharing their local knowledge, they're sharing dinner, that I would call the sharing economy. When a property magnate owns various different assets and is just renting them out, that is not sharing. So that's the thing that's confusing—even one company you can throw under different labels.

The gig economy, which I think is a horrible term, and clearly invented by people who've never spoken to the people making money off these platforms, I think more applies to something like Amazon Mechanical Turk, even things like Instacart and Postmates, where you are basically breaking down a job into gigs that is very insecure and you have to work multiple gigs to earn an income. But I've spoken to a lot of the

> It's recognizing that the brand is made up of millions of individual reputations and interactions

providers on these platforms, and that is not the way that they would describe their life or their work through these marketplaces.

*Q. To what extent can the collaborative economy be applied to services?*

A. Often people think of physical assets when we talk about assets and they forget about human potential, skills, energy and time, so I think it's really interesting when you look at all the professional service marketplaces starting to appear where they're taking the principle that really qualified people are largely underutilized in a big firm capacity and if they could work directly with clients through marketplaces, whether it's Skillbridge, UpCounsel or HourlyNerd, you could create benefits both for those with these skills and also for the client directly buying these services. So that to me is really interesting because it kind of disrupts the whole notion of you never got fired for hiring McKinsey—maybe the future isn't about hiring McKinsey.

*Q. You've also talked about how the collaborative economy can be applied to production and distribution. How is that playing out?*

A. It's early stages. I think after consumer goods the next big area is capital or financial markets, so that's everything from things like eToro, where you're using the collaborative knowledge of networks to really transform trading, all the way through to peer-to-peer lending platforms such as loans from Lending Club. And then it's starting to emerge in logistics and then all the way through to energy where people are saying maybe we can buy and sell energy off each other. Fon is a really good example of people sharing excess capacity in Wi-Fi plans. Financial services is more mature, but other areas, where these same principles apply to very different assets, are starting to emerge. And that also goes for the way these goods are actually made and got from the manufacturer to the end consumer, so that could be everything from do you actually need an in-house delivery service, or can you use a crowd-shipped model, all the way through to local manufacturing networks where you don't have one big industrial plant, but instead these things are made by groups of individuals. So Local Motors is a really good example of that in the manufacturing of cars.

*Q. Have you noticed any kind of differences in the way that the collaborative economy manifests itself in emerging markets?*

A. I think what is interesting about China is in the last year it's had the largest injection of [venture capital] funding in these ideas in the world. To answer your question, there are more similarities than differences, so in terms of the business model and the key principles that are being applied, it's almost exactly the same. The interesting thing is the cultural adoption and there you do see differences. So the first thing I would say is in many emerging markets ownership is still an aspirational goal—I want to own my car, I want to own the luxury hand bag. It's almost like emerging markets have to go through the same period of consumerism that we saw in the developed world to realize that you can get the same benefits through shared systems.

I think the second thing is, and I've studied this more in India than in China, is that peer trust has different cultural connotations. So for example I was interviewing passengers in India and it really struck me that they said they find it hilarious that in Europe Uber drivers would offer you sweets because you would never do that in India because one of the first things that you think is that this is a drug. So there is more authority and respect placed in institutional forms of trust and this idea of peer trust is more in its nascent stages.

*Q. When it comes to regulation, how can government officials and policy makers at different levels be best brought up to speed on the collaborative economy so it can thrive but any kind of necessary safeguards can still remain in place?*

A. It's a really good question because I think the focus at the moment is around what are the laws and policies we need to change, versus how do we change the lens, the way regulators see the world, and that's a really different way of approaching it. There are a number of regulators I talk to and you're like, "Are you really immersed in using these systems, or are you observing them from a distance? Are you really asking yourself the question as to how well can these peer systems self-regulate themselves so that you understand the gaps and the holes as to where government regulation is really needed?" So the regulators that really get it, they say this isn't just about changing the law, this is about a fundamental questioning of the role of regulation in society and that maybe these top-down, government-heavy regulations that we put in place for very good reason need to be completely rethought.

So the best way is actually to try and immerse them in this world and, say for those who are for example very focused on taxis, often they will get the big insights if they start interacting in financial peer-to-peer platforms or Airbnb or food or whatever it is that isn't directly related to the piece that they're being asked to regulate. The real shift that's needed is not just about the regulations and the laws themselves, it's a complete mindset shift that perhaps the world has changed and the roles of government regulation can look really different.

*Q. You've said you feel there's this shift in trust from top-down, centralized institutions towards trust between individuals. So how can those kinds of institutions manage that transition? How can they maintain a relevance in people's lives?*

> I think Uber and Airbnb, they're starting to become the new monopolies of the 21st century

A. Again, it's a lens shift in the way they think about brands and the way they think about relationships with customers. So, if you talk to many corporations they will think of the brand as the company itself—that it sits in the walls of the institution and it's something linear and they can control—and they will even talk about their people as human resources, as assets, as brand assets. But it's a different way of thinking about it where your brand doesn't come from the corporation, your brand is made up of all the individuals that make up that organization. So for example, if you take a bank, of course the brand Bank of America or Citibank is important, but in the future the brand of all your individual traders and bank managers is going to become more important to customers than Bank of America itself. So it's recognizing that the brand is made up of millions of individual reputations and interactions.

The second thing I think is back to this notion of trust, it's not that these traditional companies will all move to these peer-to-peer collaborative models, but the impact's going to be on the expectation of service and personalization and transparency and humanness that we will expect from these more traditional service providers, because if you get such a detailed window into the product, the service or the person that you're interacting with before you even make any kind of transaction, you're going to expect that from more traditional brands.

*Q. For those companies that are looking at their business model and questioning whether they need to move towards a more peer-to-peer basis, how can they begin to make that assessment?*

A. I often say that there's three questions that they can start to ask. So first of all is how does their company create value? And can they think differently about that? So the way they think of creating value from their assets, can they flip that on their head? Are there idle assets or breaks in their supply chain that they can apply these principles to think differently?

The second thing is how is value scaled? So the way many companies think about scaling their products and services is they get more and more asset heavy—we need more companies, we need more employees, we need more distribution channels—so applying this asset-light model, are there different ways that we can actually get our products and services to market and scale it in a different fashion.

And then the third question is how is value trusted? Will the way people make decisions around whether they should use that product or service and whether they should trust our brand and our company look the same in the future? For me, asking those questions is more powerful than looking at business model opportunities. So you'll hear a lot of people say, "Oh, perhaps you could turn your product into a service." Now, if companies do that that's great, they're going to come up with an innovative offering, but they're not really shifting their mindset to start to operate in this age.

*Q. To what extent do you think the collaborative economy could end up creating a new kind of centralized institution? Is there a risk that it's simply replacing one with another?*

A. I think [those concerns are] absolutely valid, and it's an even bigger problem when you're dealing with marketplaces because you have network effects at play. So I think Uber and Airbnb, they're starting to become the new monopolies of the 21st century and it's a big, big concern. I think two things are really important: one is, and this is where regulation plays a really important role around market competition, that we make sure Lyft, Sidecar and other entrants are there alongside Uber in every single market so that they don't have a dominant hold.

I think the second thing that is further along is that we're going to see a move to more and more decentralized structures. So, imagine the block chain applied to Uber where the taxi drivers, they don't need any kind of centralized platform, they can just operate on a block chain exchanging value, and that's where I think we're heading to. With Uber, it would actually be how could Uber become redundant because people who want to drive and people who need lifts could create a whole network without anyone in the middle.

*Q. In your TED talks you spoke about how you feel the collaborative economy can be empowering. To what extent do you think the collaborative economy has delivered on that promise? Critics have tended to characterize things as workers becoming atomized and operating outside of the usual protections and regulations—what would your response be?*

A. I get this question, I get the criticism, rather, on a daily basis and I think what's interesting is that when these ideas felt small or niche, everyone said they were lovely and they were empowering and they totally believe everything I had to say, and then as they scaled and they've taken over or really disrupted different segments people just assume that they are all about profit and commercialization and there is nothing different going on. At the end of the day, yes, some entrepreneurs are making a lot of money off these systems but that doesn't change the fact that it's still empowers providers and customers in different ways. So even Uber, which is the most commercially aggressive, if you talk to most people they would say when they get in a car with an Uber driver

## We're going to see a move to more and more decentralized structures

they behave differently, they have different interactions, they ask them how they are because they know who they are, they know their face, they know a little bit about them and what's interesting is how that information changes the interaction.

I also think when you remove Uber from the equation and you look at the plethora of companies operating in this space, the number one benefit is empowerment, whether that is hosts on Airbnb empowered to make money from their spaces all the way through to people say on TransferWise who are suddenly empowered to get much better rates on international conversion, completely bypassing the banks, and more than that understanding how the banks were screwing them in the first place. There is a profound shift in this interaction between the person buying those services and the person providing those services and in most instances they would describe that as empowering.

The thing I do agree with the critics about is that we have to prevent this becoming all about a new dynamic where the haves are on one side and the have-nots are on the other side and it just becomes a cheap labor pool. So I think it's really interesting that there isn't more focus on regulations and laws that really protect the providers. It's not that providers want to be employees, that's the wrong conversation, it's that they want new forms of protection that are really apt for this relationship they have with these companies.

*Q. In your conversations with providers do you still see a satisfaction with the opportunities that these different platforms are providing them?*

A. One-hundred percent. Most people will say this was income or this was experiences or this was a form of flexibility and control that was previously unavailable to them. The reason why I hate this gig conversation is because many of the different people I've spoken to, whether it's someone on TaskRabbit or it's someone on Etsy or whatever it is, traditional jobs are not available to them—either they can't get these jobs or they're just not flexible to work with their lives.

So that's why I think it's really interesting that on many of these platforms stay-at-home parents are a massive category of supply. One of the big mistakes is when we look at these things and we talk about them in blanket terms without realizing that these individuals form into really unique groups and have different needs and motivations for doing this type of work.

*Q. In the conversation about the collaborative economy there are names that keep recurring like Uber, Airbnb and TaskRabbit, but what are the most exciting start-ups you've encountered recently?*

A. I think The Food Assembly which is coming out of France and just expanded across Europe is really interesting in terms of what they're doing to connect food providers, farmers directly with customers—I think they're going to be really big. Some of the platforms that are part of the enabling ecosystem I think are really interesting. So, the payment platforms like Stripe and the identity platforms, so companies like Onfido, where they are verifying that you are who you say you are. FiscalNote I think is a fascinating company enabling companies like Uber and Airbnb to look completely differently at the legal picture. Learning I think is another really big space—we've seen the MOOCs (massive open online courses), but the likes of Skillshare and Duolingo, they're just starting to emerge.

*For the full interview, log on to CKGSB Knowledge: knowledge.ckgsb.edu.cn*

# In the Circle

## Brian Robertson, Co-Founder of HolacracyOne, gives an overview of his revolutionary new self-management system

By Chris Russell

About 15 years ago, Brian Robertson was feeling fed up and frustrated. More specifically, he was feeling fed up with the management hierarchy traditionally used by companies and the way, to his mind, it had a tendency to stifle innovation, create inefficiencies and prevent individuals from fulfilling their potential. But rather than bottling it up inside, Robertson has channeled that dissatisfaction into the development of one of the best known self-management systems, Holacracy.

That mission to change the way we work led him to co-found HolacracyOne, an organization dedicated to the development and dissemination of Holacracy, and he's also literally written the book on the subject in the form of *Holacracy: The New Management System for a Rapidly Changing World*, which was published in June 2015.

In the process, Robertson and his system have earned the admiration of Tony Hsieh, CEO of e-commerce site Zappos, and Evan Williams, Founder of the publishing website Medium—both companies have or are in the process of implementing Holacracy. There's been recognition from Thinkers50 too, with Robertson shortlisted for the 2015 Breakthrough Idea Award. But along with the praise, Holacracy has also met with a more skeptical audience, and particularly when it comes to its adoption by Zappos, with no small amount of articles decrying Holacracy for "bringing confusion" to the company.

In this interview, Robertson clears up some of the misconceptions and gives an overview of the at times daunting world of Holacracy. Excerpts:

*Q. For those who aren't familiar with Holacracy, what are the basic elements of it?*

A. I use the metaphor of [Holacracy being] a new operating system for an organization, in this case a social operating system, and it's an alternative to the one we're used to. We're used to the management hierarchy as the fundamental operating system for how we structure and organize business and we look to the management hierarchy to give us some really necessary functions. It gives us alignment, it gives us a way to break down the work and distribute it out, it gives us a way to make sure we have accountability, it gives us a lot of other things, and we need all of those. Holacracy doesn't throw those out, but what it does is give you a different system to get them. Holacracy replaces the function of managers doing that with a series of processes that get embedded in every team and that have the same effects. And the processes that Holacracy uses are a little different in some key ways.

One, everyone on a team gets to be involved in the process. So instead of a single manager figuring out who's responsible for what and who's going to do what, there's a group process for every team that figures the same things out. So at the end of the day you still get clarity on who's going to do what, who will make which decisions, what are the responsibilities of the different parties involved, but we get there through a group process of trying to learn together what serves the purpose of the company, the purpose of the work, how do we need to break down and structure the work and organize ourselves in order to achieve the best results, and it's an on-going process. [With management hierarchy] you might have a big reorganization once every few years, but other than that the structures are static—with Holacracy, it's very dynamic.

**Holacracy Dictionary**

**Role** – a job for a specific function within a Circle/company. Has autonomy within the bounds of that Role.

**Circle** – autonomous teams fulfilling different aspects of the company's work

**Tension** – a concern about the present situation and how the staff member thinks it should be

**Tactical meeting** – a recurring meeting for updates, dealing with Tensions and handling future projects

**Governance meeting** – a recurring meeting where changes to Circles, Roles and the company's organization are made

Another one is, because there's no managers in the conventional sense, when you fill a role within a company using Holacracy, you get a lot of autonomy. Typically, ideally, a management hierarchy also gives you autonomy, right? The idea is a manager defines the boundaries and says, "Hey, you know, this is your work and within these boundaries you go use your judgment and make decisions." But in practice, most managers are not very good at that—most managers end up saying, "Go do something that makes sense to me and as long as it makes sense to me I won't jump in and micromanage you, but as soon as it doesn't I'm basically going to jump in and make sure you're doing what I think is best."

With Holacracy, you have some protection from that when you fill a role that's defined by the group process—with Holacracy, you get a lot of autonomy on how you execute the role. If you're in charge of the website for example, it's up to you what you do with that—you know the bounds, you know your responsibilities and you know when you need to get somebody else involved, which means short of that you can do anything that makes sense to you to get the job done. So you end up with a company where people have, even at the front lines, real leadership autonomy and no boss to micromanage or trump that autonomy. But you do have a team process that can update it to find constraints or bounds on it and responsibilities that go with your authority, so that is all kind of at play in the system.

So put all that together and what you end up with is a very different way of structuring a company, and one that gives you more structure, not less than a management hierarchy, but at the same time gives you a more flexible, dynamic structure that's constantly changing and evolving and leaves more room for autonomy at the same time.

*Q. To what extent is Holacracy better suited to new or young companies as opposed to those large ones that have a legacy of traditional management structures?*

A. I think the larger firms actually have more to gain potentially, but a much, much harder transition. If you're trying to adopt this in a 30-person company or a 100-person company you can gather everyone in the same room, give them the same coaching, training, experience, whatever, and knowledge of the new methods will spread in the culture much quicker as you have fewer layers of management to shift and work through—it's just easier to make the change. It's still hard, but it's easier. For a company like Zappos' size, they've almost 2,000 employees now, so for them to make the change is a daunting endeavor, it's much bigger, but at the same time, they've probably got more to gain from it—they're probably suffering more from the downsides of a management hierarchy, which is as a company grows it tends to get less innovative, more bureaucratic, things slow down, you get more waste in the layers of management. So in some ways there's more to gain than a start-up that's already entrepreneurial. I think Holacracy still enhances that [for start-ups], but the challenge is maintaining that as you grow.

*Q. Are any industries or sectors where companies are perhaps better suited to Holacracy or even any where you'd say it's perhaps not right for them?*

A. I usually turn that around by saying what industry would the management hierarchy be right for? Are there any industries that the management hierarchy might not be the right fit for? When you look at it that way, the management hierarchy is just a basic underlying system—you can run any company in any industry using a management hierarchy, and the same is true for Holacracy. It's just a basic underlying way of breaking down work, making sure you clarify who's going to do what and who's accountable for what. So it's just as generically and broadly applicable as the management hierarchy that is replaces.

So I think a slight shift on the question is more what kinds of companies is it more worth the investment to change their approach? If a company is really not facing much external pressure at all, if they're in a very static, slow-moving market and everything they're doing is working really, really well, they don't face the kind of competitive pressures to be really innovative and dynamic and agile, they have a workforce that isn't demanding new things from them, that doesn't describe many companies today, but it might describe a few, especially in protected industries of sorts that really don't have to worry as much about the changing world around them—those companies might not find it worth the investment.

Likewise, sometimes there's an assumption that it's companies that are struggling with something they've adopted from Holacracy, [but] it's actually the opposite—it's the companies that are actually doing really well with management hierarchy, they've almost reached the limits of it. Like Zappos was an incredibly healthy company in every way—their culture was healthy, their performance was incredible, they had really, really good managers in that company compared to most I've experienced—so you look at a company like that, it's those companies that are actually saying, what's next? They got that way for a reason, they're thriving in their competitive environment, [but] because they're outperforming others and they're not going to just rest on that, they're going to say how can we do even better and [ask] what other platforms or processes might be even better than what we're doing. So I think it's any company that has an advantage to do that kind of innovation and that is in a world where they can actually find some benefit by being a little more dynamic, by being a little more agile, a little more purpose driven or whatever the case may be.

[Holacracy] gives you more structure, not less, than a management hierarchy

*Q. Can Holacracy serve as a bit of a distraction and perhaps affect productivity as employees are constantly having to figure out their roles?*

A. Well it definitely does when it's new—it's absolutely a hit. You can expect a dip in performance when you adopt it over the short term. Over the long term, it's a very different story. In fact, there was a study on this I read about recently that wasn't looking at Holacracy specifically but it was looking at self-leadership, self-organizing, self-managing systems, and what they found was exactly that. They found in the short term, those systems when they're first adopted underperform a good directing boss. But over the long term they significantly outperform that directive leader, even a good one. And that matches exactly the experience I've seen with Holacracy. It is an investment and there is a productivity hit in the beginning.

Now at the same time, with practice they'll get good at the new one and if the new one better serves the needs of the business, that's going to translate. So in the long term, companies running with Holacracy spend so much less time in wasteful trying to figure out who does what, trying to make group decisions—all that stuff goes way down—and you end up with just lean, efficient, focused operations, but it takes building a lot of new habits and disciplines to get there.

*Q. What is it about Holacracy that makes it better at ensuring roles are filled based on competency as opposed to other factors?*

A. So one, Holacracy just brings more transparency, much more clarity of here's what the role actually is and here's what it needs, here's the responsibilities of the role, the authorities of the role, the purpose it's serving and you have a process then of people, not that dissimilar from the management hierarchy, pitching themselves for roles. So if I want a new role I have to convince someone else who has the authority of assigning that role I'm the best fit among all available talents. What develops is like a role marketplace almost where everyone can go and see here's all the roles that need talent and somebody that's trying to get a role filled can go in and see here's all the talent looking for roles and then from there there's a process of trying to find the best fit.

In companies that we're working with we'll see cases where, maybe at Zappos [for example], somebody that is mostly answering the phone, that's their main work, but now they're free to go pitch themselves for other interesting roles, small roles in other parts of the company and try to convince them look give me a shot at this I can add a lot of value. And it's much easier for them to see all these roles and it's not a huge change in their job, it might just be something they 10% of their time, 20% of their time. So there's more fluidity in that and I think that allows more experimentation and if you want to find the optimal fit of people to roles, which I think any company does of any structure, one of the best things you can do is iterate faster and let experiments happen. Try it out for awhile and then change it if it's not a good thing. Holacracy just enables more rapid experimentation to find that fit as well as a whole marketplace, the transparency, to find the match.

*For the full interview, log on to CKGSB Knowledge: knowledge.ckgsb.edu.cm*

# Finding a Balance

## Henry Mintzberg, the Cleghorn Professor of Management Studies at McGill University, on global imbalances

By Neelima Mahajan

Henry Mintzberg was once called the enfant terrible of management thinking. It's not hard to see why. The author of books like *The Nature of Managerial Work*, *The Rise and Fall of Strategic Planning* and *Strategy Safari*, Mintzberg has always put forth radical ideas that sometimes rub people and organizations the wrong way. He wrote his 2004 book *Managers Not MBAs*, a scathing critique of business schools and MBA programs, while working at a business school.

More recently, Mintzberg, the Cleghorn Professor of Management Studies at McGill University, has trained his guns on an unlikely topic: society and politics. His latest book, *Rebalancing Society*, talks about how dangerous the lack of balance between the public, private and the plural sector (civil society) really is.

In this interview, Mintzberg, the recipient of the Thinkers50 Lifetime Achievement Award for 2015, talks about his new book.

*Q. What events have led to this lack of balance? And where and how did we go wrong?*

A. I think the United States always favored private sector forces over other forces. The US from the beginning controlled government—they talked about checks and balances on the government in the constitution, they never talked about checks and balances on corporations. So the US always tended in that direction and it built up over time, but I think the real turning point happened in 1989. In a sense, you could say that communism constrained capitalism because there was another model available that despite the American criticism of it, offered people inexpensive housing, guaranteed government welfare programs, health insurance and so on. So that kind of constrained American capitalism. When that collapsed in Eastern Europe, that just took the gloves off, took the constraints off American business. So there were just no constraints left on corporate power.

*Q. The fall of the Berlin Wall in 1989 was a defining moment in history. You say that the Berlin Wall "fell on us". How did the fall of the Berlin Wall change the world either for the better or worse?*

A. It was for the better for the people in Eastern Europe, particularly in East Berlin. Obviously the fall of communism that was dominant there was terribly constraining for people and they wanted out of it. It seemed to be positive for the West, in the sense that the American perspective was 'we won'. But sometimes winning is the curse—you win and then you discover that there's an arrogance and a blindness about winning that doesn't enable you to see what's going on. That's why I say eventually the Berlin Wall fell on us in the sense that it took the constraints off capitalism.

*Q. Are communism and capitalism necessarily bad or does the fault lie in different countries' implementation and how they go about really interpreting the concepts?*

A. I don't think bad is the right word, but

I think that by themselves unconstrained by the other sectors they're dysfunctional. I can't imagine any situation where either one dominates that is healthy. If you look back at the US before 1989, after World War II, the public sector was very strong. People forget about the welfare programs that Lyndon Johnson introduced, they forget about the tax rates that were much, much higher in that period, especially on rich people, they forget about the much greater equity and the distribution of wealth in that period.

*Q. If you look at the American system today, what are the two or three big problems you can identify?*

A. There are many problems in the US—most of them revolve around the excess power of the private sector. I can talk about the income inequalities for example. They're very unhealthy. I could talk about the corporate malfeasance, the amount of corporate corruption that's taking place. I think the most significant thing is the legal corruption—political donations in the US are now a form of bribery, but it's legal. Legal corruption in the US around Congress, around bribing, around lobbying is out of control and doing a huge amount of harm to the country.

*Q. You place a huge emphasis on something you call the plural sector. What is the plural sector really and why is it so important?*

A. Well, it's important because when you only recognize two sectors, public and private, then you constantly go back and forth between them and have what I call pendulum politics, which is first left then right, then right then left, then left back and forth, or you have paralyzed politics where governments get paralyzed between the left and the right. It's not healthy. If you have three sectors, then you have more of a triangulation of power and you can see better opportunities to balance. I use the metaphor of a stool that needs three legs. The American stool sits on one leg now: the private sector. The Chinese stool sits on two legs: the private and the public sectors. But Brazil, Germany and Scandinavian countries are on three legs—they sit on a plural sector as well as a public and a private sector, and they're all strong. Nobody is going to describe the private sector in Germany as weak, but nobody's going to describe the German government as weak and civil society, what I call the plural sector, is strong.

## If you have three sectors, then you have more of a triangulation of power and you can see better opportunities to balance

So if you say what is the plural sector, I can give you three different answers: one is everything that's neither private nor public, and that means non-governmental organizations, churches, in the United States and Canada it means hospitals and universities, it means organizations like Red Cross and Greenpeace, it means social movements like we saw in Egypt or social initiatives where people try and change things. But it's also what almost everybody I know does aside from working for a business or voting for a government—we all belong to clubs, we all have associations, we all have gyms we go to, and so on. You might've been to the hospital—that's probably what I call a non-owned organization—nobody owns the hospital. You might've made a donation to Greenpeace—nobody owns Greenpeace. Or you might work for a co-op, which I include in the plural sector because it's owned by members, not investors.

*Q. Given our current social and political structures—governments and how they function—how can the plural sector rise to a position of enough prominence to be able to play an important role in the rebalancing? Unlike the government or the private sector, most associations and co-operatives have much less power and the movements tend to be very 'amorphous', like we saw in the Occupy movement.*

A. That's the question I ask myself every single day: how do you enhance the power of the plural sector. One of the examples I use was why does [Mahatma] Gandhi's Salt March suddenly appear in 1930?

Because I guess people are just getting so fed up with the British and suddenly they just got their act together, just like the Americans got their act together in 1776. So people do rise up. They rose up in Egypt but unfortunately the military just came back and destroyed it. But it'll come back again.

*Q. So how do we go about fixing a country like perhaps the US, which has gone to one extreme?*

You start with consciousness. People have said the final stage of slavery is when you no longer realize you're a slave, and people have to become more aware of that and that's why I wrote the book. So that's number one. Number two is getting active about things that people no longer want to tolerate. In Holland for example, some people in the plural sector took the government to court [for] inaction in global warming, and they won. It basically forced their government to become active in global warming. So there are all kinds of ways in which people can be clever about it. They weren't particularly clever in the occupation of Wall Street. In fact, I always thought the occupation of Wall Street made it clear who they were opposed to in general, but they didn't go after anybody in particular. If they had challenged certain banks for certain behaviors and humiliated them it would have been much more effective.

# Bling it On!

## Luxury pastimes are making their way to China, and they're taking on Chinese characteristics as they do so

By Erica Martin


Image by Beibei Nie

On a sunny, clear day in October, a few dozen smartly dressed people mill around the lawn of a huge villa at the north end of Shanghai's Bund, peering at a ring of vintage cars parked on the grass, mainly American imports like Ford and Cadillac.

Inside the Waitanyuan villa—the former British Consulate-General building erected in the Renaissance Revival style in 1871—lies a hodgepodge of luxury branding and promotion which, in addition to the *concours d'elegance* outside, makes up the third installment of Bund Classic, an annual luxury lifestyle event. There are Vacheron Constantin watches in glass cases, a booth for Silver Cross vintage-inspired baby carriages and a workshop conducted in Mandarin on "Heritage Investment and Family Offices".

The main exhibit on the villa's ornate second floor is a preview for the autumn season at the Hong Kong branch of renowned British auction house Bonhams. A print from Damien Hirst's infamous "Kaleidoscope" butterfly series ($7,100-8,400), a signed Mario Testino photograph of Kate Moss ($6,500-7,700) and calligraphy on satin by Wang Duo dated 1641 ($130,000-190,000) are on offer.

In the "rare and precious jewels" section of the auction room, a middle-aged couple wearing matching Panama hats inquires about a large jadeite Buddha pendant inlaid with diamonds, speaking in perfectly American-accented English with the Bonhams attendant, then turning toward one another to discuss further in Mandarin. Bidding for the piece opens at $46,000; it's decided that the couple will fly to Hong Kong to see Bonhams' full jadeite selection before making a bid.

## Fresh Off the Boat

Bund Classic is organized by China Rendez-Vous, a company founded by French expatriate Delphine Lignieres to promote the adoption of Western luxury pastimes—car shows, auctions, yachting, polo, finishing school—by Chinese High Net Worth Individuals (HNWI), a demographic that grows each year at an unprecedented rate.

Polo is one of many luxury pastimes being exported to China

According to Capgemini's Asia-Pacific Wealth Report 2015, China had 890,000 HNWI as of 2014 with a combined wealth of $4.5 trillion, a 17.5% rise from 2013. China is also currently ranked second in the world in dollar millionaires, trailing only behind the US. In October 2015, *The Hurun Report*, a magazine known for its annual "China Rich List", released a survey revealing that the number of dollar billionaires in mainland China surpassed that of the US for the first time, with 596 to the US's 537. With these numbers in mind, it's no surprise that "the China market is the most important market for most luxury brands," says Liz Flora, Editor at Chinese luxury business publication *Jing Daily*.

One of the first pastimes to make headway in China was polo, with the launch of Beijing Sunny Time Polo Club in 2004 and Nine Dragons Hill Polo Club in Shanghai in 2005. At Nine Dragons Hill, Chinese polo aficionados can purchase a "Whole Life Polo and Riding Membership" for three people—ideal for a wealthy family with one child—for RMB 500,000 ($78,000), while a "Zero to Hero" 10-week course is RMB 10,000 ($1,600) for members.

In terms of luxury finishing schools, the first successful venture on the Mainland was Institute Sarita, founded in March 2013 by Hong Kong-native Sara Jane Ho, a Harvard Business School grad who speaks five languages. Ho has made a point of distinguishing Institute Sarita from the stigma associated with the Chinese equivalent of finishing schools, which are mainly working class vocational schools for bank telling or waitressing. "My students are the ones sitting front row at couture for Dior," says Ho. "They're the ones flying over [to have] VIP dinner at Versailles."

The most popular (and most expensive, at RMB 100,000 for 12 days) course at Institute Sarita is Hostessing, in which wealthy married women learn to use a salad fork,

greet foreign dignitaries and pronounce French designer brands. There's also a debutante course for unmarried women, and several entrepreneurship courses.

HNWI in China have learned about yachting culture and subsequently purchased yachts mainly from boats shows like SO! Dalian and SO! Hainan ("SO!" is a rather twee acronym standing for "superyacht owner") organized by the aforementioned China Rendez-Vous. Yacht prices vary, but the more troublesome expenses for Chinese yacht owners are marina membership fees, which fall between RMB 1.5 and 2 million annually, plus a tax mark-up of approximately 43%. Owning and maintaining a yacht is significantly more expensive in China than in other parts of the world.

## "From Baijiu to Balenciaga"

*Jing Daily's* coverage of high-end culture in China reveals that Chinese HNWI look for a luxury lifestyle that's a hybrid of Chinese and Western pastimes, rather than the wholesale import of Western luxury—as evidenced by their tagline, "…from baijiu to Balenciaga." Despite the appeal of these pastimes as status symbols—something undeniably important to wealthy Chinese—the fact remains that such hobbies by definition require effort, time and avid interest.

"While demand for a status symbol may be a good reason to buy a Birkin bag, it's not really enough of a reason to adopt a time-and training-intensive hobby like polo or yachting," says Flora. "China's rich don't adopt Western luxury pastimes simply for the sake of copying the West; they find certain values in these types of activities that are informed by their own culture and background."

For example, polo has origins in the East and was played by wealthy horse owners during the Tang Dynasty, a tidbit often emphasized in the marketing campaigns of Chinese polo clubs like Nine Dragon Hills and annual events like Beijing's British Polo Day. Even so, polo enthusiasts are still a small, niche group in China; Tang Polo Club in Beijing, one of the clubs associated with British Polo Day, had 60 members as of September 2015.

"The polo clubs right now are mainly working on getting wealthy Chinese parents to sign up their kids for polo in order to make it popular with the next generation," says Flora. "A big part of this marketing is convincing parents that it will help the kids get into top foreign schools."

Similarly, finishing school appeals to wealthy Chinese because it offers the tangible benefit of facilitating work, study and travel abroad. "All my clients have been in a situation where something happened where they didn't feel very comfortable," Ho of Institute Sarita says, recalling an anecdote in which a female Shanghainese entrepreneur was unsure of whether to shake hands or simply nod at an Indian business contact because of the culture's lack of cross-gender touching. "What we provide is the knowledge of what to do in any situation, which then gives one power and confidence to focus on the larger issues at hand."

Meanwhile, luxury pastimes with fewer practical benefits have been slow to take off. Yacht companies have taken great pains to make headway in the China market, and have perhaps done more than any other sector to tailor their products to Chinese clientele. Prompted by the drop in Chinese yacht sales over the past few years due to the country's on-going anti-corruption campaign, most major yacht companies have created specific China models with larger indoor living spaces for entertaining guests, no sunbathing platforms and smaller bedrooms.

As of June 2015, only 500 Chinese HNWI could be described as yacht owners who have "embraced the lifestyle," according to Thibault de Montvalon, Managing Director of French yacht company Beneteau.

What little growth the Chinese yacht market has seen is due in large part to China Rendez-Vous and their pioneering yacht shows. The company's promotional material emphasizes the glamorous allure of yachting, but also the opportunities it offers for business networking. This is a savvy approach, according to Flora, because "you don't see a lot of leisure activities purely for the sake of enjoyment or status right now. There often needs to be a more tangible benefit."

While China may have offered the West's luxury goods companies a huge opportunity thanks to its unprecedented growth, this growth is now slowing and will continue to do so as its economy matures. "The luxury market has to adjust to the fact that the massive double-digit growth rates of the past decade are over as the market normalizes," says Flora. "But China is still their most important source of customers."

Even if growth continues at a less dramatic rate, trends indicate that wealthy Chinese consumers will have more and more impact on the luxury market, and the high-end companies that are most attuned to Chinese culture will likely fare the best. Eventually, Chinese consumers might even become the tastemakers as new luxury pastimes develop. In that case, Westerners may end up scrambling to adopt pastimes from China.

# Dynamic Learning

**Kenneth Jarrett tells about the different categories of books for understanding China**

When it comes to my favorite books on China, I put these into two categories—the more serious reads that are filled with information but require time and concentration, and the books that are more fun to read and indirectly give you information. In terms of the more fun books I would say Peter Hessler's works, whether it's *Oracle Bones* or *River Town*, and Evan Osnos's *Age of Ambition* are among my favorites. I would also add *The Private Life of Chairman Mao* by Li Zhisui, which is just a very eye opening book on what happened in Zhongnanhai at that time.

These books humanize the trends, social changes and transformations that are taking place in China, and they're just more engaging as they're focused more on the society and people as opposed to just hard economic trends. It's easier to absorb the information as it tells you a story, which is always a nicer way to learn stuff.

For the more serious reads I would recommend *The Party* by Richard McGregor, *China Shakes the World* by James Kynge, *One Billion Customers* by James McGregor and *Governing China* by Ken Lieberthal, who also has a shorter book on doing business in China called *Managing the China Challenge*. This last book goes through the dynamics of doing business in China and is perfect for the busy executive who could read the book on the plane to Beijing before a meeting.

Books like *The Party* are very well written and focus on key aspects of the political structure and what's happening in the economy. Thus, they help business people learn more about the dynamics they will encounter in China without it feeling too much like a college text book. But if you have the appetite for a textbook on Chinese politics, *Governing China* is a great choice. It's not something you sit down and read like a novel, but it's a valuable resource. If someone's really keen to understand China's political structure then Lieberthal can help you with that, but for the harried executive that's probably not so important unless they're here for the long haul.

In terms of recent reads, a lot of it has been China-related fiction, for example Ha Jin and Qiu Xiaolong, who writes detective fiction set in Shanghai. Another book I've read recently was *1Q84* by Haruki Murakami. That was a great book and perfect for long plane trips back and forth since the story is gripping and also very long. In fact, it was so good I didn't wait for the next plane trip. It has vivid personalities and characters and an interesting futuristic flavor. For me there is also just the freshness of reading about a place other than China, in this case Japan.

I'm a long-term fan of Jonathan Spence, who was actually my graduate school professor. He writes in a very literary style and I'd say *The Death of Woman Wang* is a good example of that, as are *God's Chinese Son*, his book on Hong Xiuchuan from the Taiping Rebellion, and *The Memory Palace of Matteo Ricci*.

I have quite a few books on my 'to-read' list. Nicholas Lardy's recent book *Markets over Mao* is one of them, as is David Shambaugh's *China's Communist Party: Atrophy and Adaptation*. Thomas Piketty's *Capital in the Twenty-First Century* is also on there, although I'm not certain I'll really get to it. I would like to read more Haruki Murakami, so his book *The Wind-Up Bird Chronicle* is on the list too along with *The Luminaries* by Eleanor Catton, which won the Man Booker Prize. I also have a copy of Mai Jia's *Decoded*, but I haven't had a chance to read that yet so I don't know if it's any good.

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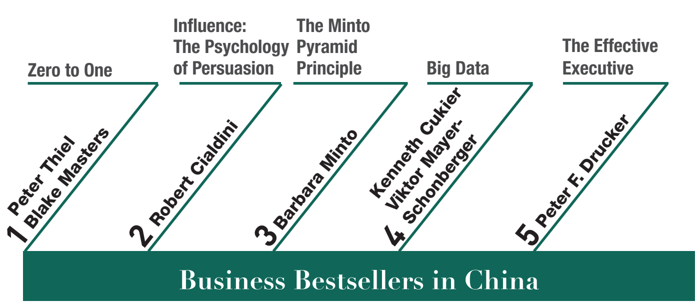
Source: Amazon.com



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