DISRUPTIVE INNOVATION
ALTERING INDUSTRIES
Editor’s Message – The Innovative Issue

China is a hotbed of innovation, especially in the tech and e-commerce fields. But much of this innovation takes place in a vacuum of regulation, often having a disruptive effect on the current market in which the innovations are deployed. This disruption often benefits consumers, but entrenched institutions sometimes become nervous about unfamiliar players encroaching upon their territory. This issue of MESSENGER looks at some of the most disruptive examples of innovation throughout China, and the companies causing such positive disruption.

Editor-in-chief: Stuart Wiggin
China is arguably the world’s leader in a rapidly growing industry of Internet finance; though it would be fair to argue that the country’s progress and innovativeness in this area are the side-effects of an inefficient and unfair banking industry. Online wealth management products are giving normal people their first taste of investment while at the same time offering an incredible level of convenience that physical banks are just not able or willing to offer. But how disruptive is this rapidly evolving form of financial innovation?

By Stuart Wiggin

The key to Internet finance has been mobile technology and the main players are the country’s biggest tech giants: Tencent, Baidu, and Alibaba. Each company offers their own online wealth management products which can be accessed via mobile apps, and each company is employing slightly different strategies by playing to their existing strengths.

Prior to search engine giant Baidu’s launch of its own wealth management product in association with Huaxia Fund Management Company, Zhang Liyuan of Baidu’s public relations department stated that the company’s strategy was to make such a move “twice” based on knowledge about our target group, together with the technology of big data and the level of innovation within the tech industry. Likewise, e-commerce giant Alibaba had its own target group and provided a product, known as Yu‘E Bao, which allows consumers to invest their spare cash into money market funds via its Alipay online payment service.

Jiang Saichun, Chief Analyst at Desheng, a fund research center in Beijing, points out that while Alibaba relies on its huge e-commerce resources, Baidu does not have an e-commerce system, and serves more as a platform for connecting resources within the financial industry. Meanwhile, Tencent offers a product called Caifutong, which is closely related to its other products, QQ instant messaging service and the WeChat mobile messaging app.

The importance of mobile technology with regards to the future of Internet finance was clear to see in this past Spring Festival within China, as millions of Chinese people linked their debit cards to their WeChat accounts. At the time, people did so in order to pursue payment options and gift giving services via the mobile-only messaging app, but the collection of data stands Tencent in good stead when it comes to convincing people to use their wealth-management product, as users will be one simple push of the button away from doing so.

Liu Baosheng, Director of the Centre for International Business Ethics at UIBE, points out that this kind of innovative idea can cause such a “disruptive surprise” within the industry as a whole that it will likely result with traditional banks having to innovate by themselves in order just to keep up. Liu goes on to add that the government is likely to be very supportive of such “disruptive innovation,” adding that, “Just a year ago, it was beyond imagination that the government could be so tolerant about such processes.” However, observers of China’s market say that it will take some time to see what impact further regulation has upon Internet finance. As Liu explains, “Innovation normally takes place in the vacuum of legislation and then legislation will catch up. So both the financial operators and the financial users are anxious to see what can be turned out in the new (government) regulation.”

Prior to whatever regulation the government does decide to implement, Internet finance in its current state will have an undeniable effect on China’s traditional banks. At present, Internet finance highlights certain areas where traditional banks fail incredibly short with the most obvious shortcoming being that banks fail to make small transactions convenient for their customers.

Alex White, Assistant Professor at Tsinghua University’s School of Economics and Management points out that banks do not consider why they are regulated because they are regulated. As a result, “The banks have had relatively little pressure to provide a great product for consumers and instead, the banks have become kind of stuck with the banks. And now, as these new innovative Internet finance options become available, consumers will start to demand better services because they have some place to go to pay for things other than just using their bank accounts.”

As for what changes traditional banks will implement in order to increase the convenience of small transactions is anyone’s guess, but they will no doubt attempt to tackle the issue of frustration among customers, brought about by long waiting times and increased transaction costs. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy, as millions of people log their personal information online. However, the chip and pin system in China is also the issue of privacy.
The Common Man’s Wealth Management Tool

A survey earlier this year, carried out by the China Youth Daily newspaper, revealed that 68 percent of Chinese people are planning to divert some proportion of their bank deposits to Internet finance products in the future. The survey was conducted online and had more than 10,000 respondents. Alongside the high percentage of people planning to move funds into Internet finance products, the survey also revealed that 84 percent of all respondents have already invested in some kind of Internet wealth management product in the past.

82 percent of all respondents said they are content with their investment income and most listed higher return rates and greater convenience as the major reasons for choosing Internet finance. Almost two thirds of respondents were born in the 80s and 90s. According to the survey results, this group seems more interested in taking “new” risks, with some stating that online investments not only save time, but also enable them to perform small-asset investments between 10 and 20 thousand yuan, which could never be realized in China’s traditional banks.

Xu Xiao, a resident in Luoyang city, central China’s Henan Province, began her latest hobby after spending 22-thousand yuan, or 3,600 US dollars, buying into Yu'E Bao, a popular online money-market fund. Each morning, the 28-year-old checks her Alipay account, China’s equivalent of PayPal, through an app on her mobile phone to track the rate of return on her investment. Despite the fact that the interest amounts are small, Xu is overjoyed every time she sees her new “investment earnings.”

“It’s very convenient. I don’t need to go to the bank to make investments. All I need to do is get on the internet and away I go. The inter
et rate is much higher than that of the banks,” explains Xu. The product in question, Yu'E Bao, is designed to make it easy for Internet users to invest idle cash from their Alipay accounts and earn a higher rate of interest compared to what a traditional bank savings accounts offers. Xu’s attitude towards the product is typical of most Yu'E Bao investors, and it is the enthusiasm they hold towards the product that has made the concept such a success in China.

Yu'E Bao is an internet money-market fund co-developed by Tian Hong Asset Management Corporation and Alipay, the online payment arm of e-commerce giant Alibaba (See page 20). At times, Yu E Bao offers over 6 percent in annualized returns, while the big four Chinese commercial banks only offer around 3 percent yields for a one-year-term deposit. The most attractive feature of the product though is that the investment threshold is only one yuan and investors can redeem their money at any time.

According to Tian Hong Asset Management Corporation, 51 percent of which is owned by Alibaba, Yu'E Bao became the largest money market fund in China within four months of its launch date last June. In just 260 days, the Internet money fund accumulated 350 billion yuan and gathered a colossal customer base of 81 million users, surpassing the number of China’s share investors.

It’s no wonder then that other internet companies have rushed to follow suit and offer similar financial offerings. Baidu, China’s biggest Internet search provider, is one such company that moved into financial services, launching an online finance product called Baifa in October, 2013. Baifa’s rumored annual yield of 8 percent attracted so many prospective customers, Baidu reported that their financial service brought the company about 1 billion yuan within five hours of launch.

Online retail giant, JD.com, has also decided that Internet finance will be one of the main engines for driving the company’s future growth. Just as the Internet has changed the landscape of retail business around the world, insiders believe it will reshape China’s financial sector: Professor Qian Jun, of the Shanghai Advanced Institute of Finance at Jiaotong University, believes that the widespread use of internet finance will play a positive role for the finance industry in the future. “I believe (Internet finance will benefit) two sectors. One is the payment sector; basically, it facilitates transactions. You do things online much quicker, and we see there is already a big boom in this sector. The other sector which is more interesting is that of online lending, because they are increasingly behaving like banks; they collect money and they invest the funds.”

Though the issue of online lending suggests that the companies offering the services could actually become private banks competing within the market alongside state run banks (See page 8), the leap is not exactly a big one. “We know a lot of Chinese investors have the capital, but other than the stock market, which is not doing great, or the real estate market, which is clearly risky, they don’t have a whole lot of opportunities (for investment). Furthermore, for many good small firms, they have a very hard time securing loans from banks. This is where internet financing and other forms of alternative financing can play a big role,” notes Qian.

However, as Qian points out, internet financing is still something of an unknown phenomenon and warns investors that they are essentially sailing in uncharted waters. “As we learned in the 2008 global financial crisis, the main danger within the financial sector is systemic risk, so anything that is systemic, you need to be very, very careful.” At present, services such as Yu'E Bao and Baifa act as intermediaries on an individual-based system, where there is no problem in terms of information exchange. But as Professor Qian adds, “If the intermediary firms bring in a lot of money from very different sources, and they lend to an equal number of firms and investors all over the place without knowing either the lenders nor the creditors well, then you get into this sort of shadow banking problem due to problems related to the complexity and lack of information. In this case, the government should, for sure, be very careful in terms of regulating both the size and the procedural side of Internet finance.”
China’s Privately Owned Banks

Chinese depositors and companies seeking loans will soon find themselves presented with a longer list of options thanks to the establishment of China’s first batch of privately-owned banks.

China’s banking watchdog has confirmed that five privately-owned banks, funded and operated by ten private companies, are set to jump into the private banking sector. It is not clear how these privately owned banks will affect China’s banking business in the long run, but it is quite certain that competition will intensify and market forces will play a more significant role in the allocation of banking resources as technology looks to become central to their operation.

In an attempt to gain a clearer perspective on the reasons behind introducing such banks and what impact they will have on the market, MESSENGER presents the views of Winston Wang, Managing Director of international private investment firm Shipston Limited, and Rui Meng, professor of finance and accounting at the China Europe International Business School, providing both the academic opinion and an industry-insider opinion on China’s private banks.

Winston Wang, Managing Director of international private investment firm Shipston Limited points out that the introduction of private banks into China’s financial system will be a “revolutionizing move in terms of creating more competitive financial markets” within the country; not least because private banks will provide a lifeline to China’s small and medium sized enterprises (SMEs) that currently struggle as a result of the existing system.

“We’ve seen a lot of challenges to the old model; the existing system. We have a lot of money supply, but actually most of the money is channeled to the large scale state-owned enterprises. A very significant part of the economy, the small and medium-sized companies don’t have adequate access to capital. The low efficiency of this system is very obvious to most people. So, introducing private capital into this segment is going to, or is at least supposed to create more access to those that need more capital, and create a more dynamic economy. Wang is keen to point out that the country has already liberalized its lending rate, and is expected to liberalize the deposit rate shortly, though some reports state that such a move won’t come for at least another 1-2 years. Nonetheless, once the deposit rate is liberalized, Wang notes that that will differentiate the products of the banks; playing a major role in the make-up of a system which involves both private and public banks.

However, Wang points out that the business model of private banks will be vastly different from their state-owned counterparts. “Right now, it’s almost like an oligopoly situation in the banking industry. There are very few banks in play. When you add more private banks into the picture, they will have to move down the value chain because the larger clients are already the clients of those large banks. In order to make profit, they will probably have to cater to smaller clients.”

Wang believes that the central point of the reforms is to create competition so the smaller businesses hopefully will have better access to capital. At present, Wang explains that China’s finance industry isn’t following the usual tenets of a market economy, i.e. that all players should be treated equally and that those institutions unable to compete should be phased out of the system, thus improving efficiency.

“We’re not able to do that (at the moment) because some of the banks are already too big to fail. This is the same case in western economies, but that’s not the ideal scenario. So what I believe the regulators are trying to do is start with the new entrants. Some other institutional reforms will be needed to accommodate the new reality, such as the deposit insurance schemes. The banks will have to ensure a certain amount of the deposits of the depositors, so in the case of any trouble people still have some kind of recourse to their problems. This kind of preparation, a pre-written will of what will happen if the banks run into trouble, will set people’s mind on market-friendly terms. At this moment, most people believe that whenever there is any problem then the state will come to the rescue.”

Even though the huge state-owned banks will remain “too big to fail” as private banks navigate the market in the initial stages, Wang is optimistic that there will be a ripple effect of sorts. “I think the government is trying to create a real competitive financial industry. Going forward, when the competition becomes more and more full, I hope the playing field will become more liberal.”

The new private banks will be physically located in the country’s major cities, Beijing, Shanghai and Guangzhou. However, many commentators point towards the need for greater access to finance in rural areas of China. But locating private banks in rural areas poses a number of difficulties going forward. “You will find that in more developed regions the financial services are more professional. You have more talent and the institutions will operate in a more professional manner. In relatively poorer regions, the financial institutions tend to be less sensitive towards following the rules or to comply with best practices. So this is really a dilemma, if you start with the poorer regions and encourage more players in that area, they tend to be a little bit less professional and more likely to run into problems. It’s not an easy choice.”

As for the participation of web giants Alibaba and Tencent as investors, Wang thinks their involvement can only have positive results for the industry as a whole. “They are internet companies, they tend to be more innovative and more forward looking. Their technology is quite disruptive to the current status quo. For a lot of the existing players, they may be viewed as trouble makers, but for the country as a whole and for the economy as a whole, I believe they’re bringing real dynamism, real competition.”

Furthermore, Wang sees their decision to jump into private banking as a logical step given their existing business model. “Operating their own financial arms to facilitate the existing transactions they’re doing to make it more convenient, more effective, cheaper for average consumers, it’s in the best interest of the existing customers of these internet companies. There is an inherent logic for them to extend into the financial segment.”

Rui Meng, professor of finance and accounting at the China Europe International Business School, is certain that the government is acutely aware of the need to alter the state of the current financial system and distribute funds according to the need to spur growth. “Obviously the current financial system does not function properly. So, introducing privately owned banks is one of the mechanisms to solve the problem in the financial system. The new government
intends to break the monopolies shared by the current state-owned banks. So, in order to boost economic growth, they need resources allocated by the financial system, especially for small and medium-sized businesses and enterprises located in rural areas.”

Furthermore, Rui believes that China’s financial markets can only be altered via external impetus purely because the state-owned banks have very little reason to reform when the current system serves them so well. As Rui explains, the monopoly position of China’s state-owned banks means “they can enjoy a very high interest spread - the interest difference between the lending rate and the deposit rate. But that really hurts the real sectors. Most of the time, money only flows in and out of the banking system, it doesn’t flow into the real business sectors. So, in order to break these monopolies, it’s difficult for the existing interest group to reform by themselves. They need external force; one such external force (will come) from the privately owned banks because they will be more efficient and more flexible.”

However, Rui warns against people assuming that private banks will offer more favorable interest rates than state-owned banks. “It’s difficult for privately owned banks to raise interest rates because the interest rate is, in theory, regulated by the People’s Bank of China. In order to get licensed they have to be subject to the same rules or regulations. In my opinion, it will be difficult for them to raise interest rates significantly.” As a result, private banks are likely to gain most of their revenue from middle business, rather than the interest spread. Privately owned banks are likely to focus on efficiency and convenience, because “competing on the interest spread is not their comparative advantage.”

Assuming that the government wants to foster a competitive and fair market, it is understood that privately owned banks will not be treated differently from a regulatory perspective and will be regulated in much the same way but must have clear provisions for orderly dismantlement in case of bankruptcy. Upholding regulatory standards is critical to the success of the economy as Rui explains. “As long as they are banks, they have to be subject to the same set of regulations or rules. So just because you have different ownership, you cannot implement different kinds of regulation or monitoring mechanisms.”

With a view slightly different to that of Winston Wang, Professor Rui feels that the advantages offered by Tencent and Alibaba, when it comes to achieving increased capital allocation to SMEs or people living in rural areas, are sizeable but will not guarantee immediate success. Initially, Rui believes that Tencent and Alibaba will mainly target potential clients from e-commerce sectors, as this is the field they know best.

“But once they accumulate enough knowledge, they can expand their client base from e-commerce to SMEs. I think this is the objective behind this reform. The regulatory bodies really want to encourage these new banks, the privately owned banks, to help the capital allocation to SMEs or to those people living in rural areas. These two internet giants have comparable advantage in their technologies and also client bases. But they lack financial industry experience or expertise.”

Most importantly of all, Rui emphasizes the need for a comprehensive ownership structure, in reference to the fact that each privately owned bank will require at least two investors. “The capital adequacy ratio (the ratio of a bank’s capital to its risk) for the bank is very low. It’s around 10 percent. In other words, the leverage ratio for the banking industry is about 900 percent... One risk is that the owner of a privately owned bank benefits themselves; in other words, accepts the deposits and lends the money to themselves and uses the money to invest in high risk projects. In case of bankruptcy, because (the bank is) too big to fail or because of national security reasons, the government has to lend a hand. There are serious moral hazard problems. In order to counter these moral hazard problems, we have to design the ownership structure carefully. You cannot let one company dominate ownership. One way is that you introduce at least two big players to form the ownership so that they can monitor each other. Balance can mitigate the problem of moral hazard.”

Constantly compared to the Silicon Valley giant Apple, China’s Xiaomi is making waves in the domestic tech market and is a household name when it comes to smartphones. The company is now attempting to tackle Apple’s dominance in the tablet market. But what ethos lies beneath one of China’s most innovative young companies, and what is the story behind it?

By Cui Chaoqun
At an event touting Xiaomi’s latest product release, a promotional video projected onto a big screen shows the company’s young staff from the logistics, repair service and customer support departments. Different from other tech companies, which allow their engineers and designers to talk about the products they produce, Xiaomi puts its focus on its people and its users. This is the secret of Xiaomi’s business success.

Established 4 years ago, Xiaomi, one of China’s most exciting tech-hardware producers, managed to catch the public’s attention with its innovative and affordable cellphones. Utilizing a creative android experience and delivering high performance, the Xiaomi phone quickly gained a huge number of fans. Xiaomi sold 18.7 million phones in 2013, more than double the amount of sales for the previous year.

In China, as social media has developed, the term “Fan Economy”, used to refer to the fact that the consumption ability of fans can be turned into cash, has become an important factor within the world of marketing. “Fan economy” is also a key term for Xiaomi’s approach to marketing. For instance, the company’s annual product release event, held on May 15 this year, was more than just a product presentation; it was a carnival for fans of the company.

Tickets to the product release event sold out in just 10 seconds online. As Xiaomi’s global vice president Hugo Barra has previously stated, Xiaomi carries out all its marketing via social media. Xiaomi’s forum has some 8 million users, who give the company feature suggestions, file bug reports and user feedback. Fans are involved in every aspect of the product, from research through to development, testing, marketing and even PR; and are considered the foundation of the company.

Natural comparisons are often made between Xiaomi, an innovative young company willing to push the boundaries, and Apple, a company which possesses exactly the same traits. Xiaomi’s founder Lei Jun spoke to Business Insider in an effort to address this comparison. “We’re actually an Internet company,” said Lei, “We’ve already got a business in mobile phone hardware and we want to add to that an Internet platform. We can earn money from that once it’s established.”

Lei insists that Xiaomi and Apple are totally different companies. According to Lei, Xiaomi is more akin to a combination of Apple, Google and Amazon; having once stated that Xiaomi selling mobile phones is similar to Amazon selling Kindles, though it is really more like Amazon with some elements of Google. Clearly, comparisons to the western tech giants are unavoidable, even from the high-ups within the company.

The Xiaomi tablet and the Xiaomi TV were the highlights of this year’s product release. At present, Apple’s iPad is the dominant player in the Chinese tablet market, with a 36 percent market share in 2013. According to Lei, Xiaomi is hoping to put pressure on Apple. This may be an ambitious statement from such a young company, but the price point for the 64GB Xiaomi tablet, at 1,699 yuan (272 US dollars), will certainly be attractive to many who are unable to afford Apple’s pricier products.

Clearly, the obvious attraction of Xiaomi’s products is the price, alongside their ease of use; and these are exactly what Xiaomi fans appreciate about the company’s products. Upon receiving a Xiaomi phone, first-time users will immediately gain a flavor of the company’s no-frills approach. The phone, available for sale online only, arrives neatly packed in a plain cardboard box.

After opening the box, customers will see the slogan “Born for the Fever” printed on a piece of plastic film attached to the phone’s screen. The slogan unveils the mindset of those who produce Xiaomi products. The phone can be easily rooted, meaning that users can gain privileged control and optimize the phone’s performance or user interface. For most android phones, rooting a phone’s software is not officially endorsed and is a difficult process. Xiaomi, however, encourages users to root their products to unleash the full potential of the hardware.

As for Lei Jun, rather than wear jeans and a t-shirt, the founder of Xiaomi adopts a business-type appearance at the Xiaomi product release. It appears as if he is attempting to distance himself from the image of Steve Jobs or Tim Cook; as he himself has admitted, he is tired of the comparisons.

Unlike Jobs, Lei finished his studies at university. He is one of the co-founders of Kingsoft, one of the best known software companies in China, and is also an angel investor within the Chinese economy - the Ron Conway of China. He has invested in various projects including Joy.com (later acquired by Amazon), UC web browser, and Vancl.com (B2C web site).

As both a CEO and an investor, Lei managed to earn a reputation for himself within the tech industry. This reputation meant that when he came up with the idea of making phones, he was able to attract top talent to what was actually just another startup. At the age of 40, Lei Jun started to build his team for Xiaomi. He invited a number of veterans from the industry, including Lin Bin, VP of Google China’s Engineering Research Institute; Zhou Guangping, Senior Director of Motorola Beijing R&D Center; and Li Wanqiang, GM of Kingsoft Dictionary.

Above - Xiaomi’s flagship store located at its headquarters in Beijing. Despite having physical stores, Xiaomi handsets can only be purchased online.

Below - The Xiaomi TV is part of Xiaomi’s offerings alongside its popular range of smartphones.
Despite such a heavyweight staff, the company encountered many difficulties in their initial stages, especially with regards to sourcing, as material suppliers were reluctant to sell products to another startup company. Li Wanqiang has since joked that if he had known there would have been so many difficulties in making phones, he would have quit straight away.

After weathering the early storms, Xiaomi has developed into a company with over 4,000 employees, generating revenue of 31.6 billion yuan last year. "Xiaomi’s priority is not revenue, not profit, nor market share," Lei Jun has stated, "We focus on making the product that makes users scream." But Xiaomi has come under criticism for its marketing model – offering a limited number of phones that quickly sell out, leading some critics to accuse the company of purposely selling only a small number of units in order to drive up hype and demand. After the online release of the RedMi, a Xiaomi cellphone designed for the low-end market, many users were greeted with 404 error pages at the start of the sale. Within a few minutes, 300,000 RedMi models had sold out.

However, Xiaomi denies any so-called attempts at “hunger marketing” and instead places the blame on the production capacity of its manufacturers. "When we try to expand our production line and try to increase our orders of basic components from our suppliers, we’re essentially relying on them to increase their production capacity and decide to shift their allocation to us," Hugo Barra explained whilst talking about Xiaomi’s supply chain during an interview with CNET.com.

Nonetheless, despite the fact that many have been left disappointed when attempting to purchase Xiaomi’s products, the company has still become a household name within China. "When the typhoons come, even a pig can fly in the sky," said Lei Jun when commenting on the success of Xiaomi. Essentially, Lei is a big believer of doing the right thing at the right time. The huge domestic demand for smartphones and the fast development of China’s e-commerce sector were the typhoons which allowed for Xiaomi’s success.

Xiaomi has disrupted the mobile phone market in China, putting pressure on Apple, Samsung and other manufacturers. The company has set ambitious goals to expand its market vertically and horizontally. Xiaomi’s other products range from smart TVs and tablets to wireless routers, television media players and other sideline products. The company has also begun selling phones in Singapore and plans to enter the Southeast Asian market. Even though the company was able to employ a successful marketing strategy in China, the global market will be the true touchstone for Xiaomi’s products.
Laying its foundations through its instant messaging (IM) service, Tencent’s business has penetrated into almost every sector related to the internet and technology, including online games, mobile applications, software development, websites, internet finance, blogs, and videos.

It even launched its own Android-based application store MyApp (yíyōng bāo) at the beginning of 2014, advancing into yet another new area of business. Apart from developing its own products, Tencent is also buying stakes in a number of domestic and international companies. Its acquisition of the state-owned Navinfo was approved by authorities in May; and earlier in April, Tencent announced an agreement with Leju, an online real estate services provider, after buying a 15-percent stake in the company. However, Tencent’s expansion is still ongoing.

It would have been almost impossible to imagine that Tencent’s online IM software known as QQ, identified by its penguin logo, would have laid the foundations for one of the world’s biggest tech companies today. In 1998, a boom year for the IT industry in China, Ma Huateng along with a friend founded a small IT company in Shenzhen, south China’s Guangdong province. This was the humble beginnings of Tencent.

The next year, the company developed online chat software called OICQ (Open ICQ). Despite being an imitation of the world-famous ICQ messenger software, Tencent’s first offering soon proved its popularity with over 200,000 users registering within 2 months of its launch in China. In the following several updates for OICQ, the small team behind the chat software added a number of functions including online chat rooms and file transferring.

By the end of 1999, more than 1.3 million people were using OICQ, accounting for more than 80 percent of the IM market in China. According to data released by the China Internet Network Information Center (CINIC), there were only 5.37 million internet users in the same period throughout China at that time.

However, Ma did not have much time to savor Tencent’s early success as their budget was no longer sufficient enough to cover the fast-growing number of registrations and constant server updates. As a result, they decided to try to sell OICQ for 1 million yuan, but no one was willing to take a gamble on the software, especially in the context of the IT bubble having just burst in China.

Desperate for funds, Ma sought investment from overseas. It is understood that Ma turned to one of his personal friends who then introduced him to a business partner called Yang Fei at the American company International Data Group (IDG). Yang was apparently impressed by the technology and design behind OICQ and eventually agreed to invest.

Though the amount of funding provided by IDG has not been specified in reports, PCCW from Hong Kong and IDG together invested some 2.2 million U.S. dollars in Tencent in April 2000; a sum that eventually saved the burgeoning company. Ma Huateng later expressed his gratitude in an interview, mentioning that no one else was willing to take the IM software off their hands for just 1 million yuan. Ma also pointed out that business, as he sees it, is not about short-term income; it requires true vision in order to grasp future trends.

However, it’s safe to say that PCCW and IDG made a bold move by investing in Tencent, who actually had to change the name of its IM software from OICQ to QQ after receiving two letters respectively in 1999 and 2000, from a legal firm in the U.S. claiming that the name of Tencent’s IM software constituted product infringement, as many users mistakenly took OICQ to be part of ICQ.

The incident, however, had no impact on users’ enthusiasm for the little penguin. Internet users, especially young people, found QQ to be an irresistible product, with the likes of which they had never seen before. Some ten years ago, QQ gave high-school students, such as myself, the chance to gosip online without being overheard by teachers and parents, and form groups with friends in order to stay updated with the latest news on campus. A QQ registration number could almost have been considered a fashion item.

When those same high-school students left for college, QQ enabled users to video chat with their friends and family. Faced with the possibility of making expensive long-distance phone calls, many Chinese parents decided to register their own QQ account numbers, broadening the user base of China’s most popular messaging software. As a result, QQ was no longer exclusive to China’s youth. After hitting 1 billion users in 2012, Tencent stopped publishing registration numbers. But the huge number of people that use or have previously used QQ helped to build the very basis of Tencent’s booming business today, which is undeniably focused on mobile.

Back in 2000, Tencent decided to cooperate with China Mobile to launch an IM service on mobile devices. Though only gaining a quarter of the profits from the deal, Tencent achieved over 10 million yuan in net profit by the end of 2001. Ma had stumbled upon a sustainable way of development for Tencent going into the future. The company soon started to develop added-value services affiliated with QQ. Some of the services that Tencent offered are listed as follows:

- **QQ Show**, a virtual personalization system that allows users to design their own online outfit. Most virtual garments and accessories are not free. You can pay with virtual money, known as QB, with each QB unit worth 1 yuan.
- **Ozone**, a blog website where users can decorate their space with flying stars, flowers and other colorful and shiny items. Likewise, most of these items are not free. The more you pay, the fancier your QB, with each QB unit worth 1 yuan.

The number of QQ users online is proudly presented on the official website for the popular messaging software.
messages, pictures, videos and emoticons to each other free of charge.

As WeChat allowed QQ users to link their accounts to the app, the number of users quickly jumped to 600 million by November 2013; making WeChat the largest messaging application in Asia. The impact it brought to e-commerce and social networking was also phenomenal.

WeChat has an in-app social networking platform called Moments where users can share photos and texts with their friends. However, the content remains private, is limited for viewing via the app and is only available to those on one’s contacts list. Sina Weibo, the Chinese equivalent of Twitter, has seen an abrupt decrease in its active user base after WeChat’s Moments function became popular among WeChat converts.

Traditional media panicked after seeing how fast information was able to spread on WeChat; realizing that they had to adapt in order to stay afloat. With companies and institutions able to open their own public WeChat accounts, staff members working at media companies around the country have had to include WeChat as part of their job load, as they look to write anecdotes or new items on a daily basis in order to reach the maximum number of people.

The challenge for users and companies looking to make use of WeChat is that the content being posted has to be mobile-friendly, unlike that of Weibo or Twitter where users only share links and photos. Short texts and multimedia demonstrations which take very little time to view are effective forms of communication when using WeChat as a tool for spreading information; something that news organizations find difficult to adapt to.

In the world of e-commerce, WeChat has also ruffled a few feathers. E-commerce giant Alibaba has been deeply influenced by WeChat’s ascendance. At the beginning of 2014, Tencent via WeChat, and Alibaba were involved in an intense war with regards to taxi booking applications. Each company was offering bigger discounts (around one U.S. dollar per fare) to those users who booked taxis using their respective app.

Likewise, WeChat and Taobao, part of the Alibaba group, also started to trial mobile financing by providing financial services on their mobile applications; battling for a bigger share of the market by providing greater returns to investors. Despite the frenzied competition in areas outside of the IT industry, Tencent is constantly looking to develop the next new thing as the individuals in charge of the company are acutely aware that users quickly move on to the next trend.

Media companies still struggle to make use of WeChat and when faced with emergencies such as the recent case of this missing Malaysian flight MH370, social networks such as Weibo and more traditional television broadcasts were still the sources that most people turned to for information. For this reason, it is uncertain as to whether WeChat can be truly seen as a social networking platform in the sense that Weibo is.

Nonetheless, Ma Huateng has built a Tencent empire within China by monetizing two groups of application users; its QQ user base and its growing mobile WeChat users. But Tencent’s realm does not extend beyond the borders of China at present. Neither QQ nor WeChat have been able to make waves in the international market or among non-Chinese groups. That may be because there are already local alternatives for foreign users and Tencent’s products do not have anything new to offer, but it also has something to do with the fact that Tencent is just too good when it comes to localizing its products in China. Ultimately, the company has made it harder for itself to effectively sell its own products to foreign cultures.
In China, if you don’t know where to buy some specific goods, such as “poetry for the soul” or even a boyfriend/girlfriend for rent, you can always search for it on tao-bao.com, the country’s leading customer-to-customer website. Taobao, together with Tmall, a business-to-consumer (B2C) site, was formed by the e-commerce giant, Alibaba group.

Already bigger than a combination of eBay and Amazon put together, Alibaba is growing much faster in recent years, especially since it single-handedly created a new festival within the country; Singles Day, celebrated annually on November 11th. The event has proven to be so popular among China’s tech savvy youth that last year, the firm’s sales exceeded 5.7 billion US dollars on Singles’ Day.

Will Alibaba become China’s most valuable internet company?

Alibaba has always been a strong competitor in the Chinese internet market. The total trade volume of Taobao and Tmall reached 250 billion US dollars last year, accounting for 80 percent of China’s e-commerce market. But, with the rapid development of mobile internet technology, the company is now facing a threat from its long-term rival Tencent (See page 15), which launched WeChat, a popular mobile social messaging application which now has over 300 million users worldwide. The lack of strong mobile products is a headache for Alibaba. Last year, the company invested around 83 billion US dollars into new tech companies, such as e-commerce search engine Taotaosou and taxi-hailing application Kuaidi Dache (Call a Cab Fast). The new products certainly led to more innovation underneath the Alibaba umbrella but their offerings seem to be far from enough to allow Alibaba to compete with Tencent on the mobile front. On March 10, 2014, Tencent announced that it would be joining up with JD, China’s second largest e-commerce website. Under the terms of the cooperation, Tencent bought a 15 percent stake in JD.com at a cost of 214.6 million US dollars, making it one of the largest shareholders of the company. At the

Alibaba finally unveiled its prospectus for a listing on the New York Stock Exchange on May 6th, 2014, amid doubts over timing, as the value of tech stocks listed in America has fallen by around 150 billion US dollars since peaking in early March.

In the filing, Alibaba revealed that it values itself at roughly 110 billion US dollars while analysts predicted that the highest valuation would probably reach 250 billion US dollars. Despite the current tech stock rout in the US, it’s expected that the Alibaba IPO would be the largest IPO since Facebook. The market value of Facebook now stands at around 150 billion US dollars.

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same time, nearly all of Tencent’s online commerce business would be taken over by JD. The partnership is clearly designed to break the dominance of Alibaba in the e-commerce market. But what makes this story even more interesting is that JD recently completed its listing on the NASDAQ on May 22. The market value of JD is around 28.6 billion US dollars, while Tencent’s market value has exceeded 100 billion US dollars, nearing that of Facebook.

According to foreign media reports, Alibaba will launch its IPO in the US this August. Then only will it be possible to know which company can claim the title of most valuable in China.

Alibaba’s secret weapons

Jack Ma, founder of Alibaba, has long advocated that the company devotes itself to building and nurturing a healthy eco-system, in which small retailers and large companies can all find their own place to grow. Within the huge empire of Alibaba, there are a number of important weapons that help it maintain its competitive advantage.

Alipay

Alipay is a PayPal-like online payment service which has become a very popular payment service even among many other Chinese e-commerce companies. However, Alipay is currently not part of the group being floated in New York; it is held by a sister financial firm controlled by Jack Ma and a handful of associates, having been spun out of Alibaba in 2010.

Besides offering a payment service, Alipay has also tested the waters of internet finance (See page 6). Alipay’s online investment product Yu’e Bao, which allows users to invest money left over within their Alipay account, was launched last June. As of January 15, 2014, Yu’e Bao had received over 250 billion yuan (almost 41 billion US dollars) worth of investment from over 49 million small-scale investors, according to Tian Hong Asset Management Co.; the operator of the investment product. However, the service also triggered conflict between Alipay and China’s banking system, which led Alibaba to state in its IPO filing that it was worried about the possibility of Chinese officials interfering with Alipay due to its expanding influence and reach in the world of internet finance.

Alipay has also tried to expand its foreign market. In 2013, the company earned nearly 767 million US dollars overseas. At the beginning of 2014, it announced that it would be investing 15 million US dollars in US online luxury market-place 1stdibs. Reports claim that Alipay will focus on developing a mobile application product for the website.

Alipay's online investment product Yu’e Bao.

Finally, the high-)(ups within Alibaba have been trying to change the definition of the company from that of an e-commerce giant to one based around technology. Alipay, or AliCloud is one such important and successful move in the attempt to achieve such a redefinition. AliCloud is a cloud computing and data sharing platform, which provides Alibaba with a convenient method by which to control millions of pieces of data for its registered users. With this information, business owners can precisely predict the consumer’s purchase behavior and make smarter decisions based on it. For example, statistics from Tmall show that 1.5 billion packages were delivered during last year’s Single’s day festival, 60 million of which were handled by express couriers on the day of November 11th, and the express delivery time was cut by half compared to the same period last year. In 2013, 75 percent of all Alibaba’s transactions during the festival were dealt with by AliCloud.

Aside from providing support to its online business, AliCloud also provides Aliyun TV and mobile phone products as well as cloud computing and data management services to other companies. Statistics released in 2013, it announced that Alibaba earned over 121 million US dollars through its AliCloud services.

Not content with being the e-commerce king domestically, Alibaba has also tried to expand its foreign market. In 2013, the company earned nearly 767 million US dollars overseas. At the beginning of 2014, it announced that it would be investing 15 million US dollars in US online luxury market-place 1stdibs. Reports claim that AliCloud will focus on developing a mobile application product for the website.

Aliyun/AliCloud

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Ultimately, the path ahead for Alibaba will not be easy since buying its shares is like betting on a continued surge in what is already the world’s largest e-commerce market. No matter how people look at it, Alibaba’s IPO is the most anticipated financial event of the year. The company is holding a very cautious attitude and is not expecting much, probably not even meeting its IPO price. But if Sina Cloud was a success, with and without, let us admit that technology, in its most basic form, is a business proposition.

While physical boundaries no longer restrict communication; language and culture continue to heavily influence our behavior, whether online or off. As a business proposition then, we do why continue to assume that different markets, informed by different histories, languages, and cultures, would even remotely resemble one another?

I am continually amazed by a US-based tech blogosphere that can, in the same article, say that Sina’s Weibo microblogging service is “China’s Twitter” and then go on to document their myriad differences. Differences that, by their very nature, only go to prove that Weibo is almost nothing like Twitter.

Secure investment products and service, which according to Sina’s Weibo, are an almost unique trait that makes Weibo unique.

Tencent’s secret weapons

According to foreign media reports, Alibaba is opening a US store – 11Main.com – is exciting and a clear example that they want to expand their operations overseas; but it will also be a litmus test as to whether their approach to e-commerce can prosper in a market like the US, where overheads and logistics are far more costly.

According to Steven Millward, editor at Tech in Asia, a technology blog focused on Chinese and other Asian markets, “[These] analogies are only true for the moment they launch. After that, China’s web services tend to grow so quickly that the comparison becomes invalid and the situation evolves to be very complex.”

It is true, that China’s tech products have grown so quickly in the past couple of years, and are becoming so popular that it is hard to even remotely compare one to another. For those of us from English-speaking nations (especially the US), we automatically assume that since we created the Internet, we must have been behind in our own image across the world. Silicon Valley, out of marketing necessity, has done nothing to disguise this of us of this.

“Technology is worth anything,” they say, “it is only because it will change the world for the better.” Indeed, it is impossible to deny that the services have been quick to adapt to the way people buy and consume devices, and information at our fingertips have all made the world smaller and translated dying communal arrangements into thriving online groups where physical boundaries play no role. But if Silicon Valley was honest with itself, and with us, they would readily admit that technology, in its most basic form, is a business proposition.

When Sina Weibo launched, it quite closely resembled Twitter. As a platform, it was basic and was built upon an existing desire to post small updates to a public audience. While it may now be the most successful microblogging platform, it was certainly not the first; nor was Sina the only Internet company looking to expand its offerings. In order to fend off not only competing offerings, but also competing types of social products, Sina Weibo has expanded its services to an extent where many China-based commentators will readily say that it is actually, superior in many regards to Twitter.

“Sina Weibo grew rapidly to include photo albums, cloud storage, social gaming, group messaging, and a great deal more, so that it was eventually doing most of what Twitter, Facebook, and WhatsApp can do. It’s never safe to make a simple comparison between a Chinese web service and something from the West,” say Mr. Millward.

While many companies struggle to engage users on their mobile phones, social networks and e-commerce platforms included, WeChat managed to capture the attention and wallets of 272 million active users as of November 2013. In January of this year, WeChat managed to draw what e-commerce giant Alibaba had failed: get access to over 5 million users’ bank account details. Both Alibaba and Tencent have mobile payment applications. Both used the Chinese tradition of giving New Year’s money (hongbao), but with WeChat’s user base and some inventive gamification, Tencent gave users massive incentive to link their bank account details to the social networks payment system, thus proving the viability of m-commerce, or online-to-offline (O2O), in China.
Banking for the Win

Winning the New Year's battle, however, is by no means akin to winning the war over online payments and mobile finance. In June 2013, Alibaba, parent company of Taobao, China's largest e-commerce platform, launched China's first mobile finance product, Yu'E Bao. Over the course of 18 days, Yu'E Bao attracted 2.5 million users who collectively deposited RMB 6.601 billion (1.07 billion USD) with no marketing. Now linked with their payment platform Alipay, users of Yu'E Bao can wait in line [which can take up to 1 day afternoon, get a number and then use Alipay to transfer money to Yu'E Bao] and curator of the Beijing Startup Festival and gamification platform Kwestr, as Frank Yu, founder of marketing agency Amaétat, says that the most amazing feature, however, is how often outside observers assume that the online world must mirror the state-owned enterprise-dominated real world. Indeed, Duncan Clark, chairman of BDA, an investment consultancy specializing in Chinese and other Asian markets, says that the biggest misconception of the Chinese Internet is “that the Internet is not competitive here, run by companies anointed by the State. The reality is far more competitive.”

What began in 2012 as Virginia’s Dream, a P2P lending platform promising convenience and ease in a cab-hailing environment characterized by over-worked drivers and cutthroat hassles has been increasingly dominated by two companies backed by Tencent and Alibaba. Combined, Didi and Kuaidi account for almost 97 percent of the market and have seized nearly 100 percent of the charging infrastructure at present consign these vehicles to taxi-calling apps, but more to do with the increase in users and usage of mobile wallets to pay for real things. Both AliPay and Ten-Cent are locked in a battle, not only between themselves but also with traditional providers, to determine the future of how people will pay for real world goods and services. According to Leesa Shrader, of the Consultative Group to Assist the Poor, a global partnership of financial institutions that seek to advance financial inclusion, “Both AliPay and WeChat are working to make financial services become lifestyle services, finding ways to be part of the user’s financial routine, like paying for a friend’s dinner, ordering taxis, paying in convenience stores and topping up transportation cards.”

America’s WeChat

Clearly, the Chinese Internet is a vibrant, competitive, and cutthroat collective second to none. The most amazing feature, however, is how often outside observers assume that the online world must mirror the state-owned enterprise-dominated real world. Indeed, Duncan Clark, chairman of BDA, an investment consultancy specializing in Chinese and other Asian markets, says that the biggest misconception of the Chinese Internet is “that the Internet is not competitive here, run by companies anointed by the State. The reality is far more competitive.”

It’s not just the potential returns that attracted so many users to Yu'E Bao, but as Frank Yu, founder of marketing agency Amaetat, says that the most amazing feature, however, is how often outside observers assume that the online world must mirror the state-owned enterprise-dominated real world. Indeed, Duncan Clark, chairman of BDA, an investment consultancy specializing in Chinese and other Asian markets, says that the biggest misconception of the Chinese Internet is “that the Internet is not competitive here, run by companies anointed by the State. The reality is far more competitive.”

What began in 2012 as Virginia’s Dream, a P2P lending platform promising convenience and ease in a cab-hailing environment characterized by over-worked drivers and cutthroat hassles has been increasingly dominated by two companies backed by Tencent and Alibaba. Combined, Didi and Kuaidi account for almost 97 percent of the CNG (Online to Offline) cab hailing market.

Every person interviewed for this article echoed these sentiments. What quickly emerges from their comments is that, while alien on their US counterparts, these services can be understood easily as long as we take it for what it is. From the first connection to the Internet in 1994, the Chinese Internet has taken the learned wisdom of SodaStream and turned it on its head. It is time we start giving the entrepreneurs credit for navigating what Mr. Yu calls “a wild and woolly frontier.”

Sooner or later, we’ll no longer talk in terms of “China’s clone of a US tech success, but rather the other way around.

China’s domestic auto makers are struggling to find their niche even though vehicle sales are still on the rise. Car ownership in China is constantly rising and as more people become wealthier in the country’s so-called second and third-tier cities, sales figures will continue to increase and China will continue to consolidate its status as the world’s largest auto market. And while electric vehicles present Chinese auto makers with a clear opportunity to lead the way, globally speaking, the high pricing and low demand alongside the state of the country’s charging infrastructure at present consign these vehicles to little more than a footnote in the ongoing conversation about today’s auto market in China (See page 28). Instead, any discussion about the Chinese auto market tends to focus solely upon traditional gasoline powered cars, which in China are doing a roaring trade.

Last year, according to figures released by the China Association of Automobile Manufacturers (CAAM), sales surged by 13.9 percent to 21.98 million vehicles; of which 17.93 million units were passenger vehicles, 4.05 million units were commercial vehicles. The total sales of passenger vehicles was 17.93 million units, and 4.05 million were commercial vehicles. The total sales of passenger vehicles was 17.93 million units, and 4.05 million were commercial vehicles. And yet, as Xing says, “If you look at the American and European auto industries, one of the things that caused the downfall was the overcapacity and the extra costs that the companies incurred because of that. In China, you have serious overcapacity particularly among the domestic manufacturer, where the utilization rate of the capacity is just slightly over 50 percent. So, it’s basically wasted cost to have that much capacity.”

According to Xing Lei, Chief Editor of China Auto Review, China has about 35 to 40 million units in capacity. If this year’s estimates of 24 million units in capacity for 2014, China will have sold roughly two thirds of its overall capacity by the end of the year. Xing notes that the industry requires a capacity utilization rate of 75 percent in order to be profitable; something that the country falls well short of. And yet, as Xing says, “If you look at specific companies, the foreign giants, GM, Ford, and Volkswagen; they don’t have enough capacity. They’re still adding plants.” The issue, therefore, looks doubly worrisome for domestic manufacturers, who are struggling to find their niche even though vehicle sales are still on the rise.

Lost in Familiar Territory
By Stuart Wiggins

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At the lower end of the market, the domestic manufacturers are more likely to lose market share than their foreign counterparts, who are less affected by the economic downturn. The domestic manufacturers have been under pressure from foreign brands that have been able to offer higher quality and safety features at lower prices. This has forced the domestic manufacturers to increase their investment in research and development to improve their products. However, the process of making strategic choices with a foreign acquisition is anything but smooth, especially when both sides are approaching the market with different goals. However, people at Volvo have hit back saying they have developed a Chinese version of the S40 that will be launched in the Chinese market soon. The move is expected to help Volvo in its efforts to increase its market share in China.

Ultimately, the underlining factor is that Chinese car brands are failing to convince consumers that they are selling trustworthy products. This is not only because of the pitfalls that exist when purchasing a car, but also because people aspire to owning their first car, foreign automakers are making a concerted effort to try to enter the lower end of the market, which will squeeze domestic manufacturers even more.

Domestic brands face a number of hurdles when it comes to keeping up with their foreign counterparts. Economies of scale are obvious reasons to cite when explaining why foreign brands operate at an advantage within China, but local brands are now facing a new problem. Traditionally, domestic manufacturers operate at the lower end of the market and their attempts to upscale have not produced the desired results. But as China becomes richer, and more and more people aspire to owning their first ever car, foreign automakers are making a concerted effort to try to enter the lower end of the market, which will squeeze domestic manufacturers even more.

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It is something of a mystery as to why Chinese manufacturers still lag behind their foreign counterparts in terms of design and technology, especially when you take into account that foreign manufacturers are only able to operate in the Chinese auto industry as part of a Joint Venture alongside domestic companies. Furthermore, one might expect that domestic manufacturers would have a better grasp on what the Chinese market actually wants. These facts are not lost on Oded Shenkar, Ford Motor Company Chair in Global Business Management and Professor of Management and Human Resources at Ohio State University, who believes that domestic manufacturers have not taken advantage of the opportunities afforded to them and as a result will require state assistance in order to make up the gap between themselves as foreign brands.

“China is literally the only place in the world where it is possible for local manufacturers to actually team up with not only one but multiple foreign makers, which creates tremendous learning opportunities. And yet, I would say the learning has been somewhat limited. Keep in mind that the local producers did know the market better, but the foreign makers have been (in China) now for many years, a quarter of a century,” explains Shenkar. This is a sentiment echoed by Steven White, Associate Professor at the School of Economics and Management, Tsinghua University. White notes the “fantastic disaster” of the Shanghai Auto Company’s acquisition of SsangYong in Korea as an example of how fraught buying innovation can be. “A 500 million dollar investment ended up being a billion dollar write-off. The fundamental problem was that they were not able to learn anything.”

Geely’s move was daring, not only because of the pitfalls that exist when purchasing a car, but also because people aspire to owning their first car, foreign automakers are making a concerted effort to try to enter the lower end of the market, which will squeeze domestic manufacturers even more.

And as Towson continues, Volvo needs China to be a niche for quality and safety, not luxury. “Volvo is losing sales on almost all of its cars. They’ve got one or two brands that are going (well), Europe is not going well for them. In the US they’re having problems. China is an opportunity, so they need China.”

Ultimately, China’s car brands are weak; not only in foreign markets but also within China. Trying to upscale is proving difficult and acquisitions are not guaranteed to help as there is always a question of how much learning and transfer will take place. Nonetheless, consumers will continue to select foreign vehicles and if foreign brands can crack the lower end of the market, domestic auto makers will feel even more lost despite the fact that they are surrounded by familiar territory.
China's endeavor to hit its ambitious energy-saving and emission reduction targets requires efforts to be made across all industrial sectors, not least the auto industry. Enshrined in the country's 12th "Five Year Plan", the development of new energy cars has raised hopes that indigenous new models, powered purely by electricity or hybrid engines, will make China's roads less polluted, while allowing consumers to save more at the pump.

A number of China's indigenous new energy cars debuted at the 2014 Beijing International Auto Show, including the Roewe 550 Plug-in by Shanghai's SAIC, and the E6 by BYD. But new energy cars in China still face a bumpy road ahead despite a series of preferential policies being put in place by the government. Inadequate battery capacity is still a huge obstacle when it comes to electric cars making long distance journeys in China. Likewise, there is still a lack of charging stations in the country's big cities, let alone medium and small-sized cities.

In terms of overall market prospects for new energy cars in China, the total sales volume so far is still very small, standing at less than 18,000 units including fully electric (EV) and plug-in hybrid vehicles. The market for such cars is likewise very small, especially when you factor in the surprisingly high cost of the car despite the addition of price subsidies. Another major problem is the fact that China needs to build a charging infrastructure in order for these cars to be viable. This is not the case in many western countries. In the US, for example, many consumers own or rent independent houses which have access to a garage. Therefore, the US and other countries in Europe do not have an infrastructure issue because people can charge their cars in their own homes. It is this reason that helps to explain why hybrid cars enjoy strong momentum in the US, as they do not require a strong charging infrastructure.

Yale Zhang, managing director of Auto Foresight [Shanghai] Co. Ltd, a market and industry research firm points out that in China, full hybrid vehicles do not qualify for government subsidy, meaning that the EV and plug-in EV cars that do qualify require a very strong infrastructure in order to be of use. Furthermore, Yale also highlights a further problem for the growth of the electric auto industry in China, namely that people want their vehicles to be able to travel long distances. "The majority of Chinese consumers are still first car buyers, buying the first car ever in their family. They still need to have a traditional petrol engine car so that they can drive long range. If their first car is an EV, they limit their driving range to 100-400 km and that is something the average consumer cannot accept."

Technology bottlenecks are the number one issue when it comes to selling electric cars. The lack of a breakthrough with regards to battery technology has really prevented EV and plug-in EV from really making a considerable dent in the auto market. Even when using one of the larger batteries, such as the BYD 6 battery, which weighs 2.3 tons, there are still a lot of limitations. For example, using the air conditioning cuts a car’s driving range by a third while using the heating cuts the range by up to a half. In China, where the summer and winter seasons are often very extreme in terms of temperatures, these problems become even more defined. As a result, electric cars in China are little more than an interesting footnote within an industry that highly relies on the sale of petrol-powered vehicles.

While many people talk about an insufficient charging infrastructure, the truth is that infrastructure is not that big an issue. Installing such infrastructure does not require a huge amount of investment and Yale Zhang notes that a lot of companies and venture capitalists are willing to enter this area and invest. Many industry insiders believe that if the government truly devotes itself to the infrastructure issue, it could be overcome with ease. However, as long as the cars themselves are not meeting the expectations of consumers, in terms of efficiency and use, then no amount of charging stations will help to convince people to part with their cash for an electric vehicle instead of a petrol one.

Oded Shenkar, Ford Motor Company Chair in Global Business Management and Professor of Management and Human Resources at Ohio State University, believes that the government would be keen to see growth in the electric car market for two reasons. Firstly, it would help to address the pollution problem within major cities, and secondly, according to Shenkar, “there is the belief that if this is going to be the technology of the future, maybe here lies the opportunity for Chinese car makers to become significant players.”

But are EV models really so green that they could help to address the country’s pollution problems? Certainly, within major cities like Beijing, the use of electric vehicles would help to reduce smog considerably. However, 90 percent of China's electricity is produced using coal, meaning that a shift from gasoline fuel to electric vehicles will not reduce the amount of carbon emissions at all. Yale Zhang even suggests that such a shift would lead to a slight increase for carbon emissions within China. Ultimately, electric vehicles shift pollution from the city to the suburbs; to wherever the coal burning plants are situated. And while that may be preferable for those living in the cities, it doesn’t really address the country's worsening pollution problem.

Electric Vehicles in Beijing: An Infrastructure Dilemma
By Zhang Peng

Over the past few years, Beijing’s city government has tried to promote the widespread use of alternative-energy vehicles, or what they call ‘green’ cars, through a variety of favorable policies. However, in a recent green-car lottery, only 1,428 bids were submitted by individuals wanting to drive one of these more environmentally sound vehicles; falling short of the 1.666-car quota set by the city. Clearly, alternative-energy vehicles are yet to catch on in China’s major cities.

Besides the lofty price-tag for electric cars, one of the oft-mentioned obstacles to their widespread usage is a shortage of charging stations even in the major cities. China’s capital, Beijing has so far built 65 electric vehicle charging stations, with a total of 1,274 charging posts. These facilities are able to provide charging services for around 3,500 green cars at the same time.

However, the pace of development for these charging stations is moving at a snail’s pace. Furthermore, the majority of existing charging stations in Beijing are only available for public transport vehicles, including electric sanitation trucks, electric buses and electric taxicabs. Charging stations for privately owned green cars are difficult, if not impossible, to locate.

To compound this situation, almost all the existing charging stations in Beijing are distributed under various bridges; making them even harder to find. But the most telling sign of how well electric vehicles are doing in China is the fact that a number of Beijing’s existing charging stations are not being used properly, with some even lying idle.

Located at the bottom of Lianfang Bridge in the Shijingshan District of Beijing, the Lianfang Charging Station is mainly used for charging electric sanitation vehicles. However, upon my visiting the station, it was clear that the entrance was firmly shut and none of the charging posts were being used. Dozens of sanitation trucks parked at the station were covered with a thick layer of dust in an appar
ent sign that the vehicles have not been used for days, if not weeks. Completed in June 2012, the Lianfang Charging station is designed to provide charging services for 2-ton sanitation vehicles. With 10 charging posts installed, the station is able to charge as many as 20 sanitation vehicles simultaneously.

A similar situation is also apparent at the charging station under Huixinxi Bridge in Beijing’s Chaoyang district. Once again, when this reporter visited the station, there were almost no staff members working and only one security guard looking over the facilities. The security guard on duty stated that the station has been up and running for several years, but the facilities are not frequently utilized. Few sanitation vehicles occasionally visit the Huixinxi charging station for charging purposes. However, according to the security guard, the charging station is still not open to privately owned green cars. While many state that the current charging infrastructure in place within the capital is not sufficient enough to meet the needs of electric car owners, it is clearly also the case that not all existing charging stations are being utilized to full effect.

The same cannot be said for those stations intended for electric buses. The Qijiahuozi EV Charging Station, located in Chaoyang district, mainly provides charging services for electric city buses. The 10 charging posts at the station are able to provide charging services to 20 electric buses at the same time and it only takes three hours for a bus to be fully charged. The station cars simultaneously. Duan’s comments clearly highlight the frequency of the facilities in different charging stations varies, and the prerequisite for the existing stations to open up to private owners is a unified standard of facilities. Duan’s comments clearly highlight a problem with how the city is approaching electric vehicles. No matter how many favorable policies the government issues, and how many subsidies it provides, the scattered development of the city’s charging facilities will remain a significant issue which will need to be resolved if left unchecked.

Firstly, there aren’t enough charging stations within the capital, which will obviously hinder the usage of electric vehicles. Secondly, aside from building more charging stations, the overall layout and location of these stations needs to be considered by the government. The location of the stations should be more accessible and the facilities need to be addressed by the government and the industry as a whole. Establishing as many charging stations as possible is not a wise or useful choice. Instead, authorities should promote the efficient use of those stations that they do decide to build.

It has been reported that the Beijing municipal government intends to establish 100 large-scale direct current charging stations for private drivers, which will include a total of 1,000 charging posts. Facilities on this scale would certainly help to alleviate pressure should more people buy electric vehicles. Several existing charging stations in Beijing are gradually opening up to private drivers. The State Grid Corporation now allows private drivers to purchase a card, which allows electric vehicle owners to charge their cars at designated charging stations by simply swiping said card. Although, it is taking a long time for electric vehicles to capture the imagination of the public, and though there are still many major problems related to the charging facilities and the hardware within the cars, it does appear that Beijing is taking some solid measures to help propel the development of its existing charging stations, but many are still asking whether they are enough.
Luxury in China: Time to Rethink

By Bejan Siavoshy

With an economy that boomed for over a decade, a manufacturing sector that produced the largest number of exports in the world, and average income levels tripling in just over eight years, by 2009, one thing was certain; China didn’t just have money—it had money to burn. And with an influx of disposable income comes a wider-reaching taste for the finer things in life.

In the face of a global economic downturn, China had a sector of its economy that was thriving, where other countries saw a free-fall; that was in its luxury market, which grew 16 percent, amounting to 64 billion yuan, in 2009, according to figures from McKinsey. While that number is down from the 20 percent in growth that China’s luxury market saw in the previous year, it far exceeded that of other countries during the same time period. Likewise, by 2010, China overtook the U.S. to become the second-largest consumer of luxury items in the world, just under Japan, which it is poised to overtake by 2015 if growth remains steady, according to a report released in December of 2013 on China’s luxury market by management consulting firm, Bain and Co.

But the operative word is still “if.” While big brands of all types, from Mercedes to Haagen-Dazs, enjoyed the gold rush that China provided for luxury goods producers in the past few years, 2013 saw China’s shimmering luxury market start to dull. The 2013 China Luxury Goods Market Study showed that the country’s luxury market crawled to a growth-rate of just two percent, down from seven the previous year, causing many who were betting big on China’s luxury sector to rethink their strategies.

A China Daily piece from Feb. 2014 showed that Gregory J. Furman, founder and chairman of the Luxury Marketing Council, said luxury retailers won’t look to pull out of the Chinese mainland, but brands are going to most likely avoid investing as aggressively in the country’s retail sector as before. This coincides with many luxury brands that announced plans to carve out a piece of the domestic Chinese market by opening retail stores to scale back or outright abandon those measures. A Bain and Co. report entitled, “China Entering New Era of Luxury Cool-down,” revealed that just 100 stores among the 20 brands in the report opened stores on the mainland in 2013, down one-third from 150 the previous year.

The slowdown, which the Bain report said would continue into 2014, could be attributed to a number of things. The first is Chinese leader Xi Jinping’s government “frugality” campaign that was launched in an effort to curb graft and overt public spending. Being that luxury items, from top-shelf liquors to high-priced watches, were often given as “gifts” to authority figures in China, the Hurun report’s Chinese Luxury Consumer Survey 2014 shows that gift-giving expenditures dropped by 25 percent last year.

The Bain report stated that men’s watches—a popular item to gift among officials—accounted for about one-fifth of China’s luxury market. Amid the government’s frugality campaign, high-end watch sales for men declined 11 percent in 2013. Likewise, menswear was a growth-point in the domestic luxury market, but became a slightly declining part of the market in 2013. Additionally, women’s cosmetic, beauty and perfume products took a similar hit, with Bain’s report showing that sales in these products fell to 10 percent in 2013, down from 15 percent a year prior.

Another factor driving down the consumption in luxury items is the amount of Chinese looking to shop abroad. Luxury news outlet Jing Daily said that the better services luxury retailers provide abroad, cheaper prices, the differentiation in products offered overseas versus domestically, and the easier avoidance of counterfeit products are all key factors driving China’s big spenders to purchase luxury items outside the country. The Bain report shows that over two-thirds of luxury consumption by mainland Chinese was done overseas.

Additionally, it is China’s higher-income population that is footing the bill for most of its luxury consumption—and over 84 percent of that population has either emigrated or is looking to emigrate elsewhere, according to the Hurun report. With an increase in money, people tend to covet an upgrade in quality-of-life experiences; China’s luxury consumers are no different. Another factor that has bitten into the country’s luxury market growth last year is that more Chinese are opting for high-end vacations, spa sessions and activities over purchasing just another big-ticket item.

However, many experts say that the appeal of China’s luxury market is far from gone; it is just no longer easy to enter. With luxury brands flooding in amid the luxury sector’s domestic growth, competition has become fierce. In a Forbes piece in January 2014, Roy Graff, an expert on Chinese luxury travel and hospitality and founder of China Edge, said that the flood of entrants into the Chinese luxury market has impacted growth for established brands.

And with the competition has also come a shift in the tastes of Chinese luxury consumers. While the
country’s luxury market has been characterized by a taste for gaudier high-end products in the past, China’s new luxury consumers shun logo-laden designs and instead covet higher quality, subtle products that are bigger on a lauded heritage and craftsmanship than on showiness. This change in taste has led to brands like Hermes and Chanel overtaking their long-standing rivals, Louis Vuitton and Gucci, according to a New York Times piece from March of this year.

While China’s traveling luxury consumers are causing key shopping destinations to clamor for their attention, the country’s luxury market has been characterized by a taste for gaudier high-end products in the past, China’s new luxury consumers shun logo-laden designs and instead covet higher quality, subtle products that are bigger on a lauded heritage and craftsmanship than on showiness. This change in taste has led to brands like Hermes and Chanel overtaking their long-standing rivals, Louis Vuitton and Gucci, according to a New York Times piece from March of this year.

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go against the cardinal rule of holding a cut-price sale, Gu strongly believes that fashion houses should not give in to short-term pressures and should instead find more subtle methods for clearing leftover inventory. “Big discounts or obvious discounts will be really bad for the brand. It may lead to short-term sales increases but in the long term that’s bad for the brand. So what we see is a discrete kind of discounting. They could either sell their unused inventory to some discounted branch, like a VIP shop for example, or they could select their VIP customers and have a sale a bit early. But the last thing they want to do is put up a big ‘For Sale’ sign in their stores, because that would cause them to lose their prestige.”

As China’s fashion industry matures, and as consumers mature too, designer brands are rethinking their sales strategies. “We definitely see a trend of consolidating stores. In the past, it was all about a rush to open new stores. A - it’s too much of an investment, and B - there’s a problem of being too ubiquitous,” notes Gu. “The whole point of luxury is to create a point of desire. They need people to travel to certain places to buy them. If people see that (another store) is just opening across the street, it kind of loses its prestige. As China becomes a more mature market, luxury brands are thinking, how do we drive more sales out of existing stores? How do we consolidate our sales?”

As for those luxury brands attempting to break into the Chinese market for the first time, the task of marketing and customizing products is not straightforward. Customization is something of a balancing act as Gu Wei explains. “You don’t want to create a line just for the Chinese market. It’s just for Chinese, Chinese people may actually not want it. The whole point of buying western luxury is to be aspirational and fit into this global lifestyle.”

Here, Gu highlights another subtle change among Chinese consumers. Initially, Chinese people wanted to show off their new wealth. Of late, buying luxury fashion items is seen as more of an aspirational purchase, allowing individuals to stand out. “Chinese consumers are quite fickle and they’re changing at a speed faster than anywhere else in the world,” according to Gu. For this reason, she emphasizes that it is incredibly important for brands to learn why Chinese people want to buy luxury items, adding that in Japan, people buy luxury goods in order to fit in. However, in China, the market is subtly different as people are willing to go against the grain.

As for marketing, Gu believes that brand strategies depend on how sophisticated consumers are. As she explains, Chinese consumers are becoming more sophisticated over time. Gu identifies three clear stages that consumers identify with when looking to purchase luxury fashion items. “At first, they can’t really tell what is better; they rely on marketing, and they rely on big names to tell them that this stands for quality. But over time, they learn to tell for themselves. Right now (China is) at stage two. Stage one being: people carrying luxury items with big logos to tell themselves and others that they are rich enough to afford them and that they like quality. At stage two, you don’t see people carrying logos anymore, but it’s pretty obvious which brand they’re going for.”

Judging by the rapid progress of the fashion industry and the increased maturity among Chinese consumers, it won’t be long before China’s fashion buyers reach stage three; the point at which you can’t tell where an item comes from or which brand it is just by looking at it, or what Gu likes to refer to as “the understated, real luxury.”
New data shows more Chinese cities are reporting month-on-month drops in new home prices. The National Bureau of Statistics says that among 70 major Chinese cities, 8 recorded declines in April; double the number recorded in March. Price gains were recorded in 44 cities, down from 56 the month before. For existing homes, prices increased in 35 cities month-on-month in April, down from 42 cities in March.

Mike Bastin, visiting professor at China’s University of Economics and Business discusses China’s small-scale property bust with CRI.

Overall the current trend in the real estate market is a reflection in the cooling of the Chinese economy generally. I don’t think there’s any time for panic here. It’s also telling us that these are very, very different market segments that we’re now seeing. Certainly, first-tier property prices and second- and third-tier property prices are reflecting very different segments.

I don’t believe a bubble is really bursting nationwide. Certainly, in certain second- and third-tier cities and those areas, there has been a construction boom, prices are unsustainable and the economy cannot support those prices. So certainly, we’ll see quite massive reductions and a massive decrease in investment in those areas. In first-tier cities, it is likely that prices will cool but remain robust.

It’s useful to remember that the typical Chinese homeowner, even with second and third homes, is relatively under-mortgaged. They haven’t incurred heavy borrowings like a typical western homeowner, so they’re not under pressure, necessarily, to sell even at a loss to avert any loss in terms of mortgage repayments. Chinese homeowners have bought with a long-term interest and rental income in mind anyway; I don’t think they’re trying to make a quick kill in the short term, even if that was the case on paper.

Related sectors, supporting industries, cement, steel, furniture, will be affected. Together with the property market, they comprise around 20 percent of the Chinese economy. So there will be a detrimental impact on the overall economy most definitely, and in second- and third-tier cities that will be most marked. So, this will contribute to a further cooling of the national economy, but again I don’t think it’s time to panic.

Local governments will start to relax the curbs on property purchases (and) down payments, and they’ll try to (provide incentives). I don’t believe that will have much impact, to be honest; with an excess in terms of supply in these areas, there’s nothing much you can do about that. The national government will be quite relaxed about this, as long as this is a further cooling and no more; which I believe it is.

(Mike Bastin shared his thoughts with the Beijing Hour radio show and CRIENGLISH.com)