

CHINESE BILLIONAIRES OUTNUMBER AMERICAN ONES

I was sitting on a leather couch in an opulent meeting room in Shanghai's five-star Okura Garden Hotel in the former French Concession in 2010. Above my head dangled a chandelier of such scale that it would fit in at Versailles. I imagined former supreme leader Mao Zedong sitting in the room, as he did decades earlier when the hotel was his stomping ground on visits to Shanghai.

A man who appeared to be in his early forties was standing in front of me and doing tai chi. He was thin, had a fully shaven head, and wore a simple white oxford shirt unbuttoned at the collar. He had a serene aura about him that commanded the respect

of everyone else in a room that included some of the most successful businessmen in China; he seemed to be the king among kings. He smiled at me, asked me to sit, and gently requested that someone pour me some tea as he continued his routine.

Looking around, I knew that most of the others joining us were worth tens if not hundreds of millions of dollars. A few might have crossed the billion-dollar mark. All were entrepreneurs who had built up brands every Chinese person knows. There was Chen He Lin, the slight and gregarious founder of ASD, a kitchenware company known by Chinese housewives for durable, safe, and affordable crockery. He had looked at me curiously, perhaps because I was the youngest and the only foreigner in the room or perhaps because I was the only face he didn't recognize. After looking me up and down, he, too, grinned at me and handed me his business card.

Sitting to my right was a tall, bald man chain-smoking furiously. He stuck out because he was dressed in an all-white athletic suit while everyone else was wearing dress clothes. Like the king of the room, he, too, had a shaved head, although unlike his friend he did not offer me his card. He pretty much ignored me when I asked him a question about his business. He told me his name was Shi Yuzhu. He was famous for losing his entire fortune before building it back up again when he took his online game company, Giant Interactive, public on the New York Stock Exchange. Shi Yuzhu became infamous among Western investors several months later for ultranationalism when he publicly sided with Alibaba's founder, Jack Ma, in his public dispute with Yahoo! over the ownership of the online payment service Alipay by calling Ma on his Sina microblog a "patriotic hooligan."

On Shi Yuzhu's right sat Zhou Xin, a towering man with short, cropped hair who reminded me of Yogi Bear. He was the cofounder of E-House, an online and offline real estate

brokerage firm that was also publicly traded on the New York Stock Exchange. He beamed at me with a mix of pride and humility when I told him that consumers my firm had interviewed had responded they were very happy with his company's products and services.

While the rest of us listened, the man doing tai chi started to talk about the business environment and the economic problems facing the country as a result of the financial crisis in America and Europe. The man's name was Guo Guangchang, the founder of the Fosun Group. The *Hurun Report*, which tracks the net worth of the Chinese rich, estimates Guo's wealth at nearly \$5 billion.

As I listened to Guo and the others discuss the business climate, I looked around the room at their faces. All seemed to have the intensity of Olympic athletes about to compete. Optimism and confidence, born from being raised with nothing but making it big through their own sweat and grit, seemed to ooze from their pores. They knew they could overcome any challenges with enough hard work and patience.

To my left a number of the executives gathered to talk about joining forces to lobby the government more. They were worried about a credit crunch hitting small and medium enterprises, and they wanted to band together to present their case to the government to remedy the situation. Concerns about underground banks, loan sharks, really, calling in loans was starting to become a topic of conversation.

As I listened to the discussion, it was clear these were some of the savviest businessmen not just in China but in the world. I have advised chief executives of Fortune 500 firms and trail-blazing entrepreneurs whose innovations change the world, but these Chinese entrepreneurs were as impressive as any executive or thinker I had ever met and perhaps even more so, considering

the filthy poverty and chaos they had grown up in just a few decades before.

Despite intellectual property problems, uneven government regulation, corruption, poorly trained labor forces, and difficulty raising capital, these battle-hardened executives had all taken risks and built up groundbreaking organizations in the past 10 years. It was also clear that these entrepreneurs were building up strong Chinese brands. None of them was simply copying Western business models or stealing intellectual property as many Westerners think all Chinese do—they were creating new ones.

Not only were these businessmen building brands in China, but many of them were also growing abroad organically and competing on foreign turf. Some had even begun buying up iconic foreign brands. Guo's Fosun Group had started scooping up stakes in foreign firms. He had acquired 7.1 percent of Club Med, the French resort company known for opening all-inclusive resorts in exotic locales, to cater to more of the 50 million Chinese tourists who travel abroad every year. Guo had also bought the rights to *Forbes* magazine in China and had signed several major deals with foreign investment firms. His company had set up a \$600 million joint investment fund with Prudential Financial to invest in foreign and Chinese firms that have significant growth potential in China. He had also launched a cobranded fund in renminbi (China's currency) with the politically well-connected Carlyle Group, the private equity firm that once had former President George H. W. Bush and British Prime Minister John Major on its payroll, for investment in China.

As I looked at these executives, it became clear that too many Western observers of China foolishly discount the management and branding abilities of Chinese companies, much as many American companies discounted Japanese firms such as Toyota and Sony in the late 1970s. Aggressive, confident, and

capital-rich Japanese firms quickly took advantage of bloated American firms such as General Motors and forced American companies to reassess their business models. Japanese firms went from making cheap, tacky products to defining quality in some industries. Chinese firms might similarly disrupt entire industries if American companies are not forward thinking enough to react to evolving Chinese companies and stay ahead in innovation before the business threat materializes.

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When you walk along the aisles of your local Walmart or Best Buy, most products are marked with a “Made in China” label. Trying to keep costs down, many multinational companies established direct-owned manufacturing operations in China or began sourcing from Chinese-owned factories through intermediary firms such as Li & Fung. Even in your own home, you would be hard-pressed not to find at least some products in each room touting this sticker.

You would also probably be hard-pressed to name any Chinese brands, despite China being the factory of the world for the past two decades and having the world’s second-largest economy. Unless you had observed the rise of Chinese brands in the past decade, the absence of these brands in Walmart might lead you to agree with the many Western analysts who think that Chinese companies simply do not have the ability to build brands.

Atlantic Monthly journalist James Fallows is one of those observers. He calls the 44 percent of Americans who think China is the world’s leading economic power, according to a 2009 Pew Center poll, “crazy” because he does not think Americans can “name even 10 [brands] from China.” Fallows, disparaging the research ability of Chinese scientists, continues: “Name the most recent winner of a Nobel Prize in science from

a Chinese university or research institution.” That was a trick question because there have not been any winners.

Fallows believes Chinese companies cannot create their own brand and that its leading minds in the sciences do not have the innovation and creativity to win a Nobel Prize in the sciences. He seems to agree with the conventional wisdom of Western analysts that Chinese are better at copying what worked in America, building a clone of it, or simply ripping off intellectual property to make money. After all, many of China’s publicly traded companies, such as search engine Baidu or e-commerce auction site Taobao, seem to be rip-offs of Google and eBay. Are analysts like Fallows right, or are there deeper explanations why Americans cannot name many Chinese brands?

At first glance, Fallows is right. Few Americans would be able to name more than 10 Chinese brands. The ones Americans might know, such as information and communications technology provider Huawei, tend to be more focused on selling products and services that are good enough but cheap to businesses. They tend to focus more on business-to-business clients, rather than on more fickle and brand-conscious end consumers. Or Americans might know brands like Huawei not because of their quality but because of fears they are fronts for the Chinese military and pose security risks, which make them a frequent target in the Western media and of members of Congress on the campaign trail. However, everyday Americans’ lack of knowledge about Chinese brands does not really mean that Chinese companies cannot brand and build global champions. A deeper glance, and a basic understanding of recent Chinese history, will show that underestimating Chinese businesspeople as Fallows does would be foolish.

Not having a Nobel Prize winner in science does not mean Chinese scientists cannot conduct leading research. Such awards are usually conferred for work done decades earlier. Japanese

scientists Ei-ichi Negishi and Akira Suzuki won the 2010 chemistry Nobel Prize for research conducted in the 1960s and 1970s—the same period when the Cultural Revolution was ravaging China, as we will explore in Chapter 3.

If Chinese scientists have not won a Nobel Prize by 2050, one could then argue Chinese researchers in a Chinese institution cannot do groundbreaking research—but I bet one will. After all, when I was a student at Harvard's Graduate School of Arts and Sciences at the turn of the millennium, more mainland Chinese were enrolled there than from any other country except America, and many of my classmates have been lured by government initiatives to recruit mainland scholars to return to Chinese universities rather than stay in America.

Fallows is also correct that few Americans know Chinese brands, but once again he is wrong about the reasons. He would be correct if it were still the 1990s, when Chinese management teams were weak and focused on the short term, but surprisingly, Fallows seems to have missed China's business evolution in the past decade.

Today's Chinese brands are quickly moving up the value chain to compete on branding and innovation rather than just on price. They have had to figure out earlier than foreign competitors how to deal with the end of cheap China. Rising labor and real estate costs and demanding consumers are forcing them to think more long term about building sustainable brands and changing manufacturing operations to command the fatter margins they need to stay alive.

Those entrepreneurs sitting with me at the Okura Garden Hotel are all developing strong brands—in fact, it is directly because of branding efforts that they have been able to beat local competitors over the past decade to emerge as domestic powers. They defeated state-owned enterprises, with their easy access to

credit and political patronage, because they offered the market what it demanded and stayed ahead of trends. None had made their riches by being the stereotypical cheap Chinese original equipment manufacturer, squeezing razor-thin profits. They had created brands that had earned Chinese consumers' trust, and they had become rich in the process.

A decade ago, most Chinese brands competed on price, but not because Chinese inherently lack creativity or the government stifles creativity and innovation. Executives' focus on planning was more short term for several reasons.

First, incomes were still low. The dramatic, sustained rise in incomes and purchasing power that China has seen was only beginning, so it did not make sense to compete on anything but price. In the 1990s, China was steeped in real poverty. The average per capita gross domestic product (GDP) was less than \$1,000 a year, and the majority of the country earned less than \$300 a year, below the World Bank's definition of extreme poverty. Meat was often a luxury, and eating at a restaurant like McDonald's or KFC was reserved for special occasions. Hot showers were rare—most people still stood outside in full view of neighbors and passersby and used a bucket of water to wash themselves or went to company shower facilities on weekends. The lack of running water explains why even today getting your hair washed at a salon is an essential part of the hair-cutting process; in those days, a visit to a salon for a warm hair wash was a real treat.

Competing on anything other than price in that climate would have been foolish. Global brands took this strategy, launching global brands in China and investing for the long term. One Kodak executive told me in the 1990s they were investing not for short-term profits but to "make a lot of money 20 years from now." Fewer than 10 percent of Western brands selling into the Chinese market in the 1990s actually made

money there, in part because no one could afford their products. Another reason was that Western brand positioning often did not fit the aspirations and needs of everyday Chinese people. It is hard to relate to Ralph Lauren, with its preppy lifestyle image of summering in the Hamptons, when you dream of indoor plumbing and eating meat for dinner.

The lack of profits and price sensitivity on consumers' part changed in less than a decade. In its 2010–2011 report, the U.S. Chamber of Commerce in Shanghai found that 79 percent of American companies now make money in China and 87 percent reported revenue growth in 2010, up from 47 percent in 2009. A thriving middle class, with the desire and the money to sustain brands that focus on more than just price, is fueling these profits.

Brand managers must cater to the demands and sophistication of the market into which they are selling, and in the China of the 1990s, levels of sophistication were pretty low. Few consumers had the money to buy real brands. It was natural that most Chinese companies and executive teams focused on maintaining low operating costs and sales channels to compete on price when consumers could not afford to care about branding and when labor and real estate costs were low enough to follow that strategy. Likewise, it is a natural progression that they are now evolving along with rising consumer sophistication to focus on building strong brands.

A second reason brands did not emerge earlier is the importance of connections during the disruptive shift in the late 1990s toward encouraging private enterprise. Executives used governmental and other business connections to grab quick profits. It did not make sense to spend money and time building a brand when it was so easy to make gobs of fast money through these connections.

Well-connected executives could lobby the government to erect a building, get a lucrative supply contract, or buy assets

that the government wanted to divest on the cheap. One son of a government official who became a real estate magnate and head of a large import-export firm told me that in the 1990s, local officials literally gave away land and sweetheart deals to well-connected people in an effort to bring business and investment dollars to undeveloped areas because everyone was so poor.

In such market conditions, why would smart executives try to establish brands? It takes decades, huge budgets, and patience to build brands that resonate with consumers. Sony and Toyota took decades to gain a true foothold in the imaginations of American consumers as anything but cheap alternatives to American brands such as General Electric and General Motors. Even Korean companies such as Samsung and LG Electronics still lack the same premium brand positioning as Japanese firms and are often seen as cheaper versions. Like Taiwanese brands such as phone maker HTC and computer maker Acer, they suffer from a perception of cheapness, even though their products rival the quality of any technology brand in the world.

Western businesspeople in China still love to tell one another about the quasimystical importance of *guanxi*, which many define as “connections,” when doing business with Chinese. But although good relationships are still important, as they are anywhere in the world, they do not have nearly the importance they once did and are not nearly as vital as creating sustainable businesses that fit consumer needs and aspirations. Women don’t buy lipstick because the owner of the brand is the son of some government official; they buy it because it makes them feel beautiful and vibrant. Nobody buys a shirt because a government official’s wife owns the company; they buy it because it fits their body type and aspirations.

Even in real estate, where connections are often paramount, the government is now making land-leasing processes more

transparent as a result of a renewed government focus on raising tax revenue and sustainable development. Domestic real estate developers such as ShiMao Group, Vanke, and SOHO China are grabbing market share because their branding and style attract Chinese home buyers; it's not because of connections. Many of the current political leaders' offspring are looking to Africa and other nations for investment because it is easier to leverage connections in those markets than back at home, where quick moneymaking schemes are harder to come by.

Branding has become critical for Chinese firms as the combination of product safety scandals and increasing wealth has forced consumers to become sophisticated, skeptical, and less trusting. Well-branded firms that build trust with consumers are the ones grabbing market share and charging premiums for their products and services. Domestic firms like medical device company Mindray, herbal beverage maker Wang Lao Ji, dairy products company Mengniu Dairy, travel services firm CTRIP, and sports apparel firms Li Ning and Anta have emerged in the past decade as serious competitors to Western brands in China and even slowly abroad. These domestic firms understand this brand-oriented shift toward value in consumer demand. Retail sales have been growing 16 to 18 percent a year for the past five years. Mindray's competitor, General Electric X-Ray, even relocated its business unit to Beijing from Waukesha, Wisconsin, in 2011 because it expects China to be the fastest global growth market for medical devices.

Numerous domestic companies have already established their brands within Chinese consumers' minds and are stepping into the global market. It would be shortsighted for Western brands to discount the abilities of domestic Chinese firms and their potential to compete globally, as observers such as Fallows do. To help lobby for its America-based initiatives and contracts, communications

technology provider Huawei hired Amerilink Wireless, whose board includes retired U.S. Admiral William Owens, a former vice chairman of the Joint Chiefs of Staff; former U.S. House Majority Leader Richard Gephardt; and former World Bank President James Wolfensohn. Sports apparel maker Li Ning has set up design facilities near Nike's headquarters in Beaverton, Oregon.

One inevitable trend in the coming decades—now that rising costs and the end of easy money are forcing Chinese companies to become long-term strategic thinkers and look for new revenue models—is that more Chinese companies will go abroad. Western consumers had better get used to seeing Chinese brands, not just the “Made in China” stickers, on the shelves of America's retailers. Likewise, Western brands will have to start fending off competition from new emerging Chinese brands that will disrupt the world's markets and the global pecking order, much as Japanese firms did in the 1980s.

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The consumer market has risen so fast in China that Chinese brands have focused for the most part on capturing the domestic market. During the financial crisis my firm interviewed 500 senior executives with 100 of China's largest companies across 10 sectors. Many executives told us they have not made much effort to become global players because the Chinese domestic market is growing so fast and the best opportunities are still at home, explaining in part why Americans have never heard of their brands. They also worry they do not have enough talent at the middle-management level to grow well abroad. They do not want to lose long-term viability by making the same mistakes as Western brands did when they first went into China, so they often move into markets like Africa, Southeast Asia, or Eastern Europe, where local competition is weak and stakes are

not as high if they misstep. A new focus on the Western world is emerging; as companies get more ambitious, they create a professional middle-management layer, and the central government supports the rise of national champions through low-interest loans and tax breaks.

Many companies have started to invest abroad for future growth, too, as Guo Guangchang's Fosun Group has done. More than 70 percent of executives told us that they would take advantage of the financial crisis to accelerate their international expansion plans into America and Western Europe by capitalizing on lower evaluations and cash-strapped competitors. They have been hiring leading advertising firms like Ogilvy & Mather and JWT to help shape their long-term positioning.

Branding is not an easy and short-term initiative. Chinese executives know this, so they often buy brands rather than build them. They have seen how long it took Sony, LG, and Samsung to become global players, and they do not want to wait so long. Instead of being second- or third-generation leaders, Chinese powerhouses still tend to be run by their founders, who made their success by conquering the impossible. Others run state-owned enterprises and are driven to make high-profile investments to help get promoted in the Communist Party ranks.

For example, under the stewardship of its founder, Li Shufu, auto manufacturer Geely bought the Swedish Volvo brand. Home appliance giant Haier bought the domestic and Southeast Asian operations of Japan's Sanyo. State-owned conglomerate Bright Food, China's second-largest food company, was rumored to have been in talks with Yoplait and nutritional supplement maker GNC before deals fell through, but it is still on the lookout for such megadeals. After buying Australian firm Manassen, Bright Food Chairman Wang Zongnan announced that he hopes 30 percent of its sales will come from overseas by 2016 and that

he is actively looking to acquire more European or Australian companies in the food-distribution and sugar industries.

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As I said good-bye to those leading entrepreneurs in the Okura Garden Hotel that night, it became obvious that the rise of Chinese firms will disrupt world markets in a way most never could have imagined just a decade ago and that the country was as far from Mao's vision of China as it could be. The end of cheap China means that Western executives need to be prepared to fend off increased competition from their aggressive, battle-hardened, well-capitalized counterparts. Western consumers will get used to choosing products at Best Buy or Target with prominent Chinese brand names, or brands owned by Chinese investors, instead of just those bearing "Made in China" stickers.

I was also left with some questions that I wanted to examine more closely. If these entrepreneurs had moved so quickly to build brands, what exactly had caused that change in such a short time? What changes in the labor force are forcing Chinese companies to go upstream? Was it because of soaring real estate prices, commodity markets, or something else? Visits to Chinese factories answered my questions.

CASE STUDIES

WHAT TO DO AND WHAT NOT TO DO IN CHINA

Do Not Underestimate Domestic Chinese Brands' Quality

Western executives often foolishly scoff that Chinese brands could never compete with Western ones on anything but price. "They do not have the branding ability or focus on quality like

the Japanese have,” one global executive told me. He is underestimating the competition—never a smart thing to do.

Not only has the day arrived when many Chinese firms offer products that are as good as Western goods, but many compete head to head on quality and innovation. The Chinese business landscape is littered with global number one brands that failed when they hit China’s shores. Critics complain that the government creates an uneven playing field by supporting domestic firms over foreign ones, but the reality is that search engine firm Google lost to Baidu because Baidu’s technology for Chinese-language search was far better. Internet auction site eBay lost to Taobao because Taobao adopted an escrow-like pay system called Alipay that limited fraud, whereas eBay used Paypal.

Among the Chinese product companies starting to compete against Western brands is telecom giant Huawei, poised to overtake Ericsson as the world’s largest network equipment maker. Huawei was recently chosen by Tele2 and Telenor over Ericsson in Sweden to install a 4G telecommunications system. Construction manufacturer LiuGong sells similar products to Caterpillar and Terex for 20 percent less. In interviews with dealers and end customers that my firm conducted, the majority said that for most projects, Chinese brands were more than good enough. China’s wealthiest person in 2011 was the founder of construction giant SANY, Liang Wengen, who is worth over more than \$9 billion by building up a trusted brand.

Chinese companies are often able to cut operating costs and set prices below those of foreign brands while still offering comparable quality. To combat rising Chinese brands, Western brands might need to launch secondary brands, acquire Chinese ones, or shape the market to ensure premium positioning.

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Key Action Item

Foreign brands should not discount the rise of Chinese brands. They are aggressive and well capitalized and are spending increasing amounts of money on research and development. They are recruiting armies of engineering graduates from top universities around the world to bolster research and development (R&D). To compete, foreign brands must continue to innovate to maintain a technological advantage, cut costs by tightening production processes, or launch or acquire secondary brands to compete directly.

Be Aware That Chinese Love Chinese Brands, Too

Overall, Chinese trust foreign brands more than domestic ones not to cut corners in the production process. This is especially true in the luxury sector, where foreign brands are viewed as having more refinement and appealing brand heritages.

Don't think Chinese brands will never beat foreign ones on anything but price, however. Given the choice, Chinese consumers tend to prefer local brands if they feel they are as good as the foreign competition. Buying Chinese brands appeals to rising nationalism, and Chinese believe domestic brands can better capture local flavors and scents.

Mengniu Dairy and Haier are examples of companies that even wealthy Chinese consumers will often choose over foreign brands like Danone and Siemens. Mengniu charges more for their high-end yogurt products than Danone and most other foreign brands to emphasize high-quality ingredients. They use flavors that cater specifically to Chinese. When I interviewed dairy-section heads of supermarket chains, the majority told me that wealthy consumers prefer high-end domestic brands over foreign brands made in China because they think a truly good Chinese brand will have better quality control than a foreign one.

Likewise, many wealthy Chinese prefer to buy Haier air conditioners and refrigerators, instead of German, Japanese, and Korean brands such as Siemens and Samsung, out of nationalism and the perception that premium Chinese brands are globally best in class.

Key Action Item

Western brands should not assume Chinese will always prefer foreign brands over domestic ones and that consumers always view foreign brands as more premium. Chinese will often prefer domestic brands, such as Haier's consumer appliances, over foreign ones if they feel they are world-class brands. When competing in select consumer-market product categories, as Danone Yogurt is doing versus Mengniu, foreign brands might need to position themselves as cheaper alternatives if a domestic Chinese brand is viewed as having a premium position.

Know That Chinese Are Often Shortsighted Because Rules Can Change Quickly

It is often difficult for Chinese businesses to plan long term—not because executives are shortsighted, but because rules and regulations change so quickly. For instance, many street-level Chinese stores are ramshackle and do not have nice fittings. The reason? Shop owners do not want to waste money because they fear real estate redevelopment will force them to move. Brands that create a comfortable ambiance move to high-priced malls or recently developed zones. Once urban planning gets more settled, Chinese brands will spend more on nicer shopping environments. In the meantime, smart ones save their money.

For instance, right now most Chinese buyers of luxury products like to do their shopping abroad. Recent initiatives to make Hainan Island a duty-free zone and to reduce tariffs

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on imported goods could change the luxury retail landscape overnight.

Key Action Item

Company executives need to keep abreast of potential new regulations that could severely affect their businesses. If they do not, they could suddenly find that they have invested in the wrong sectors and locations.

Know That Real Estate Is Intentionally Ramshackle

Many Westerners say Chinese real estate companies exhibit poor urban planning. A common complaint by visiting Westerners is that malls are not built attractively or that parking lots are constructed in prime building locations, like on a riverside, whereas shopping complexes and restaurant zones are built across the street without good river views. Criticism like this does not survive basic analysis. Rules force developers to start construction soon after buying land from the government. It is illegal to hold on to land as an investment, so real estate developers who think that land values will continue to rise either will build something as cheaply as possible, in the hopes of knocking everything down and rebuilding when prices go up, or will put up parking lots to fulfill regulatory requirements and delay prime construction on the property.

Key Action Item

Simply writing off or underestimating Chinese executives' long-term strategic thinking because they seem to be building inefficient projects is unwise because they often have good reasons for holding off on investing and for trying to make money in the short term.