Q&A: Zennon Kapron on what’s next for Chinese fintech

TRADING BLOWS
Are the US and China gearing up for a long-term trade war?
澳大利亚
不一样的邂逅

在澳大利亚举办商务奖励活动，
体验尽是不同

体验昆士兰大堡礁，马上登陆BE.Australia.cn策划你的下一个会奖之旅
THE HOUSE VIEW

4 DEEPER DIFFERENCES | The US-China spat has been a long time coming

NEWS IN REVIEW

5 NEWS BRIEF | The biggest stories in August

COLUMN

7 EAST MEETS WEST | Just how different are domestic and international Chinese firms’ corporate culture?

Q&A

10 CREDIT WITH A CLICK | Zennon Kapron on what’s next for Chinese fintech

14 HIGH-SPEED EMPIRE | Will Doig on China’s ambitions to build a Pan-Asia Railway

ECONOMICS & POLICY

16 BREACHING THE DAM | The return of China’s capital flight woes

18 SOUTHERN POWERHOUSE | Beijing’s high hopes for the Yangtze Delta

20 FARM FUTURES | China’s agricultural paradigm shift

BUSINESS

22 TO BUY OR NOT TO BUY | Why Chinese millennials are choosing the rental lifestyle

25 BATTLE OF THE BREWS | China’s coffee war is heating up
Deeper differences

The US-China spat has been a long time coming

Washington and Beijing appear to be stuck at an impasse highlighted by the ongoing trade ‘war’ (or ‘tension’ or ‘dispute’), and the world waits to see how this impacts on both players, and also on the world at large. Because it does not seem to be going away.

The drama has been eventful so far – a rollercoaster of ‘will he, won’t he’ with respect to President Donald Trump’s often fierce, sometimes candid rhetoric towards applying new tariffs. His random unpredictability must be driving the Beijing leaders to distraction.

In the last four months alone, we’ve seen several rounds of negotiations take place, an agreement to put the war “on hold”, an immediate reversal of this, tit-for-tat tariffs approved on $50 billion of reciprocal trade, and talks from the White House that this could be one day reach $500 billion. This type of blow-by-blow play can’t go on forever, partly because China will soon run out of US goods to slap tariffs on to. Last year the US imported around $506 billion of goods from Chinese producers – roughly four times the reverse figure.

Instead, it is possible that China’s future retaliation could encroach into the service sector, which China outspends the US by a similar multiple, or moves to affect American companies’ extensive investments on the mainland.

Team USA’s goal has not always been clear at the negotiating table. A push to cut the trade deficit by some $200 billion in May was not given wide support by US lawmakers outside the White House, many of whom instead advocated eliciting longer-term structural changes in how the Chinese do trade, particularly with the United States.

A pledge to “significantly increase” US export purchases by the Chinese delegation back in May seemed to have missed the point. Florida senator and prominent China critic Marco Rubio tweeted after the tacit agreement that “…a short-term trade deal that sounds good but poses long term danger is a Bad Deal.”

What people like Rubio want is to address what he and others in Washington, and indeed around the world, consider to be an ongoing undercutting of legal and fair trade practices by China, particularly with respect to intellectual property and the country’s grand Made in China 2025 ambitions. But also, more fundamentally, much hinges on the extent to which China is willing to consider itself a part of the international economic structure and to work within its rules.

The maelstrom surrounding the ZTE ban and later reprieve epitomised this sentiment. ZTE violated internationally-agreed sanctions and the U.S. Department of Justice set a penalty that would have effectively killed the company. Then the Trump administration waived the penalty against the bad-actor telecoms company after a round of fines and management shuffles, but the basic issues have not gone away.

Regardless of Trump’s histrionics, this consensus questioning the status quo of China’s role in the world economy for the past few decades appears to be strengthening. In August, the German government indicated it would move to block takeover bids by Chinese firms of domestic companies in key industries. The wider EU, meanwhile, has engaged in tariffs and complaints of its own against China, despite efforts by Beijing to court the trading bloc as a potential ally amid rising protectionism from Washington.

There are also many voices calling for restraint and for encouraging rather than pressuring China. There are many multi-national companies that make a lot of money in China, although the shadow of Made in China 2025 hangs over them.

Trump may be the first US President to really confront China on its trade policies, but he certainly won’t be the last. The fundamental disconnects between the nature of Chinese system and that of the West are still outstanding.

China’s leaders are reacting to this pressure, and there are moves that indicate reform in the financial and auto sectors at least. But the basic goal of reciprocity is far off, and the newly-announced measures will take time to have an impact.

Resolution of this basic systemic disconnect is unlikely to be reached anytime soon, and how this plays out is anyone’s guess. But the last few months this have indicated clearly that in economic terms China is more vulnerable and needs the West more than the reverse.
China posts first half-year current account deficit since 1998

China’s foreign exchange office confirmed that the country posted a slight overall current account deficit for the first half of 2018, the first time China has recorded a half-year deficit in twenty years, Caixin reported.

The country’s current account balance—which takes into account the balance in trade of goods and services as well as foreign payments—for the first six months of the year stood at a deficit of $28.3 billion, according to the State Administration of Foreign Exchange (SAFE).

China continues to have a strong trade surplus in goods, posting a trade surplus of $155.9 billion in the first half. But this has been offset by the steep rise in its deficit in services, fueled by a massive rise in outbound tourism.

According to Zhang Ming, chief economist at Ping An Securities, the current account deficit can be attributed to a number of factors, namely the pressure being applied to China’s goods trade (in part due to the trade tensions with the United States), the continued expansion of services trade, and ultimately the fact that the savings rate is falling, which is possibly linked to the country’s aging population.

China’s central bank brings back forex reserve ratio as yuan drops further

The People’s Bank of China raised the foreign exchange risk reserve ratio for financial institutions when buying currency forwards from 0% to 20%, Caixin reported, in a move aimed at slowing the yuan’s continued slide.

In a public statement, the central bank said that the measure aims to “prevent macro financial risks and help financial institutions operate in a healthy and stable manner,” after economic threats such as US-China trade tensions had made foreign exchange markets “volatile.”

Under the new policy, financial institutions must deposit 20% of the value of their yuan forwards from the previous month in a holding account with the People’s Bank for one year. A currency forward is a security that buys or sells a currency at a specific price on a future date to enable hedging against price swings.

The policy was first used in October 2015 after the yuan plummeted following a decision by the central bank to change how the currency’s daily parity rate was established, but was withdrawn in September of last year when the yuan stabilised.

Chinese buyers snap up domestic real estate at record rate

Growth in commercial property sales to Chinese buyers was at a record high in 2017, a new study showed, as domestic investors look increasingly inwards for sources of return amid tighter offshore capital controls from Beijing.

In 2017, Chinese investors bought $564.9 billion of commercial real estate – which includes office buildings, shopping malls, and industrial parks – according to data from Real Capital Analytics reviewed by the Wall Street Journal. This marks a large jump from the $395.8 billion sold in 2016.

This momentum took a slight hit during the early months of 2018, as the central government took a more austere approach to rising financial and debt risks. However, there have been signs in recent weeks that Beijing is easing this stance as the economy faced a series of internal and external threats.

China’s real estate sector is one of the largest in the world. Including investments from foreign parties, deals worth $633.4 billion were made in 2017, up from $456.2 billion in 2016, according to Real Capital.

Google is developing censored search services for China

Google is in the process of launching a censored version of its search services for China, according to news website The Intercept, ending a years-long hiatus from the world’s largest online community.

According to the site, the project has been codenamed “Dragonfly” and was kickstarted in spring 2017.

Among the terms blacklisted in the search function will be democracy, religion, peaceful protests and human rights, it added. A final version could go live within six to nine months following the approval of Chinese authorities.

Google has been attempting to make other inroads into China since withdrawing from the market in 2010. This year, the company has worked on game development projects with online platform Chushou and social media giant Tencent Holdings.
ZTE close to resuming normal operations
The US government and ZTE signed an agreement that brings the troubled Chinese telecommunications company close to a return to normal operations nearly three months after it was hit by a ban on using American suppliers, reported the Financial Times.

The only remaining task for ZTE is to pay a deposit of $400 million in escrow to the US Commerce Department, redeemable should the company avoid violating the terms of a deal reached last month.

Once the ban is removed, ZTE is expected to restart the company’s core business, which it ceased shortly after the introduction of the ban, allowing its 80,000 employees to resume normal life.

Shares in the company rose 23.9% in Hong Kong and hit the daily 10% maximum increase on the Shenzhen exchange in the wake of the news.

However, the share price remains down 54% and 63% respectively for the year so far.

Third Chinese province reports swine flu outbreak
Nearly 100 hogs died from African swine flu in the city of Lianyungang in eastern Jiangsu province, China’s Ministry of Agriculture announced, as the deadly virus spread across the world’s largest pig market.

Jiangsu is the third Chinese province to report an outbreak of the disease. The first case was reported in Shenyang, capital of Liaoning province, which is 1,300 kilometers north of Lianyungang, on August 3. A second emerged in the central province of Henan two weeks later, according to Reuters.

More than 600 hogs were infected with swine flu between August 15 and 20, and authorities locked down the affected areas with no hogs or related products allowed to be moved in or out.

However, if a much wider outbreak of the disease occurs, it could have significant implications for the global pork market. China currently produces around 55 million tons of the meat each year, which is roughly half of global supply.

Tariff cuts drive skyrocketing Chinese car imports
Chinese car imports quadrupled in July from June as cuts to auto tariffs kicked in, Caixin reported.

A record 165,000 foreign vehicles entered Chinese ports in July, compared with just 45,000 a month before, according to data from the General Administration of Customs. June’s figure was particularly low, the administration added, as buyers waited for the tariff changes.

In late May, it was announced that duties on 135 types of imported vehicles would drop from 25% to 15% in July, in an apparent concession to demands from countries like the US that China’s domestic auto industry was too protected.

However, recent disputes between Beijing and Washington are likely to reverse much of the import growth. Levies were raised from 15% to 40% in early July on some US cars – a move that is set to extend to almost all American vehicles from August 23, sources told Caixin.

Interbank rates fall to three-year low in lending push
Short-term interbank interest rates dropped to a three-year low as the government aimed to bolster economic growth through facilitating loans to households and small businesses.

The Shanghai Interbank Offered Rate, or Shibor, fell to 1.42% on Wednesday, its lowest reading since 2015, according to the Wall Street Journal, although it rose slightly to 1.62% the following day.

The interbank rate drop conforms to the central bank’s plans to channel liquidity to commercial banks for the purpose of small loans to retail clients, after a wider deleveraging campaign delivered a hit to the country’s credit growth.

At the end of July, the People’s Bank injected Rmb 502 billion ($73 billion) to the commercial banking sector, ready to deploy as short-term loans to boost domestic demand.

China rolls out credit guarantee fund for small business
China launched a multi-billion dollar credit guarantee fund to aid the channelling of funds to cash-starved sectors of the economy, Caixin reported.

The National Financing Guarantee Fund will kick off with starting capital of Rmb 66.1 billion (89.7 billion). The country’s Ministry of Finance is the fund’s largest shareholder with a 45% stake, with the remaining stakes distributed among 20 state financial institutions.

The fund is part of Beijing’s wider scheme to open more financing channels to small businesses, agriculture and innovative industries by using gains from equity investments to offer guarantees for loans. China’s State Council has estimated that the fund will provide guarantees on over Rmb 500 billion of loans over the next years. •
Marc, an experienced executive in his 40s, was excited to join a Chinese multinational corporation (MNC) in Western Europe. He sensed the company was going places and getting on board now would be exciting and good for his already impressive career.

Three years later, he was compelled to leave. He first sensed problems when he was not able to respond to questions raised about his department’s performance at regularly scheduled weekend meetings that were arranged—initially without his knowledge—by Chinese expatriates in the leadership team. While it is illegal to ask employees to work on weekends in several European nations, Marc did not believe he had any reason to be suspicious at first. One day, however, the Managing Director—a Chinese expatriate and veteran of the firm—wanted to introduce Marc to a new Department Head who, surprisingly, has the same title as Marc. Ever the pragmatist, Marc knew his time was up and he negotiated a leaving package before officially resigning.

“You must have been very upset?” I asked during our long interview. “Not really” he responded. “On day one here, I introduced myself to someone I thought was a colleague but it turned out I was taking her job and this was the first she heard about it.”

The cat and mouse game between management and Marc—where both sides tried to get what they want—is, on the one hand, a kiss-and-punch story seen and heard inside MNCs the world over. But it is also troubling. It reveals this particular Chinese MNC’s disregard for local labour laws as well as its leaders’ inability to nurture a collaborative environment with local
leaders like Marc who, as one look at his CV will demonstrate, is one of the most experienced executives available.

**What do we know about international Chinese firms?**

What do we really know about what goes on inside international Chinese enterprises? How familiar are we with their corporate cultures, decision making processes, hierarchies and power structures, and equality and diversity frameworks? And what do we know about the experiences of employees—both Chinese and non-Chinese—inside these firms?

On the one hand, we know a great deal about Chinese firms in China. Insider accounts as well as numerous independent researchers and scholars have painted a picture of Chinese domestic corporate culture as an assemblage of Chinese tradition (such as Confucian hierarchy and loyalty, and “traditional Chinese” cultural activities), imported western management practices (such as productivity responsibilities falling on the individual), and Chinese Communist Party (CCP) authority and Party cells (where a political and ideological agenda merges with the commercial).

But when it comes to international Chinese firms, we do not really know how similar or different they are compared to domestic Chinese firms. For the past year, I have been researching international Chinese enterprises and their organisational dynamics, trying to understand questions like those posed above. This is an important topic. While many Chinese say there are only three international Chinese enterprises—Haier, Huawei, and Lenovo—reality indicates otherwise. In fact, there are approximately 8,000 Chinese enterprises operating internationally in 164 countries. About 43 percent of employees are non-Chinese. It is not an exaggeration to say that in the future, working in a Chinese-owned or Chinese-invested firm could be a reality for a large proportion of the global white-collar population.

Indeed, better insights into the dynamics of international Chinese enterprises will help us understand and respond to incidents such as ZTE’s ongoing fiasco in the US and their violation of export sanctions, which they lied about; automaker Geely’s acquisition of close to 10 percent of Daimler Corporation’s stock through derivatives and options—thereby circumventing disclosure laws—which led to significant German suspicion and distrust; as well as the debate underway in Australia concerning its largest dairy farm—now owned by Chinese investors—and the recent mass board resignation concerning disagreements over management structures, investment decisions, and environmental management.

As international Chinese enterprises compete higher up the value chain in ‘sophisticated’ markets across Australasia, North America and Western Europe, political realities are compelling them to undertake significant reputation and brand building exercises as they try very hard to be ‘liked.’ This is especially the case for firms who are taking their domestic company global rather than pursue acquisition-led growth. The introduction of sleek mission statements and corporate public relations programs should make us more determined to understand what makes international Chinese firms tick rather than take them at face value.

**Stepping inside a Chinese MNC**

The first thing we need to understand is who actually works inside these firms. From one perspective, international Chinese firms are not totally ‘Chinese’ in the sense that they comprise—and partner with—an incredibly diverse range of people and stakeholders from all over the world. From this perspective, they are quite embedded in global capitalism and global business norms. To take one example, many international Chinese firms work with a predominantly Western group of consultants and spokespersons to craft corporate missions, visions, marketing materials, and design media placements around the world. Marc’s enthusiasm for joining his past employer is a common sentiment among white-collar workers in the West and many are flocking to work at or with Chinese firms. In some respects, a unique form of Chinese soft power surrounds its MNCs, especially tech firms.

Within this diversity, however, my research found powerful divisions that form around traits including nationality, ethnicity and demographic characteristics like age.

Let me briefly introduce several groups illuminated by these divisions. The first is mature Chinese profes-
their employer needs to adjust to global business ‘norms.’ They see China as a global power already and Chinese MNCs as sites of meritocracy and opportunities for social advancement. Found all over the organisation, many young professionals obtain overseas postings early in their career, a move called ‘going to the frontlines.’

As we can see, there are incompatible views held by different groups of people working in and with international Chinese firms.

But let us return to Marc. Why did he get treated the way he did? From one point of view, Marc failed to acknowledge and adjust to the very different corporate culture he found himself in. But I would argue something else is going on. Specifically, Marc’s employer had ambitious commercial targets that would make, as it was put to me, “any European company extremely uncomfortable.” These targets, which are actually set by headquarters, amplify corporate behaviors found in China—e.g. secretive decision-making by management and a disregard for employees outside the inner circle of power—rather than encourage Chinese expatriates to take locals like Marc seriously.

While there are numerous nuances my research is uncovering, Marc’s story reveals that the starting point for understanding international Chinese enterprises’ corporate culture is that they share striking similarities with their domestic counterparts.

**COLUMN**

Professionals, who were trained in Western MNCs in China. They believe Chinese MNCs have not yet learnt the ‘rules of the game’—referring to what they take to be global business norms—but need to if they are to be considered truly global and taken seriously. Originally defined by their desire to seek employment in non-Chinese workspaces, glass ceilings at their previous (non-Chinese) employers compelled many mature professionals to seek opportunities inside international Chinese firms, something unimaginable to them only five years ago.

Senior non-Chinese executives, another group I observed inside Chinese MNCs, hold similar views regarding Chinese MNCs’ corporate culture. Consider the following comment by a senior Australian who worked at Huawei:

As Huawei evolves I am more and more adding my perspective gained as an Australian who has spent 23 years living in Greater China. That experience is what Chinese companies need to be truly global.

Many of the other groups I observed—especially senior Chinese nationals—do not take well to these paternalistic viewpoints. Let me discuss young professionals, however, who are Chinese nationals born in the 1980s and 1990s. They reject the view that

Dr. Sacha Cody is an Anthropologist and China Studies scholar. He is currently teaching at the Australian National University and researching international Chinese firms’ corporate cultures in Australia. Follow him on Twitter @sachacody77

September 2018 09
Credit with a click

Zennon Kapron on what’s next for Chinese fintech

The extraordinary rise of China’s financial technology—or “fintech”—industry shows few signs of slowing. Where once Chinese finance was almost a byword for backwardness, today the country is home to many of the most dynamic financial companies in the world.

Of the world’s 27 fintech unicorns—startups valued at over $1 billion—nine are based in China or Hong Kong, according to a 2017 report by TechCrunch, where they benefit from access to the world’s largest, and one of its tech-savviest, consumer markets.

Payments via third-party mobile platforms have grown at a three-digit annual rate for the past five years. Chinese consumers make more transactions through payment apps Alipay and WeChat Pay today than through cash and cards put together. Peer-to-peer lending, meanwhile, has exploded to become a $190 billion industry serving millions of credit-starved households and small businesses.

But what’s next in store for the industry? Is the recent wobble in the P2P market going to spread? Could a ramping up of regulation from Beijing put a dampener on the market’s red-hot growth? Stomping out risk from the financial system has become a key priority for policy makers over the past year, and the relative freedom fintech firms have enjoyed over the past decade may be about to take a hit.

Analysing these questions is all part of the day job for Zennon Kapron, the head of fintech research and consulting firm Kapronasia. In this interview with China Economic Review, Kapron gives his take on some of the market’s recent developments, and explains why China’s fintech industry is such an exciting space to watch.

Q: Fintech is a term that includes many different sub-markets. Which of these are the most relevant in China?

A: The basis of fintech in China is payments. Alipay, the most popular online payment system in China, was set up to solve the issue of trust in e-commerce. When the country’s first online retail giants started, the system was simply ‘cash on delivery,’ and of course there are a number of potential problems and inefficiencies with this. Alibaba launched Alipay to smooth out this process: you order something online, the money goes into escrow, once you receive the goods you confirm and the money is released, and if you don’t say anything within a few weeks it’s automatically released. That really gave both merchants and buyers more confidence and trust in the e-commerce system. This has since developed into m-commerce and offline-retail payments.

At the time Alipay was really gaining momentum, around 2013, inter-bank lending rates were quite high—with banks borrowing money on a daily basis to cover their capital requirements, etc.—so Alipay worked with Tianhong Asset Management and set up the money market fund Yuebao that trades on this bank lending behaviour. So all of a sudden, what do people have? A wealth management product. This is the second major segment of China fintech.
Ten years ago, if you wanted to buy a wealth management product, you’d have to go through a pretty painful process at the bank. You’d wait in line to talk with someone, who would print out a list of different options for you and there would be a sizeable minimum investment. After that your money would be locked up for six months, a year, maybe two years. Yuebao managed to capitalise on this situation. It offered high interest rates, perhaps 7 or 8%, with near instant liquidity. So someone could invest money one day, start earning interest on it tomorrow, and start withdrawing their gains within hours, even as little as Rmb 1. The result was basically the democratisation of wealth management.

The third aspect was credit. These growing technology companies now had access to a wealth of information on people’s financial situation and their daily spending habits, from how much they had in their accounts, to when and where they spent it. This gave them a really effective means of building an individual’s credit rating, and it was then just a small step to actually offering a lending alternative to the banks.

Q: Why is China so ahead of the curve when it comes to fintech?
A: I think there are a couple of different things. First of all, there’s a lot of friction in existing transactions. For example, if you want to make a card payment in China you still have to chip, then PIN, then give your signature; with Alipay or WeChat Pay you just scan a QR code and walk away, clearly removing all of that friction.

The second reason would be the country’s credit system. The People’s Bank of China has a credit database of less than half of the population – some 600 million citizens – and of these only half again have actual details of credit ratings and history. For me, having grown up in the US, I’ve had a credit card since I was young, so Equifax, TransUnion and other credit bureaus have a tremendous amount of data on me. There isn’t the same in China, and the result is huge swathes of this enormous population that do not have a credit history, which opened another niche for fintech lending platforms to move into.

One more important factor is the government’s ‘wait and see’ approach to the industry’s development. Alipay, for example, launched in 2004, but payments platforms were only regulated in 2011. Similarly, peer-to-peer (P2P) companies began to take off in 2007/2008, but regulation for them only really kicked in the last couple of years.

There are exceptions to this approach, however: Bitcoin was very quickly stamped out. Why? Well, Bitcoin is a very elegant solution to a problem that doesn’t exist, and it serves very little value to the financial services industry. People speculate on it, but it offers nothing to benefit the wider economy.

Payments, on the other hand, have provided a necessary and visible boost to the economy. In Hangzhou, I met a salesman/repairman who previously only accepted Alipay and WeChat Pay, but had recently started borrowing some Rmb 90,000 a week with MYbank. The government is seeing the benefit of letting small lending companies help mobilise capital to small borrowers.

Q: What is driving Beijing’s recent moves to tighten regulation in the fintech industry? And do you think this poses a threat to the sector’s growth?
A: Generally speaking, the government wants to ringfence any source of potential risk. I tend to come down on Beijing’s side regarding a lot of their decisions in this area. The government is taking a very pragmatic approach
to the economy and the industries within it, though of course not everything it has done has been positive – not keeping some of its promises to the WTO, for example.

But on the example of the recent 100% reserve requirement ratio for online payment platforms, I don’t think it’s a question of not being able to adequately monitor the risk levels associated with the lending firms – I’m certain there’s the infrastructure for that – but at this point it’s probably a good idea to tighten up a bit for the sake of building trust and stability, even if that cuts back a bit on the revenues of Ant and Tencent.

Do I think there’s any threat from this? I wouldn’t say ‘threat.’ It was impossible that there wouldn’t end up being some regulation eventually. This applies to all the different spaces within ‘fintech’.

Q: The government has hinted it may loosen restrictions on foreign third-party payment companies like Visa and Mastercard. Do you think these companies have a future in China?
A: This conversation has been going on for many years now, with the government every couple of years putting out a carrot to tempt the likes of Visa and Mastercard. There’s a lot of talk at the higher levels about opening up the market, but there are a lot of details and red tape that prevent it from being realised. You can tick all the boxes on your application form to the finance regulators, but then fail a security check at the last minute. To make something of a bold statement: I don’t think we’ll see any of the major card providers making inroads into China until 2020.

There’s also the issue of how these companies are going to even market their card to the Chinese consumer base. Up to a couple of years ago, there were dual-branded cards, like Union Pay/Visa, which were pretty simple to acquire and fairly popular. The government discontinued this about a year and a half ago, leaving the only option of a single-branded Visa or MasterCard, which is potentially not as attractive. There have been some attempts by Western companies to differentiate on brand-cache, so if people carry a Visa or Mastercard it looks like they’ve made it, but I really don’t think Chinese buyers will care at all about the brand name on their card. Furthermore, the global
presence of UnionPay is on the rise, with global acceptance, at ATMs, restaurants, growing rapidly.

**Q:** In 2017, we saw around two dozen Chinese fintech companies make US IPOs, yet over half of them have seen their stock drop below the offer price. Why do you think that is?

**A:** When you look at the success of China’s tech giants – Alibaba, JD, Baidu – it makes sense that everyone wants a piece of the market. Everyone wants some exposure to whoever’s going to be the next Jack Ma. But with P2P, where so many companies are now listing, I do struggle to see how companies really differentiate. There is some specificity in terms of markets, like those that target university students, others that deal with predominantly SMEs. And there are certainly a few individuals with top-class management and services. But I think the quality of the firms just isn’t there.

**Q:** How worried should we be about the recent panic surrounding China’s small P2P lending platforms?

**A:** The fact that P2P lending platforms are failing is not surprising. Many of these platforms had inadequate internal operational processes, poor lending practices, and in some cases, were just complete scams. What will be interesting to see is if retail investors will still want to put new money on these platforms. I get the impression at the moment that many investors are just trying to get their money out. Even if the P2P industry manages to right itself, it may find that all the investors are gone.

**Q:** What are the most exciting innovations taking place in China’s internet finance space?

**A:** What stands out to me is big data. The ability to analyse massive amounts of information and come up with detailed conclusions about an individual’s financial profile. This has immediate practical applications for the tech companies themselves. As an example, many merchants that use Alipay use a personal account instead of a merchant account. Ant Financial realizes this and will look at a person’s transactions to understand more about who they are. Consider the average person’s Alipay activity: it will look like a huge mesh of transactions from your phone to merchants, to banks, to friends, from friends to you, to companies. From a merchants’ perspective the situation is more of a hub-and-spoke model. So by using big data and analytics, the payment companies will be able to identify who is or isn’t a merchant, and whether or not they are using the correct account.

However, the largest application for big data would probably be in lending to SMEs. China’s banks, despite all being listed, have significant state ownership and therefore lend predominantly to state-owned companies. Why would a bank lend to an SME at 7.5% when it can lend to PetroChina at 7%?

A lot of the applications for big data in China make use of a lack of infrastructure in certain areas, where in the West such infrastructure is already set up. A common credit database would be a good example of that, where in the US, Equifax has been offering reliable credit data for years. That’s not to suggest that one market is ahead of the other, but there are just different requirements.

Blockchain is there too, but I don’t see it having as big of an effect as its publicity might suggest. We’re certainly seeing some rudimentary applications of blockchain by the big non-bank lenders and asset managers. But at the end of the day blockchain’s benefits are inefficiencies, but it doesn’t have the ability to change things fundamentally as, say, AI or big data.
China’s Belt and Road Initiative promises to become the largest infrastructure-building program in world history by facilitating up to $1 trillion of development projects across Eurasia and Africa. And the project is already having a profound impact on one region in particular: Southeast Asia.

Beijing dreams of transforming the region by realizing the long-term vision of completing a “Pan-Asia Railway” connecting southwestern China with Singapore via countries including Laos, Thailand and Malaysia.

The railway could kick-start a fresh wave of economic development in a region with an acute lack of world-class infrastructure. But China also faces scepticism from many groups in Southeast Asia that question China’s motives and credibility as a lender and partner, as well as the long-term viability of a hugely costly project.

Will China be able to make its high-speed dream in Southeast Asia a reality? In his new book *High-Speed Empire: Chinese Expansion and the Future of Southeast Asia*, journalist Will Doig attempts to answer this question through on-the-ground reporting in the countries at the heart of the Chinese-led project.

As he tells *China Economic Review* in this interview, Doig found that the reality of Belt and Road is often radically different to the headline-grabbing announcements he had read about in the press.

**Q:** Could you give us an idea of the scale of China’s infrastructure investment of recent years in Southeast Asia?

**A:** It’s interesting. China keeps the parameters of BRI [Belt and Road Initiative] very vague, and that’s a purposeful thing. It’s easier not to fail when you don’t have very specific goals. People talk about BRI as an infrastructure plan but it’s really not so much a plan, but an idea guided by Beijing that often plays out in these individual, ad-hoc, on-the-ground ways with strong provincial influence.

So, at this point I don’t think the scale of China’s involvement in the Pan-Asia Railway is nearly as big as it seems in press releases, ceremonial ground-breakings and summits, and so on. China is a country that is very conscious of how the world sees it and it often makes these projects seem more prominent than they actually are – indeed, sometimes doing itself a disservice because things seem disappointing if you overpromise.

This has certainly been the case with the Pan-Asia Railway. For instance, China announced that they were building a railway with Thailand years ago, but there is still not an inch of track on the ground. In fact, the only part of the Pan-Asia Railway that exists is a small stretch of railway in Laos that was started in the last year. The Pan-Asia Railway has pretty much been put under the umbrella of BRI to make the initiative seem more important, but the truth is that many of the individual projects were already in the pipeline years ago and would have gone ahead anyway.

**Q:** So despite the name Pan-Asia Railway, track-building has yet to really dominate the nature of projects going on in the region by China?

**A:** It’s important to remember that BRI is not just infrastructure. There’s also a large software element to it such as opening up trade routes, controlling supply chains and making borders more permeable. That is probably having more success at present, but it’s less visible than physical infrastructure development would be. You might even say that a lot of the projects going on are not the main focus of China at all, but are just add-ons to the central goal of building stronger relationships with local governments.

**Q:** What are the drawbacks and potential risks that the Southeast Asian nations take on by accepting the spread of Chinese influence through these infrastructure projects?
A: The overwhelming dynamic with these projects in Southeast Asia is: these small countries want Chinese cash and investment but are fearful of sacrificing too much bargaining power and valuable assets. However, it varies widely depending on the country you’re talking about. Laos, the one country that China has really made progress on building the railway, is a poor, dysfunctional, highly corrupt country with basically no power right up against the border of China. This has allowed China to enter Laos with relative ease. Thailand, on the other hand, has more money, power, and can more easily push back on China, which we’ve seen.

There’s almost no country in this region, however, or indeed anywhere in the world, that just wants to tell China to take a hike. They want the investment and the attention, but some countries, like Thailand, have instead mastered the art of stalling or distracting from going ahead with deals. Thailand doesn’t need the railway – the reason it will cooperate on its construction is to be friendly with China. But they have continuously showed something of an enthusiastic indifference towards Chinese diplomats, inviting them to events and showing interest but never allowing progress to be made.

In general, China does better in weaker countries, like Laos and Pakistan, but comes across greater resistance where governments are more functional and have more international power. The success of BRI will really hinge on whether or not China can convince these slightly more powerful nations that BRI is in their best interests.

Q: How much of China’s investment could be considered ‘debt-trap diplomacy’?
A: The idea of debt-trapping is basically that China convinces a country to partner with them on a major, expensive project, with China offering attractive loans as the main financing stream. But for whatever reason – their economy is too small or interest rates on the loans still prove too high – the recipient can’t pay the money back and is forced into an equity swap where it gives China control of the project it has just built, a perfect example of this being the Hambantota port in Sri Lanka. Alternatively, the debtor nation offers support to China’s other geopolitical aims in return for concessions on the repayment, as we have seen in Cambodia.

I’m not so sure it’s happening as widely as reports might imply, however. I recently sat on a panel with two investors in BRI who were adamant that China was not debt-trapping any of these nations. Now, this is of course somewhat expected, but on reflection I think that they’re right. What China is often doing is much subtler: making such high investments in one project that that will win the day for China in the end.

China’s best-case scenario is that it becomes savvier in how it is conducting these deals and projects. Let’s remember that China is still a very recent entrant into the global development finance game with a lot to learn.

Q: Do you think that China’s current method of investment finance in Southeast Asia will be a success in producing the Pan-Asia Railway?
A: Whether or not a contiguous Kunming–Singapore railway route is built will not determine whether China’s activity in the region is successful. That was never the aim, but just a useful way to package together what China wants to do. Realistically, no one is going to take a train from Kunming to Singapore. So, whilst it doesn’t make much sense as a transportation network, it does make sense as a series of smaller networks that could benefit China’s trade interests.

One example could be the plans to link the Rayong industrial zone on Thailand’s east coast with Bangkok — two places where China has massive economic interests and could pay dividends much higher than the scale of the route might suggest.

China will build parts of the Pan-Asia Railway, but not the whole thing. And that will be just fine for what the government wants to achieve, namely integrating trade areas and opening up new markets for investment.

Q: In the months since the book was finished, we’ve seen examples of opposition to Chinese-funded projects in Myanmar, Malaysia and Vietnam. Do you think this is just a temporary setback for China, or the start of a major shift?
A: I don’t think the pushback is going to be a problem for China – it will find some in certain countries and, although scepticism is indeed growing in some places, China is also at the same time offering such a once-in-a-lifetime opportunity to leapfrog up the development chain that that will win the day for China in the end.

Will Doig is a journalist covering urban development, infrastructure, transportation, sustainability, globalism and governance.
Breaching the dam

The return of China’s capital flight woes
By Maximilian Kärnfelt

Since 2015, the specter of capital flight has been haunting the Chinese economy. In that year, faced with the threat of a currency devaluation and an aggressive anti-corruption campaign, investors and savers began moving their wealth out of China. The outflow was so large that the central bank was forced to spend more than $1 trillion of its foreign exchange reserves to defend the exchange rate.

The Chinese government was eventually able to dam up the flow of capital out of its borders by imposing strict capital controls, and China’s balance of payments, exchange rate and foreign currency reserves have all stabilized. But even the largest dam cannot stop the rain; it can only keep water from flowing further downstream. There are now several signs that the conditions that originally led to the first massive wave of capital flight have returned. The strength of China’s capital controls might soon be put to the test.

Before listing the reasons why a second bout of capital flight is looking increasingly likely, let us first address the underlying question: is capital flight truly so damaging for a country that fighting it can be economically justified? In the case of China, the answer is probably yes, for the following reasons:

• First, a government’s ability to pay for its domestic and foreign expenditure can be affected by capital flow out of the country. Large flows out of the country reduce the tax base, potentially reducing government revenue. Outflow can also result in a currency depreciation, increasing the cost of foreign investments. The Chinese government has large commitments both at home and abroad, so this is naturally a great concern.

• Second, asset price bubbles need a constant supply of liquidity. If capital flight is severe, such bubbles are deprived of funding and can subse-
quenty burst, potentially causing a damaging crisis. China’s real estate market is clearly vulnerable to this.

• Third, as the Mundell-Flemming trilemma states, a country can only choose two of the following three: independent interest rates, free capital flows and a fixed exchange rate. If a country tries to have all three at once, then once the country enters a depreciatory cycle, foreign currency reserves must be committed. And once they are depleted, the fixed exchange rate can no longer be maintained. The Chinese central bank’s controlling rate is not the same as the US Fed’s, and the country manages its exchange rate. Therefore, it must control the flow of capital.

These three reasons make it clear that without capital controls, the Chinese government could face considerable difficulties in meeting its obligations and ensuring stability.

Capital flight stems from a combination of fundamental and psychological factors. Interest rate differentials between foreign and domestic investment and savings opportunities, as well as differences in tax rates are fundamental factors than can lead to cross-border flows. Psychological factors are related to the anticipation of changes in the socioeconomic environment which could negatively affect wealth holders. Such anticipations can largely be distilled into the suspicion that if capital is not moved outside of the country’s borders a large portion of it will be soon be appropriated or lost. And since investors are somewhat like herd animals, if one scares, panic often follows.

There are currently both fundamental and psychological factors that point to the possible return of capital flight. The West seems to have finally emerged from the Great Recession that followed the Global Financial Crisis in 2008. Western economies are once more returning to their long-run economic growth trends.

On top of this, central banks in the United States, Europe and Japan have begun reducing their balance sheets and are increasing controlling rates. These factors are driving rates up, narrowing the interest rate differential. Chinese rates are still higher than those in the West, but regular savers do not have access to the returns in the interbank market. For complex reasons related to China’s developmental model, rates paid for regular bank deposits are instead purposefully kept below the rate of inflation. Tax cuts in the United States will also make it a more attractive investment destination.

There are also real or imagined economic and political risks that could cause investors to decide to move their money abroad. The Chinese financial system—and corporates in particular—have since 2009 rapidly become highly leveraged. This means that a bailout of the financial system, either through raised taxes or the printing press, is not out of the question.

Secondly, the existing capital controls ironically have resulted in the RMB appreciating close to the level that it reached in 2015, just before the devaluation. Exports have begun to fall and there have been reports that exporters see this as a greater problem than potential tariffs. If exports continue falling, policy makers might be tempted to devalue the currency to support exports. All the above risks could easily persuade wealthy Chinese that moving capital out of the country is the best insurance policy against potential future losses.

However, a key point remains: if a large enough group of investor-savers decide to move their capital out of the country, the currency will come under pressure. A relatively small number of actors can in this way cause an enormous chain reaction. As Chinese foreign exchange reserves equal only 10% of money supply, a large-scale capital exodus would quickly deplete liquid currency reserves.

There are many signs that the difficulties China struggled with in 2015 could return. Even in the current calm, few would doubt that outward capital flows would be immense if controls were completely relaxed. Perhaps the most likely cause of renewed capital flight would be a possible bailout of the financial system as a part of the ongoing deleveraging campaign. Few wealth holders would like to be subjected to the taxation or inflation that would have to follow and would try to move their wealth abroad if they suspected a bailout was imminent.

The dams are keeping the water in for now. But time has passed, and no one can be sure if they will hold once the rain begins anew.

Maximilian Kärnfelt is an economic analyst at the Mercator Institute for China Studies (MERICS), where his research focuses on China’s macroeconomy, monetary policy, and financial markets. Prior to joining MERICS, he worked as an economic consultant for several companies. In 2016, he received his master’s degree in economics from Peking University, where he also worked as a research assistant.
Earlier this month in Shanghai the Chinese government launched an RMB 100 billion ($16 billion) investment fund targeted at stimulating cooperation and modernisation amongst regional economies in one of China’s most productive and strategic geographic blocs – the Yangtze River Delta.

The Yangtze River Delta Collaborative Advantage Fund, with backing from a diverse range of government-linked institutions and private firms, marks an ambitious step in Beijing’s wider intention to create integrated, highly-efficient economic zones throughout the country. Over the next three years, the fresh capital will go towards boosting new high-value-added industries in the region’s numerous industrial parks, redistributing operations across provincial borders, and supplementing the advanced infrastructure network that links major cities such as Hangzhou, Nanjing, and of course Shanghai.

The region, although dominated by the central financial and trade hub of Shanghai, includes the satellite cities of neighbouring Jiangsu, Zhejiang, and Anhui provinces, which together constitute China’s largest discrete economic bloc. According to China’s National Bureau of Statistics, in 2017 the Yangtze River Delta contributed around one-fifth of the nation’s GDP, punching well above its weight in terms of the fraction of the country’s population it houses, and is consistently growing at a double-digit rate per annum. The gargantuan ports of Shanghai and Ningbo – the first and fourth largest in the world by value of trade processed – oversee one-third of China’s annual exports, acting as a gateway for inland regions to the wider global economy.

The government’s principal goal is to make the cluster a world-class trade
and manufacturing zone by 2030, but to do this it will have to tackle two main obstacles: the wealth disparity among the provinces, and the so-called ‘fortress economy’ mentality of local administrations.

The first issue is one of resource allocation and historical particularities among the provinces. Shanghai, given its positioning, has benefitted greatly as the world’s point-of-entry for centuries and is comfortably China’s richest metropolis with a GDP of $475 billion in 2017. Zhejiang and Jiangsu provinces have developed into significant national manufacturing centres, excelling in the production of electronic, auto and textile products. Zhejiang’s regional capital, Hangzhou, is also emerging as a leader in e-commerce, promoted in large part by being the HQ of tech giant Alibaba. To the West, the coast-less Anhui province offers a large supply of natural resources, including coal and copper, and has been the target of heavy investment in technologically advanced industries within recent years. However, with a GDP of $408 billion in 2017 for a population of 62 million, Anhui remains around twice as poor as its two neighbours.

The second problem essentially aims to switch local government policies from those of ‘competition’ with nearby provinces, to those that seek ‘cooperation’. As has been seen during other periods of China’s history, regional leaders pursuing rapid growth results for their jurisdiction have inhibited the long-term potential of the wider bloc, as they seek dominance in, say, the petrochemicals or electronics manufacturing industries. The result has been severe overcapacity in key industries and an intense environmental fallout in certain areas along the river basin.

The fund, with its immediate plans to spark around a dozen high-tech and infrastructure projects in the delta, looks to hit both issues with one strike. By redistributing production capacities among the component provinces and allowing each to pursue its respective comparative advantage in various industries, the bloc as a whole can reap efficiencies whilst poorer areas are helped up the value chain as operations are transferred from Shanghai inland. Similarly, by heavily encouraging local governments and businesses to consolidate reciprocal economic relationships, administrations will be removed of the incentive to pursue myopic, self-interested targets at the expense of their neighbours.

The Yangtze Delta integration plan is not the first of its kind, either. An initiative of similar scale and intentions was launched in the country’s north about ten years ago, hoping to unite Beijing with the surrounding provinces of Tianjin and Hebei. More commonly known as Jing-Jin-Ji, or Capital Economic Circle, this project shares many parallels with those plans for the YRD. Instead of Shanghai, Beijing functions as the overproducing, wealthy core that can pass on some of its excesses to the other areas that have local economies further down the value chain. The funds dedicated to Jing-Jin-Ji have also gone towards building intercity transport networks, fostering collaboration projects, and founding high-tech ‘new areas’ such as those in Xiongan or Zhongguancun, where new industries are trialled in cities where investment is traditionally bypassed in favour of Beijing.

The efficacy of Jing-Jin-Ji is yet to provide conclusive results, however. Despite a proliferation of high-speed rail networks and the transfer of billions of dollars of industrial technology from Beijing, one key metric – wealth disparity – remains potent. Hebei, mirroring Anhui in the south, severely lags behind the other two members of the cluster. In 2016 the province’s GDP stood at just 36% of Beijing’s, despite a population almost four times as large, and 37% of Tianjin’s.

Plans to integrate the Yangtze River Delta differ in many respects from Jing-Jin-Ji, but most notably in terms of scope. In 2016, the Chinese government proposed the ‘Golden Waterway’ project for the wider Yangtze Economic Belt, extending the plans at the delta inland as far West as Chongqing. If this is fulfilled, nine provinces would be encapsulated within the scheme, including 40% of China’s population. The Yangtze, along which lie three of China’s ten most populous cities, would give China’s insulated and poorer inner regions a conduit to the thriving ports on the Pacific coast. Relatively prosperous provinces will be able to transfer lower-value-added manufacturing inland, pulling up the entire bloc as one.

The government’s desire to stamp out inefficiencies in these economic zones coincides well with its general policy of pushing China into a new position in the global supply chain, as is stipulated by the Made in China 2025 initiative, as well its goals of greater regional connectivity as per Belt and Road. If the Yangtze River Delta and Jing-Jin-Ji clusters can prove successful, they will serve as a strong stamp of approval for some of Beijing’s trade-mark schemes and may lay the groundwork for similar projects across the country.
China’s agricultural support policies are moving towards marketised institutions, after a decade of state subsidies for direct production resulted in oversupply. A new framework of indirect support will focus on two measures: developing crop insurance for farmers, and developing futures markets for price discovery.

These ‘Insurance plus Futures’ policy pilots currently underway in China represent a giant paradigm shift for global grain and oilseed production. China is simultaneously ending state procurement on much of its agricultural product, while also opening the processing industry to imports.

There are four systemic reforms currently underway to transform China’s agricultural production system from state-procurement to market-priced production: agro-industrial upgrading, agricultural credit, agricultural insurance, and futures price-setting on agricultural commodities.

Agro-industrial upgrading will remain state subsidised, and agricultural credit has proven too difficult to effectively reform. But insurance and futures reforms are soon to move out of the pilot stage and into mainstream policy.

The government will no longer purchase grain directly from peasants, instead replacing state procurement with a new form of agricultural crop insurance. Insurance reforms will gradually step in to replace the social policy function of state procurement guaranteeing peasant incomes. The alliance of peasants and workers is enshrined in the Chinese constitution, and the Chinese Communist Party has an overt yet derogated governance obligation to the peasantry.

As an interim price-setting meas-
A ‘target-price’ mechanism is designed to work towards the development of futures contracts, commodities exchanges, and other price formation institutions in China. A target-price is a floor-price at the provincial level on a single commodity, such as corn. Each province may set different prices for the same commodity, introducing some variability into national pricing. However, a range of institutional upgrades are necessary for the upgrade to full-scale futures markets in order to be able to create and transmit credible price signals to buyers and sellers.

These previously hollow institutions, sidelined for decades from actual agricultural production, are to become effective agents in the new pseudo-market model. The government will support the development of futures exchanges to attract technical transfers in human capital and know-how from foreign institutions in order to promote effective institutional integration with global markets.

However, rapidly developing the market institutions necessary to form and transmit commodity price signals will take time.

On the international front, opening to imports does not mean a wholesale opening to foreign capital. China’s Pacific Ocean market-import strategy will be markedly different to its Indian Ocean state-import strategy. Kazakh oilseeds and grains and African fish will come under a very different trade arrangement than rapeseed and soybean imports from North America.

This all means that in the area of international commodities, the gravity of institutional legitimacy is shifting to China, as China’s leaders move the country towards becoming a net importer in a range of commodities. Just as institutions such as the Chicago Board of Trade or the London Metals Exchange have enjoyed institutional legitimacy before it, China hopes that the commodities exchanges in Dalian and Zhengzhou could entice global markets to take signals from China.

This is part of a wider move in China towards greater imports – not just in agriculture. For China, the incentive is not a sudden urge to align with global agricultural commodity trade institutions and practice. Rather, increasing imports is a way for China to expand its leverage over the price-setting institutions of global commodities.

The gravity of China’s agricultural trade is also shifting to the Indian Ocean trade arrangements and away from the Pacific. China opening to more Pacific imports will really be liberalisation after the geo-economic paradigm has already shifted.

While the short-term Trump tariffs will dominate soybean news this year, China ending its policy of state procurement on staple crops is a paradigm shift for global agricultural commodity production.

The long-term move to a market model on domestically produced agricultural commodities and the opening of China’s consumer markets to imports of agricultural commodities would be a massive benefit to China as it sources cheaper grains and oilseeds to service its food needs. For agricultural exporting countries though, if China does open to greater imports, future political risk lies in the institutional legitimacy of price-setting, indices, and exchanges.

Global political factors will likely slow down China’s international import strategy for agricultural commodities. These include the ongoing trade dispute with the United States, exclusion from the Trans-Pacific Partnership, and wider institutionalised global trade uncertainty. However, China is genuinely moving to open agricultural markets while maintaining control of an agro-industrial policy complex.

This is quite an extraordinary situation for China’s agro-industrial development, as it is the opposite of the pattern of other rapidly industrialising East Asian economies. Historically, state-capitalist economies tend to open their manufacturing sector before agriculture.

However, the end game is not convergence with open market economies, but establishing the legitimacy of institutions. Bringing China’s domestic agricultural commodities into market-based production systems should be applauded, yet the financial and social vacuum of doing so while maintaining an essentially peasant population must still be questioned.

Tristan Kenderdine is Research Director at Future Risk and lecturer in Public Administration at Dalian University.
To buy or not to buy

Why Chinese millennials are choosing the rental lifestyle
By Timothy Ang

The emergence of the housing rental market could be the next major development in China’s dynamic but troubled real estate market. Inflated property prices and a young population moving away from traditional aspirations of home ownership has opened the door for companies willing to offer an alternative to the classic house-hunting experience. One startup that has made its name in this space is Ziroom.

Starting out as a small-scale project nestled under the umbrella of Chinese high-street real estate agent Lianjia, Ziroom is now a frontrunner in the market for so-called “branded rentals,” defined loosely as properties refurbished according to a standardised template and supplemented by various add-on services such as cleaning. Since going live in 2011, Ziroom now offers over 500,000 listings to some 1.2 million tenants across China, according to estimates by the Wall Street Journal, and shows few signs of slowing down.

Ziroom was spun off from Lianjia in 2016, allowing it to consolidate its remit as a leading provider of branded rentals to China’s newly-graduated urban millennials, as well as seek funding sources independently. In January, Ziroom raised $621 million from an investment group led by Warburg Pincus and which included major players such as Tencent and Sequoia Capital. The fundraising round gave Ziroom a $3 billion valuation, making it China’s first rental housing “unicorn” (startup worth $1 billion or more).

The company’s extraordinary growth is testament to the rapid social and economic changes taking place in today’s China. Forecasts by financial firm Orient Securities Co esti-
mate the house rental market in China will reach Rmb 4.2 trillion ($664 billion) by 2030—that is almost 1.5 times the country’s total rental income and equivalent to about half of all home sales last year.

Firms like Ziroom have ridden a wave of favourable policies from Beijing, for which a stronger rental sector fits neatly with its goals of cooling the overheated property sector. The average house price in Beijing, Shenzhen and Shanghai is now over 40 times higher than the per capita annual income level in those cities. That is higher than any other major city in the world, and more than double the level in Paris and New York, according to the Financial Times. And while there has been evidence that the property market is cooling in China’s top-tier cities in recent months, prices in many smaller cities are still skyrocketing at double-digit rates.

In response, the government has begun rolling out a number of incentives designed to make renting a more attractive option. For tenants, protections against unwarranted rent increases and evictions have been put in place and pensions deposits have been made available as a cash source for renting purposes. Property owners, meanwhile, have been given tax deductions if their income falls beneath Rmb 360,000 ($54,000) per year. Rental companies can also trade publicly much more easily thanks to a lowering of the requirements for REIT (Real Estate Investment Trust) status. Mofang was the first company to take advantage of this, issuing the first securities backed by future tenant payments in January 2017. Seven months later, Ziroom raised 10 times that sum.

But a friendly regulatory environment is just part of the story. Ziroom is also tapping into deeper cultural factors pulling young Chinese to the rental market.

Whereas for older generations – and indeed still the majority of millennials – buying a house is considered both a proxy of success and often a prerequisite for marriage and a family, more and more youngsters are craving flexible housing arrangements that suit an increasingly experience-driven lifestyle. Popular online property directory 58.com estimates that of the 190 million tenants in China’s cities, 95% belong to the millennial “do not buy” generation.

For these customers, renting leaves open the luxuries of changing jobs, moving to a new city, and in light of China’s skyrocketing house prices, more disposable income to enjoy the urban lifestyle. In a survey run by the Chinese Academy of Social Sciences on 1,400 recent college graduates, over half said they would choose long-term rental over the financial constraints that come with monthly mortgage payments. Only a third opted for home ownership at the cost of a higher standard of living.

Ziroom has made this millennial mind-set the core of its business model. The company’s Chinese name – 自如, zi ru, or “care free” – sets out a clear target market and philosophy for potential customers. Upon creating a profile on the app, “Ziroomers,” as they are known, are inducted into a huge, active online community where apartment-seekers can chat, share stories and reviews, and even attend offline social events. In a demographic where mobile phones are used in every facet of one’s daily life, a strong, relevant online service is essential.

The Ziroom app provides millennials with the kind of frictionless, mobile-centric experience young people have become accustomed to through using food-delivery apps like Ele.me or online-payment services such as Alipay and WeChat Pay. Users can browse a directory of newly refurbished listings, arrange viewings and upload employment and credit information provided by Alibaba’s Ant Financial through
the app to finalise a deal with a minimum of hassle.

Ziroom tenants can also choose from a range of add-on services that help provide them with the care-free urban lifestyle they are seeking. The company currently offers four product types. Its two core branded rental options, “Friendly Home” and “Full House,” were the first products that allowed Ziroom to distance itself from the standard services of under-furnished, “bare-bones” properties listed by other property agents. Tenants have the option to select their bedroom furnishings and are eligible for Ziroom-provided services such as cleaning and trash collection. This holistic approach to rentals was taken to the next level in the most expensive and recent tier, which offers living units in a larger co-living space like an apartment block. Based on the WeLive concept developed in the US, tenants here have access to social spaces such as lounges or cafes and properties are exclusively found in areas of high foot traffic with cheap restaurants and supermarkets nearby – the natural habitat of a Chinese urban millennial.

Convenience for the property owners is similarly placed at a premium. Ziroom takes over much of the hassle of property management from landlords in return for a fee, which can range from 5% to as high as 60% of rent payments. All payments, repairs or complaints can be made through the app’s messaging service, to be dealt with by Ziroom staff, so owners have greatly reduced responsibility for basic maintenance. Ziroom even promises to cover 15 days’ worth of rent in the event of a property lying vacant.

Nevertheless, as with any maturing market housing, rentals could be on the verge of becoming a much fiercer competitive space, threatening the long-term profitability of players like Ziroom if they are unable to adapt. Rising rental costs in major cities are pushing agents to get in early and sign longer contracts with developers in more expensive areas, despite the cost of higher capital expenditure and higher vacancy risk in an industry that already operates on small, precarious margins.

There is also the threat from traditional real estate developers increasing their exposure to the rentals market, especially if there is expectation that the government will move to place a tighter lid on home purchases. Firms like Port Apartments, owned by real-estate giant Vanke, benefit from massive scale and experience, allowing them to build and rent out huge volumes of living space at low construction costs. Launched just three years ago, Port Apartments already manages 100,000 listings in 18 major Chinese cities.

To hold on to their market share, the likes of Ziroom may need to double-down on their USPs of multi-tiered products and add-on services while taking a hit to profitability. Headwinds may be accumulating for the startup, but the confidence shown by big-name investors in this year’s fundraising round coupled with a youthful, innovative company culture suggest Ziroom is in a good position to weather them.
It took a mermaid and large amounts of caramel to convince the Chinese to embrace coffee. When Starbucks opened its first shop in Beijing in 1999, the company’s mission to convert a nation of tea drinkers seemed far-fetched. But sweetened Frappuccinos, the chain’s signature drink, have proved to be the perfect gateway to coffee for China’s young, urban consumers.

Now, China’s specialist coffee shop sector is valued at $4.72 billion, and Starbucks dominates with a 58.6% market share, according to figures by Euromonitor. The American company operates 3,300 outlets in 141 mainland cities, and this number is growing at a rate of one new shop every 15 hours. By 2021, Starbucks expects to have 5,000 outlets nationwide, and aims to reach 230 cities the following year. Revenues, according to company projections, are expected to triple over the next five years.

Those numbers have attracted competition. Luckin Coffee, a homegrown coffee unicorn based in Beijing, is aggressively challenging Starbucks at its own game. Within months of a soft launch at the start of the year—and reportedly boosted by a RMB 1 billion ($150 million) investment—the startup has already hit 525 physical shops in 13 cities. That comes in addition to a purely “online” trade channel consisting of app purchases and delivery.

Luckin is pouring money into the breathless expansion as well as into juicy promotions and discounts in a bid to outmaneuver its US rival. The Chinese firm is undercutting Starbucks by around 20% on a large latte, according to the South China Morning Post. At the same time, it is offering Starbucks staff triple their current salaries to tempt them away, according to Technode. The battle further intensified in May, when Luckin sent a letter to Starbucks threatening a lawsuit over alleged monopolistic interference with industry suppli-
There are also a slew of smaller chains and independent coffee shops emerging in the big Chinese cities looking to take market share from the multinationals that once dominated in China, such as Costa Coffee, KFC and McCafe.

For now, there appears to be plenty of room for all these players. Figures by the International Coffee Organisation show a 16% annual increase in Chinese coffee consumption between 2004 and 2013. That growth will continue at around 15-20% over the next few years, reckons Thibaud Andre, a senior consultant at Daxue Consulting.

But the engines of this growth appear to be changing as consumers become more willing to trade the sugary blends of the early days for higher-quality roasts. Consumption of fresh coffee rose faster than any other product last year in both value and volume terms due to rising demand for better-tasting brewed coffee, according to Euromonitor.

Andre expects that the coffee war will also spread across the country as consumers in smaller cities increasingly catch the coffee bug. “The market will switch to more premiumization or will switch to targeting a wider pool of consumers,” he said. “The market seems actually to be kind of saturated in the main cities. I think we are above 100,000 coffee shops now in China, mostly gathered in the top cities. So, the driver for growth will not be from this segment.”

Starbucks’s move into an additional 100 cities by 2022 is a sign of this down-tier expansion, as purchasing power rises throughout the country. Costa Coffee is even more ambitious, eyeing 1,200 stores by 2022, up from 459 at present. Meanwhile, Starbucks just launched a 30,000 square foot state-of-the-art mega roastery in Shanghai last December—its biggest store anywhere—in order to hold on to ever-more sophisticated coffee drinkers.

While this may drive growth, the shift towards more home and office consumption is likely to prove more important, with the restaurant segment being another potentially lucrative yet so far unexplored arena, according to Andre. “I expect [home consumption market share] to get over 50% pretty soon, which would kind of stabilize the market, by not relying on the big chains for development,” he said.

The most potent symbol of China’s accelerating transition from tea to coffee is perhaps found in southwestern Yunnan Province. Amid declining tea prices, farmers in Pu’er, an area renowned for its fermented black tea, are switching crops. Coffee can offer double the income. Production of coffee in Yunnan has grown at 21% per year between 2004 and 2013, doubling over the last seven years, according to the International Coffee Organization.

The largest out of China’s three coffee growing regions, with 95% of the national total, Yunnan is the only one exclusively specializing in the higher quality arabica beans. Hainan and Fujian provinces remain bastions of the lower-grade and more bitter robusta, commonly reserved for instant and industrial coffee products.

It is easy to see why farmers are choosing to make the change to coffee. Per capita coffee consumption is still very low in China by global standards, at around five cups per year nationally, barely climbing to 20 cups in the largest cities. By comparison, the average US consumer drinks 400 cups per year. In other words, there is room for enormous growth in this market.

The Starbucks mermaid, which once presided alone over China’s coffee landscape, is about to get company. That could be Luckin Coffee, if it manages to avoid a cash crunch. Or perhaps another Chinese challenger will come along and start an entirely new fight.
China Foreign Enterprise Directory
18th Edition 2017 CD-ROM

China Foreign Enterprise Directory (FED) is the most authoritative directory of all top multinational companies and foreign firms operating in the China market. The Directory is published once every two years. All listings are updated daily ahead of printing, to ensure that the information is always up-to-date.

The China Foreign Enterprise Directory 18th Edition 2017 CD-ROM* version provides fast and flexible methods for searching for companies. It includes all the data in the print version and more. This CD-ROM is a powerful research and marketing tool to help you succeed in your marketing campaigns in China.

**The CD-ROM version contains:**
- More than 7,600 companies
- More than 17,200 offices
- More than 13,300 contacts
- More than 8,700 emails

**CD-ROM powerful features:**
- Print mail labels
- Export Email: All emails can be exported into an Excel spreadsheet, you can send your marketing information to all listed emails
- Hyperlinks: Link via the Internet to the websites of listed companies
- Memo: Users can enter their own notes
- FULL SEARCH CRITERIA:
  - Industry - Search companies by 60 major industry categories
  - Location - Find companies located in all parts of China
  - Company Name - Find the contact information of specific companies
  - Nationality - Search companies by their HQ locations
  - Job Title - Find the key executives you are looking for
  - Memo - Track the record you entered in the CD database

*CD-ROM is available only for Windows operating systems

**PRICING**

CD-ROM: US$450/RMB2,800

SinoMedia Best Sellers
1. China Enterprise Directory
2. China Business Guide
3. China Enterprise Directory
4. Top Global 500 Companies in China Directory
5. China Financial Services Directory CD-ROM

FOR ENQUIRIES, CONTACT:
Tel: +86 21 5385 9019
Email: seana.liu@sinomedia.net
Quality Books on China and Beyond

EARNSHAW BOOKS

ASIA BETRAYED
HOW CHURCHILL SACRIFICED THE FAR EAST TO SAVE ENGLAND
John Bell Smithback

THE SCIENCE OF WAR
Sun Tzu’s Art of War re-translated and re-considered
CHRISTOPHER MACDONALD

BLACK IN CHINA
A Black man’s experience of racism—in China and the United States
Aaron A. Vessup

THE REPUBLICAN PARTY AND THE RISE OF CHINA
How An American Political Party Helped Create Modern China
David Petriello

JUSTICE BY GUNBOAT
Warlords, Landlords and the Making of Modern China and Japan: Absolvement of the Gunboat Doctrine
Douglas Clark

I DIDN’T MAKE A MILLION
HOW JAZZ CAME TO CHINA
WHITEY SMITH
with C.L. McDermott

WWW.EARNSHAWBOOKS.COM