SPECIAL INTERVIEW
Vikram Mansharamani

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The Best, for the Biggest

BRAZILIAN MARKET
Selling High End to the High End

Emerging Markets Insight

BY MIRAE ASSET FINANCIAL GROUP
Q4 2014

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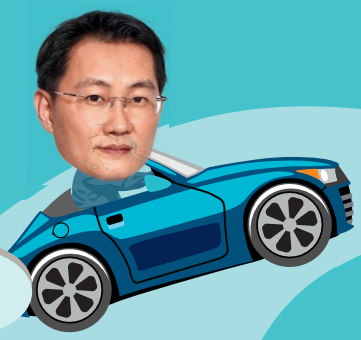
Apple

SPECIAL REPORT

SMART CAR

THE BATTLE FOR THE INTERNET OF VEHICLES IN CHINA

Google



Tencent 腾讯

IN THE BATTLE FOR SMART-CAR SUPREMACY, TENCENT'S COMPETITORS ARE NOT TRADITIONAL INTERNET OF VEHICLES MANUFACTURERS, BUT INSTEAD, BAIDU, ALIBABA, AND EVEN APPLE AND GOOGLE.

MIRAE ASSET
Building on principles

Q4 2014

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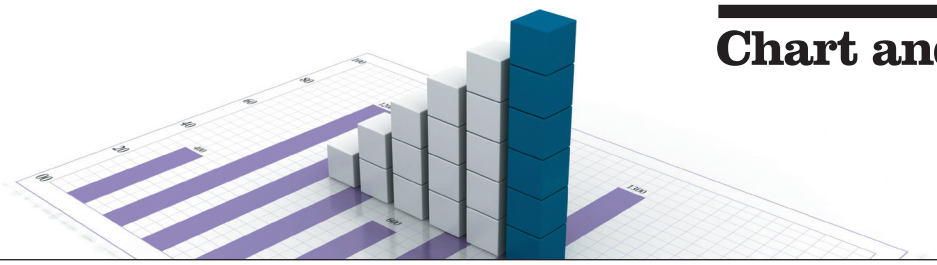

LOOKING FOR PATTERNS

Numbers worth remembering. You can find more at "Chart of the Day" in our iPhone app, *EM Experts,* that provides unique info-graphics about emerging markets, or follow us on Twitter (@emexperts).

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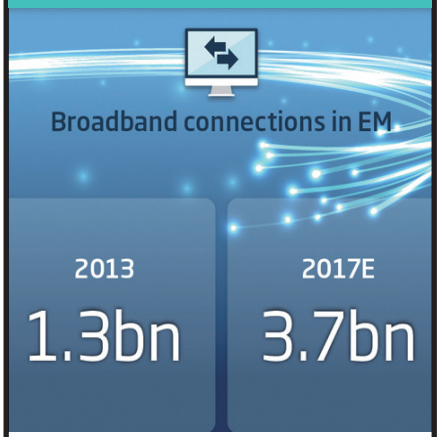
BROADBAND SERVICES TO EXPAND RAPIDLY ACROSS EM

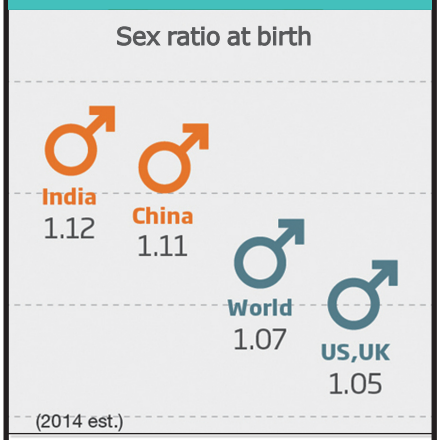


Broadband services in emerging markets are expected to grow at full speed. According to research data, emerging market broadband connections are projected to nearly triple from 1.3 billion in 2012 to 3.7 billion in 2017. Furthermore, most of these connections will be based on wireless technology.

CHINA NOW THE WORLD'S LARGEST SOURCE OF OVERSEAS TOURISTS

China has overtaken the US as the world's largest source of foreign tourists. In 2011, Mainland Chinese made approximately 70 million overseas trips outside of their home country, surpassing the 58.5 million trips made by Americans during the same year.

EM RATIO OF BOYS TO GIRLS REMAINS HIGH

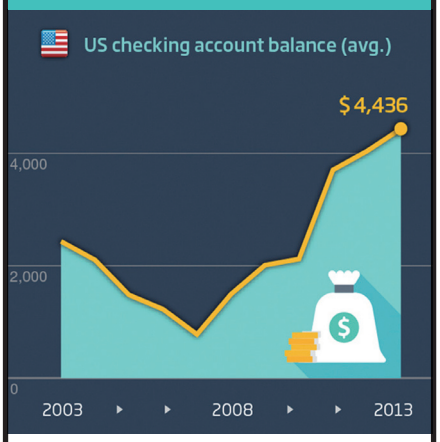


India and China recorded the highest ratio of boys to girls at birth (sex ratio). In 2014, India's sex ratio is estimated to be 1.12, and the corresponding figure for China is projected at 1.11. Meanwhile, the ratios for the US and UK were both at 1.05.

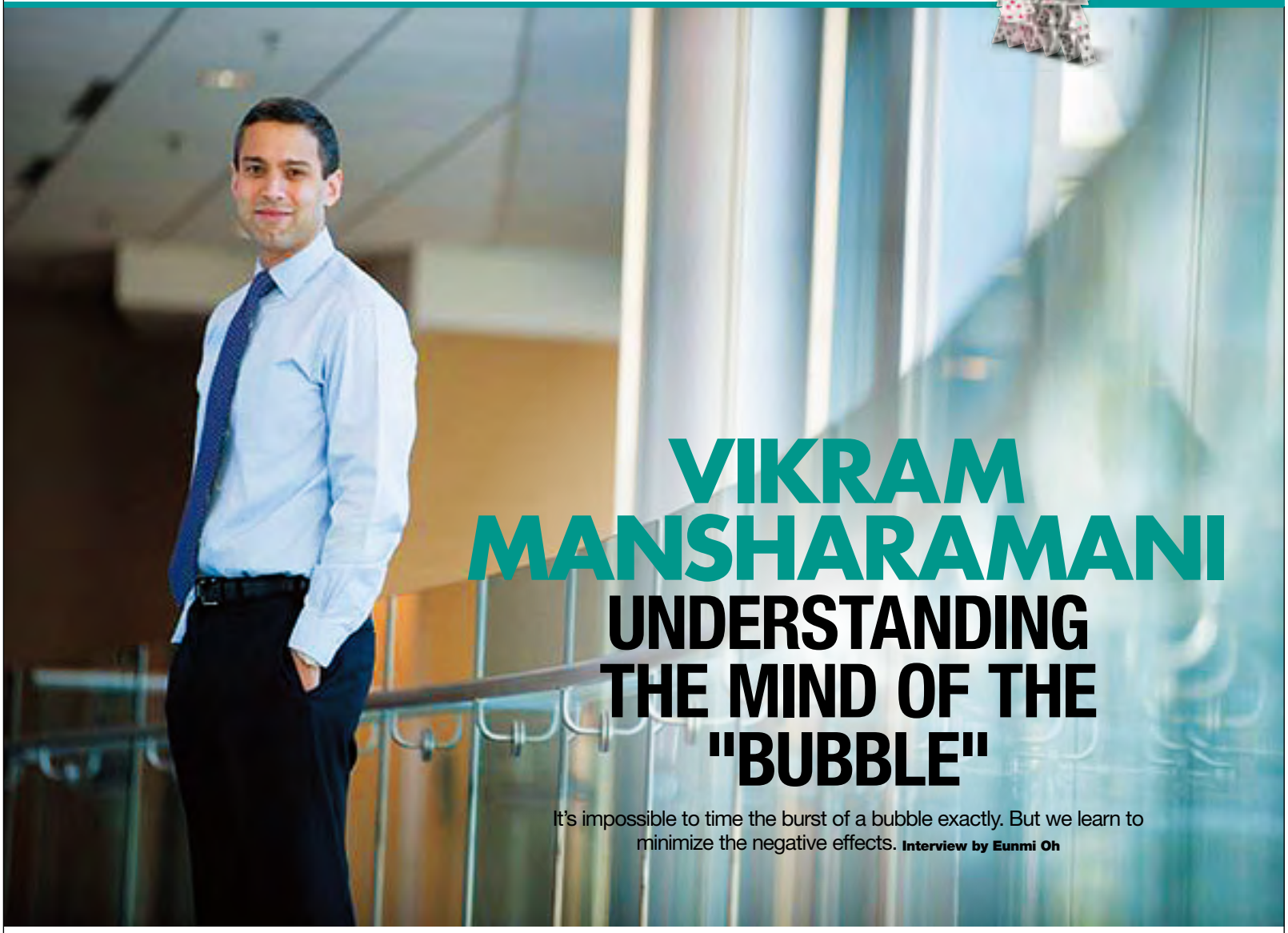
CHINA BECOMES WORLD'S NO.1 IN WINE CONSUMPTION

China has become the world's largest wine consumer. China (including Hong Kong) consumed 1.87 billion bottles (155 million nine-liter cases) of red wine in 2013, with red wine consumption in the region almost tripling between 2007 and 2013. France and Italy were next in line, with 150 million cases and 141 million cases, respectively.

US CONSUMERS PILE UP CASH DUE TO LOW CONFIDENCE



The average account balance of checking accounts in the US reached $4,436 in 2013, the highest amount in 10 years since 2003. This indicates that Americans remain cautious on spending money despite the recently improved economic figures.



VIKRAM MANSHARAMANI

UNDERSTANDING THE MIND OF THE "BUBBLE"

It's impossible to time the burst of a bubble exactly. But we learn to minimize the negative effects. **Interview by Eunmi Oh**

Well-respected global equity investor, lecturer and author Vikram Mansharamani is a student of financial "bubbles."

The New Jersey native got his start in equity sales during high-school summer internships at Bear Stearns. Later while attending Yale, Mansharamani worked summers at the American Enterprise Institute.

He earned his Master's and Ph.D. from the Sloan School of Management at MIT. He has written articles for *The New York Times*, *The Wall Street Journal, The Korea Times* and many other publications.

Mansharamani recently talked with EMI about his book *Boombustology: Spotting Financial Bubbles Before They Burst* and his views on the bubble phenomenon.

Could you briefly explain what Boombustology means? Do you have any special reasons for becoming interested in the bubble?

The title of my book, *Boombustology: Spotting Financial Bubbles Before They Burst*, was chosen to suggest that it is possible to identify a bubble before it bursts. It's worth noting that I did not imply any sense of timing on the bursting of a bubble, something which I believe is virtually impossible to do with any precision. Nevertheless, I do think that serious study using multiple lenses ("Boombustology") as the study of booms and busts is useful in gauging risk.

I grew interested in the study of financial bubbles during my first internship on the sales and trading floor of Bear Stearns during 1990. I was a student and had been reading about "efficient markets" but was witnessing inefficiency in Japan's capital markets. The contradiction continued to intrigue me as I watched the Asian Financial Crisis, the Internet Bubble and then the US Housing Bubble all progress through stages of irrationality and inefficiency. For many of those years, I was an active participant in financial markets, so it wasn't merely for theoretical interest that I studied bubbles. It was to help me navigate them as an investor.

It appears that the bubble was visited in five aspects: macro- and microeconomics, psychology, politics and ecology. Why did you use

PHOTOS/SHUTTERSTOCK

these five spectrums? What benefits can we get from using them all together?

The actual number of lenses is irrelevant. In fact, I only used five in the book because it made for nice symmetry with the cases. In my classes, my students and I also discuss a sociological lens that incorporates culture and power dynamics into the equation. Confucian societies, for instance, have an inclination towards the prioritization of the group over individuals. This naturally creates a sense of herding as contrarian perspectives are rare.

The rationale behind a multi-lens approach is that it increases the odds of finding insight within a probabilistic world. If price action (my microeconomic lens) appears to be "bubbly," the asset in question may or may not be a bubble. But if prices are "bubbly" and credit is abundant (my macroeconomic lens) and confidence is high (my psychology lens), then the asset in question is more likely to be a bubble, but we can't say anything with certainty. In a probabilistic world, the key is to increase the likelihood of insight by using multiple lenses to triangulate different perspectives.

Record high liquidity has been shown. Why do we need to look at bubbles and bust at this point?

My second lens (macroeconomics) is really about mispriced and misallocated capital. There is no question in my mind that capital (and risk) are mispriced today due to the unprecedented global liquidity support of central banks. There are many candidates for bubbles in this world. I am very concerned that the unwinding of such monetary stimulus has the potential to be very disruptive. With that said, the unwinding of US stimulus and liquidity may be offset by unconventional liquidity-enhancing monetary policy from Europe. The ECB recently joined the liquidity party, having jumped in with both feet… There are many cross-currents to watch!

Do you see the issue of a subprime bubble coming to an end?

I am actually concerned that the low interest rates and current liquidity environment are recreating many of the risky dynamics that characterized the subprime bubble. Consider, for instance, the fact that UK fast-food retailer Chilung recently raised money by offering bonds that gave investors free burritos each week until maturity. Free burritos!

Another development that concerns me is the recent rise

in the number of "covenant-lite" bonds that are being issued in which traditional investor rights are meaningfully diminished.

Some people believe that a substantial impact can be put on emerging countries when the US changes its easing policy, for example, increasing interest rates. Do you think that emerging countries have become better prepared than in the past with their economies more developed and stabilized? What impact can we expect on emerging countries' stock markets when the Fed raises interest rates?

While it is true that the developing world is more mature than it was during the Asian financial crisis, this doesn't mean they are immune to global pressures. Even if their economies have decoupled (which is a very big "if"), they are still highly interconnected to the developed world via highly globalized capital markets. This means a rapid deterioration in one financial market can easily be transmitted to other markets as portfolio managers and index funds re-weight their portfolios.

As for how the Federal Reserve's policy on interest rates may affect the emerging markets, the most obvious transmission mechanism will be through dollar strength. This tends to reduce the value of dollar-priced commodities, a ripple that rapidly flows through emerging countries more dramatically than it does through the developed world. Secondly, it will cause a rise in the effective currency value of all dollar-linked and dollar-pegged countries, resulting in a reduction in export competitiveness. Finally, rising US interest rates may in fact result in a flow of dollars back to the United States, thereby constraining dollar liquidity globally.

In your book, it is suggested that we should be wary of the recent Chinese economy bubble. Do you still keep the same stance on the Chinese economy?

In 2011, when my book was first published in the United States, many readers

(around the world) dismissed my concerns about the Chinese economy (the final chapter of the book). In fact, I recall stepping off the stage of a large investment conference, and after politely thanking me for my comments, the prominent conference organizer announced to the audience: "Well, that was thought-provoking…even if inaccurate." Very few investors acknowledged the risks to the Chinese investment story (and the corresponding risks to the commodity supply chain that fed the investment boom). I expressed deep concerns about Brazil, South Africa and Australia specifically. Many of these concerns have been at least partially realized.

I would also say that my expectation for the Chinese slowdown has not yet been fully fulfilled. I have stated that I expect Chinese GDP growth over the 2013-2023 timeframe to average 5%. Clearly, such an extreme slowdown does not appear as likely at this point as I had originally thought. I believe the fears of domestic social unrest have been the political motivator for continued government support to maintain growth. The recent events in Hong Kong are likely to add pressure on Beijing to support domestic tranquility via strong economic growth.

I also have spoken extensively about the transition of the Chinese economy from an investment-led growth story to one that was based on consumption. This has not yet happened to the extent I had anticipated when my book was published.

There is a rising worry on a bust of the Chinese real estate market bubble. What impact could we expect on the global economy if China's real estate bubble bursts at this point? How destructive could it be?

I believe a massive financial crisis in China will have a very large impact on the global asset markets. Let's consider a handful of possible ramifications. First, there are many commodities in the world in which China accounts for 50%+ of global consumption; there are many others in which China accounts for >100% of incremental demand. In many cases, the long lead times needed to increase production capacity in the commodity complex imply supply is likely to rise, at precisely the time that demand may fall. Clearly, rising supply and falling demand is a toxic combination for prices. Secondly, China is highly interconnected with the rest of the emerging world—implying a general slowdown in emerging market economies. Third, I get increasingly concerned that the Chinese might significantly depreciate their currency (as they did in 1994) to gain competitiveness, thereby putting further downside pressure on other economies. Lastly, there is the wildcard of how they will treat their holdings of US treasuries and the implications of those actions on global interest rates. Net net, a financial crisis in China is not good for any of us!

The Bank of Korea recently lowered interest rates close to 2%, aiming to stimulate the economy. Do you have any concerns about the possibility that high debt could cause a credit crisis and that the Korean real estate market may experience a bubble?

As readers of my book will see in my chapter on macroeconomics, I am a fan of Hyman Minsky's financial instability hypothesis. Minsky suggests that stability itself is destabilizing. In the case of Korea, many capital structures will adapt to the new interest-rate environment…and lower rates inherently mean people and companies can afford to borrow more given similar cash flows. The higher debt load makes the people and companies more vulnerable to future interest rate rises.

Minsky wrote about a migration from Hedge Financing—in which money is borrowed but repaid from cash flows; to Speculative Financing—in which interest is paid from cash flows but the borrower is speculating a refinancing market is available when the loan is due; to Ponzi Financing—in which the borrower must borrow additional debt to pay the interest on the existing debt. In the final stage, asset prices need not fall to create financial chaos—they must merely stop rising. The migration from Hedge to Speculative to Ponzi financing strategies is a natural outgrowth of stability in asset prices and low rates…and creates the very instability that the strategy sought to avoid.

While it is way too early to tell, I believe the global focus on low rates (in Korea and elsewhere) is creating a riskier medium-to-long-term outlook rather than a more promising one.

In the book, you wrote that analyzing a market bubble, which is the spread of speculative

investment, is similar to "epidemiology." Why do you think that people fall into such collective irrational behavior? With the ecological aspect, what kind of symptoms can be detected in our market when the bust is on the verge of occurring?

It turns out that many of the same tools used by public health officials tracking the spread of an emerging epidemic are useful in the study of bubbles. If we analogize a speculative mania to a fever or flu, then metrics such as the infection rate (how many people are catching the disease from someone already infected), the removal rate (how many people die off or develop immunity after being infected), and the still-vulnerable population prove useful.

Thus, it gets very concerning to me when investment topics are broadly discussed by the general population. Consider for instance when dinner-party conversations are focused on investment ideas. Or when taxi-cab drivers are sharing the latest hot "tips" on where to invest. These are not good signs. It means that the infection rate may be peaking and the available pool of those still left to infect is dwindling. The speculative fire is running out of fuel. Another interesting way to identify this phenomenon is to look at mass-market magazine cover stories… When popular sentiment is so focused on a particular investment domain that publishers believe the potential buyers of the publication are plentiful, it's probably too late to profitably invest.

For the individual investor, why is it useful to understand 'bubble and bust'?

By understanding boom and bust cycles, both individual and institutional investors increase the odds that they will be able to avoid the return-destroying financial crises that can adversely affect long-term performance. Simple math suggests this is a worthwhile consideration - capturing a 50% loss necessitates a 100% return to simply recover. Even after conceding that perfect timing is impossible, consider that by missing half of the downside by either getting back in too early or by capturing the beginning of the downdraft also reduces the recovery time: a 25% loss requires a 33% gain to completely offset the pain.

If we understand the cycle of bubble and bust, can we actually be prepared for the 'bubble'?

Unfortunately, it is impossible to time the burst of a bubble perfectly. Almost by definition, irrational behavior is not predictable. When a bubble appears to be nearing it's end, I suggest to my clients that they "dance near the door" (i.e. stay in liquid securities from which it is easy to exit) because the party may soon end...and that when it does, many people will be trying to exit rapidly via the same small door. Merely being one of the first ones out the door will save much pain.

THE BATTLE FOR THE INTERNET OF VEHICLES

In the battle for imported vehicles, Tencent's competitors are not traditional Internet of Vehicles (IOV) manufacturers, but instead Baidu, Alibaba, and even Apple and Google.

By Ma Jiying

There is gossip about Ma Huateng, not about him, but about his car. The gossip is that his car is equipped with "a wearable device," involving on-board diagnostics (OBD) hardware.

At the Global Mobile Internet Conference (GMIC) held May 5, Tencent unveiled its first IOV smart hardware, Lubao Box, and accepted pre-orders in advance at a price of only 16 cents. In just a little over two months, more than 290,000 potential users pre-ordered Lubao Box, and the number is growing. Meanwhile, Lubao Box is being tested among a small number of users, and one of them is said to be Tencent's CEO Ma Huateng. In the field of IOV, there have not been any clear business models, so Tencent's entry is both exciting and worrying. Many IOV companies are familiar with Tencent's Lubao Team. Before the launch of Lubao Box, the Lubao team visited several industry companies seeking cooperation agreements, but the companies responded differently to the olive-branch extended by Tencent.

"I believe if others can sell similar products, our product can sell better."
—Jin Xiangyu, general manager, Xtooltech

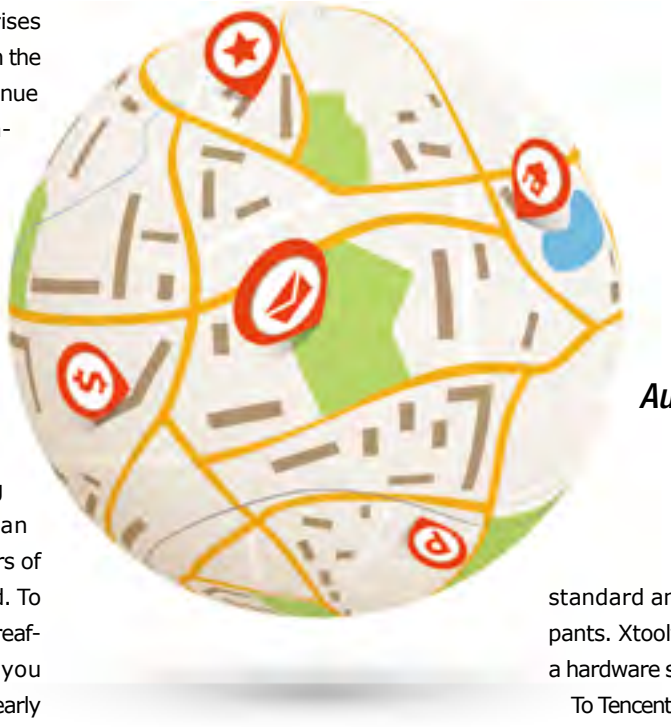
Pessimists think that Tencent is an outsider in the IOV industry. Not only will Lubao Box end up like other Tencent products, that is, making no progress whatsoever, but it will only aggravate the chaos currently taking place in the IOV industry. Yet according to the optimists, BAT (Baidu, Alibaba and Tencent) will each bring a brighter future to the IOV industry. Tencent's Lubao team has not responded to these statements and continues to maintain a low profile, remaining largely silent; Lubao team leader Zhang Xian has been avoiding interview requests from the media since the launch of Lubao Box.

Nevertheless, BAT should not be ignored in the IOV industry or even in the automobile industry.

At an automobile industry forum held in April, Tencent vice president Ma Jiren explained the changes that might take place in the automobile industry from an Internet-centered perspective. Soon after the forum, Baidu launched over 20 intelligent hardware products at its smart hardware summit; one of these was the IOV smart hardware product CarNet. On July 4, Gaode also released its first smart hardware product, Gaode Map Assistant. The product claims to be the "Miracle on the Steering Wheel" with such functions as navigation and traffic broadcast services. After Gaode, Alibaba's role too should not be ignored.

"Now Alibaba is in talks with several automakers about cooperation agreements, but this has not been publicized," said Tong Haoliang, general manager of Goade's IOV Business Center in an interview at the end of June. He revealed that many automakers were interested in Alibaba and engaging in their own in-depth thinking about the mobile

Internet. On one side are IOV enterprises with an unclear business model; while on the other are the Internet giants who continue to embrace the world with their open-minded approach. Tencent has tried to enter the vehicle service market where there are currently no standards on how to connect car owners and their vehicles. However, its attempts to do so have not earned it anyone's applause.



"Not every start-up wants to be sold to the BAT, at least not us."
—Zhang Cheng, Auto-Linked co-founder

Making a Move

Building C of the Second Longjing Industrial Zone is located in Nanshan District, Shenzhen. The first three floors of the four-floor building look abandoned. To reach Shenzhen Xtooltech Co., Ltd. (hereafter "Xtooltech") on the fourth floor, you either have to use the stairs or take a clearly marked service elevator that still has an open square hole in its ceiling.

"We are moving soon," said Xtooltech's general manager Jin Xiangyu.

About half a year ago, Xtooltech became the original equipment manufacturer (OEM) of Bubao Box. Founded in 2010, Xtooltech is a start-up that mainly manufactures and sells automotive diagnostic equipment. Ninety percent of its sales come from overseas markets. Jin Xiangyu estimated that Xtooltech's turnover could reach $12.8 million in 2014 with a net profit of $3.2 million.

Like all start-ups in industries with niche segments, Xtooltech faces double ceilings. One is the limited size of the automotive diagnostic equipment market; the annual global market is only around a billion dollars according to Jin Xiangyu. The other is the unshakeable position of the industry leader Launch Tech Company Limited (hereafter Launch). Xtooltech needs to find a new breakthrough in this market.

When Tencent's Lubao team visited Xtooltech late last year, Jin Xiangyu thought it was an opportunity. Objectively speaking, cooperation with Tencent was not very easy. Tencent's Lubao Box can be pre-ordered for 16 cents, but this tiny fee puts huge pressure on the OEM. Rumor has it that Tencent has not paid the OEM its development fee nor has it made any commitment on the quantity of boxes ordered. But Jin Xiangyu did not think that was important. "I know how the Internet industry game is played. I never asked about the quantity of an order. I believe if others can sell similar products, our product can sell better. If others cannot, it is still possible ours can."

What matters to him is that their cooperation with Tencent provides a good opportunity to raise the profile of Xtooltech. For the current IOV sector, "Tencent's entry may change its business landscape, and Tencent has many resources to educate consumers".

Indeed Tencent and others' plans for the IOV sector are becoming clearer. In January 2014, Tencent released an app called Lubao. In May, Tencent acquired 11.28% of the shares in NavInfo at a price of $278 million. Although many people think the app lacks any new features other than navigation, the thinking behind the "software plus hardware" design has become the common standard among all IOV industry participants. Xtooltech is clearly positioned-to be a hardware supplier in this sector.

To Tencent, this seemingly-simple hardware is not so simple. Although an on-board diagnostic (OBD) interface is already a standard configuration for vehicles, it is a challenging technical feat to read the information from so many different brands and models and create a standard interface, requiring deep industry knowledge and data accumulation.

Therefore, the Lubao team has anxiously but enthusiastically approached the technically skilled enterprise Launch in the OBD industry for further collaboration.

In fact, the initial function of OBD was to provide an interface for technical inspectors to read vehicle data. Launch has rich experience in the OBD industry with more than 50% share of the Chinese OBD market. Moreover, it was listed in the Hong Kong Stock Exchange in 2011.

Inevitably, Launch is a potential partner for Lubao Box if Tencent wants to achieve its desired goals in terms of automotive diagnostics. Over the past 20 plus years, Launch has sold over 500,000 automotive diagnostic devices which are scattered over roughly 200,000 vehicle maintenance locations. These provide enormous potential offline resources for the vehicle service market that Tencent is trying to enter.

But the cooperative model proposed by Tencent proved unacceptable to Launch. Tencent didn't want Launch's logo to appear on Lubao's products. Further, Lubao's proposal that it use Lubao's AppLaunch product was rejected. "We have endeavored a lot (with over 20 years' experience in the industry) and have the best technology in the industry. It's really hard not to see our logo on the products," said Launch's deputy president Huang Zhaohuan. Unlike Xtooltech which is following the lead of the Internet giants, Launch has a stronger sense of its own identity.

Launch's accumulated industry experience has increased its leverage in its negotiations with Internet giant Tencent. Tencent later proposed a compromise, in which Tencent offered that the logo of golo (an OBD product of Launch) would be displayed on the product interface; it was also willing to promote Launch as Lubao's core supplier. The data that Lubao uses for automotive diagnostics is already provided by Launch. However, Launch still refused to accept the olive branch extended by Tencent.

After hard work in traditional industries over many years, Launch has experienced pressure to transform itself from a traditional company into an Internet company. Yet the management of Launch has chosen to be its own master instead of handing the baton on to a big Internet company. At its annual conference three years ago, Launch proposed to transform itself into an Internet company and develop its own OBD products. Over the past three years, Launch has recruited a team of 200 people to develop its IOV apps.

Launch's Launch

On March 28 in Shenzhen, Launch unveiled its first OBD product, Launch golo, and its corresponding app. According to Huang Zhaohuan, golo's app was downloaded by roughly 40,000 people in the three months after its release. Since golo's release, Launch has updated the app several times and released version 4.0 in July.

Apart from industry leaders like Launch, some start-ups with strong technical backgrounds like Auto-Linked Information Technology (hereafter Auto-Linked) were also considered as partners by Tencent's Lubao team. Auto-Linked is a Shanghai-based start-up founded in 2012. One of its founders, Zhang Cheng, was once engaged in research and development at GM Shanghai's Pan Asia Technical Automotive Center. Although Auto-Linked plans to launch its products at the end of September, it has had three rounds of angel investment and round A of its financing has already been initiated.

Zhang Cheng said that, unlike other OBD products, Auto-Linked's products can collect core vehicle data through connection to low-level data and permit control of vehicles using cell phones. With these technical advantages, Auto-Linked has become a candidate partner that many Internet companies are interested in. Both Lubao and 360's teams have previously contacted Zhang Cheng.

"It's really hard not to see our logo on the products."
—Huang Zhaohuan, deputy president, Launch

However Zhang Cheng said that Auto-Linked has not established a partnership with Tencent. "Not every start-up wants to be sold to the BAT, at least not us. We want to make our own products and make good quality products," said Zhang Cheng.

Lubao's final choice of OEM for its Lubao Box shows its special preference for companies with data accumulation using automotive diagnostics. Xtooltech's founder Jin Xiangyu once worked at Launch. Launch spent three years on the R&D behind OBD hardware and software, but Tencent released Lubao Box in early May, just a few months after it announced its cooperative agreement with Xtooltech. In the Internet industry, what's more important than getting users in the shortest time possible? As for product improvement, this is achieved through rapid iteration.

From the current point of view, there is still great uncertainty whether or not Tencent's IOV strategy will lead it into a bright future.

First of all, Tencent's Lubao Box is connected to car owners' cell-phone apps using Bluetooth. A friend of Jin Xiangyu's told him that the Bluetooth approach is deceiving. "Think about it. The car owners have to turn on Bluetooth and then the apps on their cell phones after getting into their car in order to connect to the OBD hardware. It's too complicated." Of course, the Bluetooth approach has the benefit of low-cost usage; it also frees users from making troublesome repeated payments. But with 3G or 4G OBD products becoming the mainstream in the future, the acquisition of vehicle data won't affect whether or not the car owners have to turn on their app.

Meanwhile, the way Lubao Box integrates resources also reveals the assertive temperament of the Internet industry. Tencent has added the products of People's Insurance Company of China (PICC) and Shell to its i-car life platform. Besides the special benefits offered by 40,000 4S stores and maintenance shops certified by PICC, the platform also offers users quality preferential services nationally at 1,000 vehicle maintenance and repair locations operated by Shell. The industry thinks that Tencent has "an ambitious design" and wants a slice of the pie from the dealers' association. The huge profits from after-sales service have always been considered "the meat" by the dealers' association, but Jin Xiangyu believes "they are more like goalkeepers in that they don't want to lose their customers, while the Internet companies are trying to disrupt this way of thinking."

THE INTERNET CHANGES CHINESE CONSUMERS!

China is still a developing country. But the excitement about opening new businesses there is as hot as Silicon Valley. And more and more people are trying to be their own boss with their own ideas. Let's look into three new rising start-ups in Chinese business.

1 TUJIA IS MASTERING RESOURCE INTEGRATION

2 DIDI TAXI CHANGES HOW TO TAKE A TAXI

3 JIUXIAN: E-COMMERCE UNDER A RETAILING MENTALITY

TUJIA IS MASTERING RESOURCE INTEGRATION

Tujia benchmarked Homeaway, but its real strength lies in its Chinese features.

By Ji Yongqing
Photo by Shi Xiaobing

Luo Jun founded Tujia .com in December 2011, which operates in a model similar to HomeAway, a short-term lease service platform in the US.

After two and a half years as a business start-up, Tujia is finally in the teeth of storm. For the first quarter of this year, the number of apartments newly listed on Tujia is unexpectedly 10 times that of the same period last year. This is largely a result of the strategic cooperation between Tujia and Ctrip, the online travel giant. On Jan. 16, the Ctrip Tujia Channel was officially put on line. When making their travel plans, Ctrip users now have an additional option, i.e. the apartments offered by Tujia.

Without doubt, the more important reason is that the fruits of "Resource Sharing Economy" are mature, and Tujia has been waiting under this fruit tree for a long time. The so-called "Resource Sharing Economy" means that people will share their money, free time, skills and their possessions that are sitting idle, enabling more people to use them. Compared to the traditional "Resource Possessing Economy," this newer economy can not only save resources but is more environmentally friendly and can also promote a more harmonious relationship among people.

At present, the companies of "Resource Sharing Economy" that are relatively popular in the U.S. include Uber (a platform for sharing car transportation services), Airbnb (a platform for sharing accommodation services), TaskRabbit (a P2P marketplace for people to "run errands" for each other), and Zaarly (a comprehensive P2P marketplace for expert services). As a Chinese tourist, even if you are a newcomer in America, everything will be fine: You can rent an apartment easily via Airbnb and experience the life of a regular American family; you can call a car via Uber to go around and even have the driver bring along breakfast for you.

In China, the "Resource Sharing Economy" is gaining momentum as well. Companies such as Yongche Inc., Didi Taxi, Kuaidadi.com, and Tujia have started to gain the recognition of more and more Chinese users.

The Tujia Way

Tujia is also a typical model of the "Resource Sharing Economy": In a scenic tourist area, a person purchases an apartment and only lives in it for one or two months a year. For the rest of the year, the owner will hand it over to Tujia for renting out, thus earning substantial rental income. People who want to travel with a whole family or with a small team from their company doing team-building have another option for finding a good place to stay.

At present, the main clients of Tujia are still tourist families and small company teams. However, some younger groups are increasingly taking up the market share for Tujia. Some time ago, when doing field work in Qingdao, Luo Jun, CEO of Tujia, noticed that several student-looking girls checked in and stayed in one of Tujia's apartments on weekends. He sought out the manager of Tujia Sweetome about this and learned that these girls were college students who got together on weekends to socialize, do laundry and sing karaoke using the high-definition television in the apartment. They went back to their schools on Mondays. All of this stems from the fact that the accommodations at their schools are relatively poor.

"Three to five years from now, Tujia may have the most properties for rent under one roof in China."
—Luo Juan, CEO, Tujia

In this case, even the meaning of travel has changed greatly: The reason for many people to travel now is not only for sightseeing but also to socialize with the people they are familiar with and spend time together.

Luo Jun is aware that Tujia must seize this big opportunity brought by the "Resource Sharing Economy." However, compared to Homeway and Airbnb, their American peers, Tujia has a business model with more Chinese characteristics. A mature business model that can be duplicated has emerged after more than two years of experimentation by Luo Jun and his team. Unlike their American counterparts, Tujia's business model is much more complex and substantive.

For property users, Tujia positions itself is offering more diversified travel services for the rising middle class. For the property owners, Tujia can access more houses by cooperating with local governments and real estate developers. For both the users and the owners, Tujia is offering housekeeping services via its Tujia Sweetome

branch. In contrast, Tujia's American counterparts only manage online information, posting information and transacting financial payments but rarely becoming involved in such activities as offline hotel management. Of course, this is due to the highly mature existing offline commercial practices in the US; Tujia's American peers only need to cooperate with the relevant property management companies.

Through trial-and-error in Hainan and other places, Tujia has refined its business model like exceptionally precise clockwork and then duplicated it in various big cities and tourist attractions nationwide, resulting in explosive growth. Luo Jun is keeping busy further improving the Tujia ecosystem through various forms of cooperation.

For the users, Tujia has created a department of business products to start offering downstream tourist products, providing its customers with packaged budget travel solutions. For example, Tujia is preparing to launch a package of "only [$160} for staying freely in Suzhou, Wuxi or Changzhou," thus enticing potential users who like to travel in the Yangtze River Delta with plenty of apartment options in those areas. "We will not engage ourselves in any business other than contracting and renting apartments, and we will cooperate with companies like Ctrip, Yongche Inc. and Air China to build a sizable ecosystem," Luo Jun expressed.

Competition Expected

Tujia is also preparing to release an owners' business exchange, i.e. any owner who rents his property on Tujia.com can choose the property of any other owners for their own short-term stay. The two parties would only need to settle the price difference in their traded properties.

In the past year, one area where Tujia has evolved smoothly is the acquisition of upscale properties. In addition to cooperating with several big domestic real estate developers which supplied the properties, Tujia has also penetrated into an extraordinarily wide network of local governments. Last year, the forward-looking government of Shandong province contacted and cooperated with Tujia by offering all of the properties surrounding tourist attractions in the entire province, which has produced encouraging results.

Twenty-four provincial and municipal governments have reached a cooperative agreement with Tujia, creating a continuous supply of new properties for Tujia. Apartments under Tujia's arm have spread all over China, from Mohe in the North and Shangri-La in the West to Sonya in the South and Yantai in the East. "Three to five years from now, Tujia may have the most properties for rent under one roof in China. Of course, we do not own these properties but instead supply better accommodation services for everyone needing to utilize these properties," Luo Jun said with a smile. Tujia is also preparing to offer high-end villa service in Beijing and other cities. Each villa has only three rooms, but because of the size of the rooms, the service attendants of Tujia Sweetome must carry wearable devices in order to quickly respond to the tenants' service requests.

Today, the tide of the Resource Sharing Economy has already emerged. Not to mention that Uber is expected to be valued at $100 billion as it prepares to go public, according to The Wall Street Journal, which cites insider information, Airbnb, which is Tujia's benchmark enterprise in the US and the main website for tourist property rentals there, is also planning its C round of financing. This round of financing will raise an estimated $400-500 million for Tujia and will be led by TPG, resulting in a total estimated value as more than $10 billion for Tujia.

At present, Airbnb has already set up a representative office in China and reached a cooperation agreement with Qyer.com, a domestic travel guide website. It is actively preparing to enter the Chinese market. However, Luo Jun is not worried about this, as Tujia has already succeeded following a different path. This strategy lays extra emphasis on the integration of offline resources, which makes it difficult to be copied. "If the fruits in China have not matured, how can the foreigners be successful opening a fruit supermarket? Chinese businesses are better done by Chinese."

Cheng Wei founded Didi Taxi after working at Alibaba for eight years.

DIDI TAXI CHANGES HOW TO TAKE A TAXI

Didi Taxi not only needs to cope with the effects of government policies but must also continue to build rapport with taxi drivers.

By Ji Yongqing
photo by Shi Xiaobing

Most Beijing residents may not know about Beijing Xiaoju Technology Company, but they definitely know its product Didi Taxi. June 9 was the second anniversary of Beijing Xiaoju Technology Company (hereafter "Didi Taxi"). On that day, the company's headquarters were relocated from the crowded e-World in Zhongguancun Science Park to the quieter Deshi Building on Shangdi Road, occupying half of the fifth floor. Compared with the tight quarters they occupied previously, their new office environment is significantly improved with spacious cubicles and numerous meeting rooms. Before the relocation, some employees even "worked" in the Starbucks downstairs for three months. In a few months, the spacious cubicles will all be taken up by newly hired employees because Didi Taxi is growing rapidly. A team of a little over 30 people early last year has grown into over 400 employees and it's still growing.

Blazing Start-Up

"There isn't a more amazing start-up than Didi Taxi in any industry," one observer said. They are online and offline, competitive and still reshuffling, getting great attention from the media, and feeling the impact of government policies and the influence of industry giants, right? If a start-up were compared to a TV series, Didi Taxi is like a Korean TV series—full of plots! Cheng Wei, founder and CEO of Didi Taxi, worked for Alibaba for eight years and witnessed the joys and sorrows of many start-ups, but he could never have imagined that his own start-up story would prove far more exciting.

In just two years, taxi apps led by Didi Taxi and Fast Taxi have profoundly changed the way people travel. Traveling, after all, is, one of the four main daily living activities, along with dressing, eating, and sheltering indoors.

In big cities like Beijing today, having two smartphones has become a standard for many taxi drivers. One phone is used for taking orders from Didi Taxi while the other is used for those from Fast Taxi. Some drivers have even equipped themselves with 4G MiFi (a portable wireless router that provides access to multiple mobile terminals) to get orders more effectively.

Getting Drivers on Board

On the day Didi Taxi moved offices, Cheng Wei personally invited over 10 drivers to participate in a ceremony. At the end of the simple ceremony, he invited some of the drivers to his new office for some additional information sharing. "We will communicate with drivers more than once per month. Each department will invite drivers over to exchange information."

One of the drivers invited that day was 58-year-old Master Meng, who had never used a smartphone before. The employees of Didi Taxi taught him, step by step, how to set his positioning, get on the mobile Internet and grab an order. Another driver, Master Liu, known as "the King of Orders," might grab up to 35 orders in a day although on average he usually gets about 20. For his business, he can rely on all his orders coming from Didi Taxi, so now he mainly waits in his neighborhood, around Zhongguancun, Shangdi and Huilongguan near his home. According to Master Liu, he can earn a net monthly income of $3,200 from Didi Taxi, twice what he previously earned.

In just two years, taxi apps led by Didi Taxi and Fast Taxi have profoundly changed the way people travel.

The continuous improvement of Didi Taxi cannot be separated from the assistance its drivers provide. Early this year, Didi Taxi conducted a survey of drivers before promoting a new method of collecting taxi fare using WeChat Payment. Previously, company departments had tried to promote the use of a Bus Card to pay for taxi fare but their efforts failed. The taxi drivers explained that if customers made a payment with a Bus Card, the payment would take one or two days reach their bank account. Due to the lack of account verification, however, it was quite troublesome for them to check all their payment transactions; as a result, they decided to drop the practice.

After learning this from drivers' feedback, Didi Taxi established an intermediate account which makes an immediate payment to drivers' bank accounts once customers have made a payment using WeChat Payment; a message is also sent to drivers to verify payment. Because of this, Didi Taxi's WeChat Payment has been warmly welcomed by drivers since its launch in January. Many drivers strongly recommend the service as soon as customers get in the taxi.

Understandably, drivers' recommendation of apps for calling a taxi is closely related to the subsidy war taking place between Didi Taxi and Fast Taxi. The two companies began to reward both their customers and their drivers at nearly the same time earlier this year. The amount being rewarded for each taxi call rose initially from 48 cents to $2.40. The two companies originally intended to use the rewards to promote their taxi apps and online payment, but they ended up engaged in a war of attrition. However, the amount rewarded gradually decreased until the rewards were cancelled in May.

However, the subsidy battle has indeed educated the users. Even the elderly on the street know about calling a taxi using an app. Didi Taxi had a satisfactory performance from the beginning of the war early this year through the end of March: The number of users exploded from 22 million to 100 million and the average number of taxis ordered daily rose from 350,000 to 521,830, exceeding the number of Taobao's

The continuous improvement of Didi Taxi cannot be separated from the assistance its drivers provide.

mobile payment orders made over the same period. Didi Taxi had an average of 350,000 orders per day in 21 cities on as of Jan. 10, but these figures grew to 3.16 million in 120 cities as of Feb. 24. On March 28 Didi Taxi had an average of 521,830 orders per day in 178 cities. It really is growing as fast as the speed of the Internet.

What makes Cheng Wei most proud is that the company's efforts have truly changed people's way of traveling. Ordinary people have four major activities in their daily lives: dressing, eating, sheltering indoors and traveling. Although the clothing industry has been educated by Taobao for 10 years, the proportion of those shopping online is only 5%; the proportion of those booking their dining reservations online is only 1% while the proportion of those purchasing housing and accommodations through the Internet is even smaller. However, in the taxi industry, at least 30% to 50% of the business comes from taxi apps. In addition, 60% of Didi Taxi's users call a taxi in a Wi-Fi environment, which indicates that quite a few users have chosen to wait comfortably indoors for the arrival of their taxi, giving up their traditional practice of calling for a taxi by waving for one along the roadside. "Faster penetration of the Internet to traditional industries has contributed to Didi Taxi's rapid growth," said Cheng Wei.

The Cost of Growth

Undoubtedly Didi Taxi has paid a high price for its achievements. Didi Taxi claimed it has paid out as much as $224 million in subsidies using WeChat Payment during the subsidy war. Based on what is publicly known, Didi Taxi's financing that was completed at the end of last year was only $100 million.

However, as a former employee of Alibaba, Cheng Wei knows that the most precious resource to be gained from the subsidy war is user data. Didi Taxi's business model will be based on big data. Today, Didi Taxi has recruited the best algorithm experts and cooperated with some universities and research institutions to study how to continuously improve the deployment of taxis. Although the rate of success in calling a taxi using Didi Taxi can run as high as 75% in Beijing and over 70% in other big cities, Cheng Wei believes there is still more room for improvement. Along with a better deployment algorithm, Didi Taxi plans to launch carpool services to help more users get a taxi. When asked whether Didi Taxi will enter the commercial taxi market with a clearer profitability model like its counterparts Fast Taxi or Uber in the US, Cheng Wei smiled and declined to answer because "it's a very sensitive issue."

In fact, with data gathered on 100 million users, Didi Taxi has attempted to generate some income from advertising. Advertising campaigns like "Give Lychees to the People across the Country" and "Give Cakes to the People across the Country" were launched by Didi Taxi some time ago. These were actually campaigns conducted on behalf of other companies. "Users can surely use Didi Taxi for free over the next three years. But it's possible that we may support ourselves through providing value-added services and selling advertising space." Cheng Wei revealed that Didi Taxi's monthly revenues reached $1.6 million in May.

However, fast-growing Didi Taxi has been repeatedly obstructed by people with vested interests. In May 2013, Didi Taxi tried to enter Shenzhen and was initially banned by concerned municipal departments. After that, there were rumors every month or so about a certain municipal department standardizing the taxi market. To address the ever-complicated situation, Didi Taxi has formed a team of 10 people for government relations who are responsible for communicating with government departments. What worries Cheng Wei is that some local governments are both players and referees. Nevertheless, he is still optimistic about the future. "Didi Taxi survived when it was at its weakest. It will survive easily now and in the future. The market won't fall back. China won't fall back."

"Do you believe in the power of the market, technology and the Internet?" Cheng Wei was asked.

"Of course," he answered without hesitation. Cheng Wei maintains his daily habit of calling a taxi using Didi Taxi. He never grows tired of it.

Competition between taxi apps is also a competition between mobile payment apps.

Hao Hongfeng founded Jiuxian based on Walmart.

JIUXIAN: E-COMMERCE UNDER A RETAILING MENTALITY

When Internet thinking is at its highest popularity, can Jiuxian.com recreate the "five-km death zone," in the O2O wine sector?

By Cao Shunni
photo by Shi Xiaobing

Hao Hongfeng has a round baby-like face when he smiles; he also wears a string of black beads around his right wrist. He seems want to discourage counterparts' envy of Jiuxian.com's leading position, saying, "Juxian.com is fond of making many friends but fewer enemies."

But as a leading B2C company in the wine industry, it's nearly impossible for Jiuxian.com not to make enemies. Jiuxian.com is currently facing intense competition. For example, Zhongjiu.com, in continuously strengthening its O2O (online to offline) business model, has teamed up with 1919 Direct Wine and Spirits Supply to compete for the leading domestic wine sales channel. Precisely speaking, like Jiuxian.com, they want to become China's first retail wine company with annual sales exceeding 10 billion yuan ($1.6 billion).

Jiuxian.com, founded in 2009, temporarily leads the ever-growing B2C wine e-commerce scene with a 50% market share. After Round E financing of $41.6 million completed in 2014, Jiuxian.com is preparing to be listed; it withdrew its previous plans to adopt an O2O strategy. Jiuxian.com has accelerated the construction of a nationwide storage center with capital of $68 million from Round D and E financing. It has partnered up with offline stores in many cities to launch its Fast Wine and Spirits Delivery and developed a plan to integrate offline retail channels and resources.

Undoubtedly, as an e-commerce compa-

ny, Jiuxian.com is getting "heavier." More surprisingly, when traditional offline channels are transforming into vertical e-commerce companies operating under an Internet model, Hao Hongfeng proposed to become an e-commerce company run with a retailer's model, benchmarking itself with Wal-Mart to better win the second round of competition among wine e-commerce companies. As the retail industry itself is experiencing a fierce winter, isn't the "retailer mentality" of Jiuxian.com too "old-fashioned"?

The Five-Km Pardigm?

"A retailer mentality is required to be a successful wine e-commerce company. My business benchmarks are large retail enterprises such as Wal-Mart and Carrefour," said Hao Hongfeng. He described Jiuxian.com this way when he was interviewed by China Entrepreneur magazine in his new office, which was filled with a newly decorated smell June 6.

Three days later, on June 9, Jiuxian.com announced the pilot launch of its O2O sales model of Fast Wine and Spirits Delivery in 11 cities including Beijing, Shanghai, Guangzhou, Shenzhen, Zhengzhou and Hangzhou.

"It only takes 9 minutes from ordering to receiving the products." Hao Hongfeng mentioned this figure in a phone interview to the China Entrepreneur reporter. But he didn't bring up another number: five km.

The Fast Wine and Spirits Delivery customers in 11 cities can search for wine stores within five-km of their location through an App based on LBS positioning technology and then place their order for wine. That implies that the 9-minute delivery can only be achieved within the short distance of five km (just over three miles).

Five km has a special significance for the retail industry. In the pre-e-commerce era, there was a widespread saying about Wal-Mart's "5km death zone". It means that, with a strong supply chain, Wal-Mart is almost unbeatable in the industry, and

"My business benchmarks are large retail enterprises such as Wal-Mart and Carrefour."
—Hao Hongfeng, of Jiuxian.com

other retail companies within five km of Wal-Mart can hardly expect to achieve any profits and even risk losing money.

Now in the e-commerce era, the five-km zone remains a learning benchmark for Hao Hongfeng, a key number after Wal-Mart transformed itself into an e-commerce company. After a massive shutdown of its large supermarkets in 2013, Wal-Mart has shifted its priority in 2014 to e-commerce channels while accelerating the construction of neighborhood convenience stores, up to 385 this year and 415 in 2015. In the US, 2/3 of Wal-Mart customers have enjoyed the e-commerce shopping experience of "online orders and offline pick-ups" from Wal-Mart stores within five km.

Jiuxian.com's five-km Fast Wine and Spirits Delivery shares the same ambition as Wal-Mart's with the ultimate goal of covering all customers by solving the last one-km issue faced by traditional e-commerce companies. And Hao Hongfeng was even accused of eating his own words. When O2O became a fashion in 2013, he wasn't optimistic about the move of e-commerce companies to invest in offline stores; he even declared that Jiuxian.com would not implement an O2O strategy.

On May 17, 2014, Zhongjiu and 1919 Direct Wine and Spirits Supply, another Beijing-based company, partnered up and quickly developed an 020 marketing framework by integrating Zhongjiu's B2C model with 1919's offline store supply model. But before that, Jiuxian had already launched its O2O project.

On March 19, Jiuxian.com launched the Fast Wine and Spirits Delivery project to integrate business resources such as wine and spirits manufacturers, wine and spirits stores and individual wine and spirits traders. So far, over 100 wine and spirits enterprises and 20,000 individual wine and spirits traders are connected to offer products including liquor, wine and rice wine. The Fast Wine and Spirits Delivery App was launched simultaneously on iOS and Android platforms. All preparations were made for pilot operations in June.

After exchanging name (business) cards with Hao Hongfeng, you'll notice that apart from his own portrait, his name card also bears a QR code and a "red pocket"—a code for redeeming $16 cash value when using Fast Wine and Spirits Delivery.

Such small gifts and favors are even publicized on the name card of Jiuxian.com's department directors. If you visit Jiuxian.com, marketing phrases like instant ordering, group purchasing and out-of-stock reflect the marketing and sales wording of the Internet era as well as that of the pre-e-commerce era.

In 2008, Hao Hongfeng, who had been a liquor distributor for 10 years, set out at the Annual Food and Drinks Conference in Chengdu with a great ambition: to sell wine and spirits around the world and become China's largest wine and spirits company with annual sales of over $1.6 billion.

At that time, Hao was already the largest liquor distributor in Shanxi and could earn several hundred thousand dollars in two years. Hao Hongfeng once sold newspapers and frozen dumplings and worked as a security guard. He is indeed a grassroots man.

The dream of exceeding a billion dollars initially was made fun of. His buddies laughed at him. Even as the largest wine and spirits distributor in Shanxi Province, Hao Hongfeng couldn't sell $16 million worth of product in a year. It seemed

impossible to make the dream come true no matter how much he sold his wine and spirits. In the end, he hastily formed a temporary consulting team which failed to find any way of realizing his dream, even after three or four rounds of discussions.

Hao Hongfeng has attracted quite a few customers through cold calls and SMS (text) marketing, but they won't bring him explosive growth. In 2009, his eyes were opened by the e-commerce concept taught by his instructor in his last EMBA course at Tsinghua University. In August 2009, Jiuxian.com was registered in Taiyuan. Hao Hongfeng soon realized that Taiyuan did not have the right "soil" for growing e-commerce companies, so he relocated the company to Beijing in 2010.

Relying on abundant channels for spirits sales and manufacturers' resources gained from many years' trade practice, Jiuxian.com deployed its tool of "selling authentic goods at low prices" from the very beginning.

Labor-Intensive Retail Company

"Authentic goods" and "low prices" are the two major weapons used by China's first group of e-commerce companies, including such B2C companies as JD.com. By adhering to being a vertical e-commerce company without expanding its product portfolio, Jiuxian.com has grown rapidly using these two weapons to achieve an annual sales growth of 3 to 5 times. Jiuxian.com achieved sales of $16 million in 2010 and for the first time generated a profit more than $16 million in 2013.

"Our sales will exceed [$1.6 billion] the next year," said Hao Hongfeng, reasoning that China's wine and spirits market size is between $120 billion and $160 billion. Up to 2013, however, B2C companies only took a 1% share of that market.

The O2O model emerging at the end of 2013 will help wine and spirits sales, as they are a special product characterized by timely consumption. They should take up a bigger market share under the premise that their delivery time only takes several minutes.

"In the next five years, wine and spirits e-commerce companies will take up a 30% market share through the O2O model and the market size will be around [$40 billion]," predicted Hao Hongfeng. After the government implemented the regulation under which hotels are not allowed to charge corkage, the practice of "Bringing Your Own Wine and Spirits" by consumers is expected to account for 50% of the entire wine and spirits consumption market. O2O mostly helps the realization of such practices.

"In the next five years, wine and spirits e-commerce companies will take up a 30% market share through the O2O model."
—Hao Hongfeng

Facing such an enormous market, it's no wonder that Jiuxian.com ate its own words. But Hao always stressed that Jiuxian.com's offline strategy is not investing in stores, but integrating existing channels and resources to become Jiuxian.com's nearest delivery and pickup points, thus improving logistical efficiency and minimizing costs.

In the current second round of competition among e-commerce companies, the focus has been upgraded from selling low-priced authentic goods to creating the ultimate shopping experience where "Customers are God." Capital and human resources are the two factors making this possible.

Jiuxian.com received a first round of financing of $2.4 million in April 2011. It completed the second round of financing in November 2011 when Sequoia Capital and Shenzhen OFC Investment Management jointly invested $120 million for warehouse and logistics construction in provincial capital cities. In August 2012, Jiuxian.com completed the third round of financing in which multiple funds such as Rich Land Capital jointly invested a total of $17.6 million in, among other things, local warehouse construction, improving logistics quality and construction of distribution teams. The total capital of $68 million from the D and E rounds of financing completed in 2013 and 2014 respectively will also be invested in logistics, warehouses and human resources.

Along with the growth in staffing to over 3,000 people, Jiuxian.com just moved to a new home located in the office building of Digital Factory in Beijing's Technological Development Zone. Situated in a low-density area with office buildings, factories and warehouses, Jiuxian.com's office houses many computer desks and employees pounding away at their keyboards. Only the corridor on the second floor is lined with array of red racks filled with all kinds of wine and spirits, creating the atmosphere of a genuine wine and spirits enterprise.

"The Internet industry emphasizes personality and innovation. But I will make an e-commerce company operated with a retailing mentality and become the Wal-Mart of China's wine and spirits sector by improving individual labor efficiency and standard services," Hao Hongjian restated as its goal. He always reminds his staff, "Don't think that e-commerce companies are [nobility]. We are still a labor-intensive retail company. We work hard to sell wine and spirits bottle by bottle. Only with the mentality of retailing can we be the first e-commerce company to achieve the goal of annual [$1.6 billion in sales] in the second competitive round."

ANOTHER BATMAN

Internet giants are replacing coal mine tycoons as the big players in the film industry. BAT (Baidu, Alibaba and Tencent) want to be more than "small partners" in the film industry, but instead have become the "barbarian insiders." Will Huayi Bros. Media Group, Enlight Media, and Polybona be on BAT's future lists of acquisitions, in addition to UC, dianping.com and Didi Taxi?

By Zou Lin

"Do you know of any Internet companies recruiting now that you would recommend to me?" A former employee of a film production studio shared the anecdote that, in recent months, he has received over 10 such requests, all from people in the film industry. As a successful case of someone who transferred from the film industry to the Internet industry, he has been embraced by the local well-to-do ever since, and is envied by his former peers.

The frequent personnel turnover in the film industry is driven by tremendous changes that are still brewing. "In the future, film companies will be working for BAT," said Yu Dong, chairman of Polybona, at the Shanghai International Film Festival in June. His words were like a bomb that woke up the sleepy bosses in the traditional film industry. Yu Dong even said, "While Hollywood still has eight film studios, there will only be three in China (Baidu, Alibaba and Tencent)!"

Whether or not the future belongs only to these "three," there is no denying that BAT have become major players, perhaps even the mainstream force in the film industry. Traditional film bosses such as Huayi Bros. Media Group and Enlight Media are now riding on the same express train to the future with Internet giants Tencent and Alibaba.

"We just want to strengthen the capabilities of excellent content companies, introduce the Internet model of thinking to film-making, and create a new business model," said Liu Chunning, president of Digital Entertainment Group, Alibaba.

His humble words were just enough to get on the nerves of the traditional film bosses. Mergers with Internet companies have become the hot option for program production houses. Who's going to be toppled in the future? The Internet has pushed the film-making industry to a crossroads.

Competition for Talent

For the cultural and creative industries, talent is the core resource, and a fierce competition for talent is quietly coming into being, especially with the "nerve-wracking" BAT factors in play. "Promotion directors are utterly important for film companies. One of my promotion directors was once head-hunted and offered an annual income of over [$160,000]," said Wang Changtian, chairman of Enlight Media, at a forum.

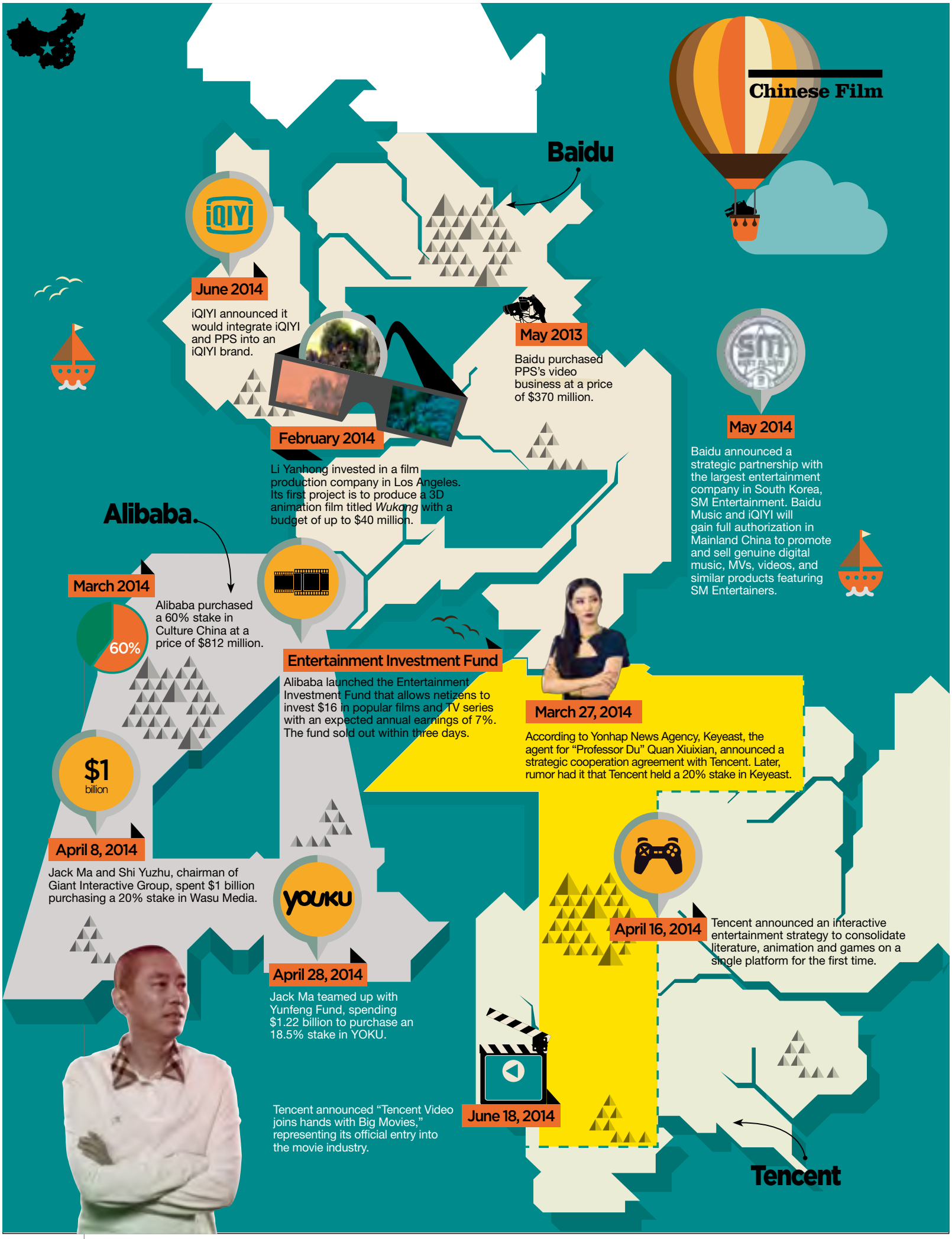
And for BAT, which have limited experience and resources in the film industry, "stealing" talent seems to be their preferred choice.

"We are an Internet-based business, so having a pool of talent is not our core competitiveness in our industry, but in the cultural and creative industries, it is the core, which is unimaginable in Internet circles," said Sun Zhonghuai, general manager of Tencent's Online Video Department. "Hiring the right talent and retaining them" is the most frustrating issue now, according to An Yugang, CEO of In-entertainment.com, a marketing company that has successfully promoted such films as *Love Is Not Blind* and *Batman*.

In-entertainment.com has been expanding rapidly, thanks to vigorous developments in the film industry. But it has also seen a lack of suitable talent. "Newcomers [to the industry] were mostly born in the 1990s. They usually quit after a couple of days on board, and we found out that many of them go to Internet companies."

And the same situation is troubling Maxtimes, which helped with the marketing of *Tiny Times*. "We want to hire some relatively green hands with one to two years of experience. But we are competing for talent against Internet companies who bid at prices we cannot afford. So we have a dim chance of hiring the right people," said Yue Yang, president of Maxtimes.

When it comes to attracting talent, it's not just the marketing area but the whole film industry chain that is competing for talented people. In May 2013, Zhang Yimou, the famous film director who had been out


Chinese Film
Baidu
iQIYI
June 2014
iQIYI announced it would integrate iQIYI and PPS into an iQIYI brand.
May 2013
Baidu purchased PPS's video business at a price of $370 million.
February 2014
Li Yanhong invested in a film production company in Los Angeles. Its first project is to produce a 3D animation film titled *Wukong* with a budget of up to $40 million.
May 2014
Baidu announced a strategic partnership with the largest entertainment company in South Korea, SM Entertainment. Baidu Music and iQIYI will gain full authorization in Mainland China to promote and sell genuine digital music, MVs, videos, and similar products featuring SM Entertainers.
Alibaba.
March 2014
60%
Alibaba purchased a 60% stake in Culture China at a price of $812 million.
Entertainment Investment Fund
Alibaba launched the Entertainment Investment Fund that allows netizens to invest $16 in popular films and TV series with an expected annual earnings of 7%. The fund sold out within three days.
March 27, 2014
According to Yonhap News Agency, Keyeast, the agent for "Professor Du" Quan Xiuixian, announced a strategic cooperation agreement with Tencent. Later, rumor had it that Tencent held a 20% stake in Keyeast.
$1 billion
April 8, 2014
Jack Ma and Shi Yuzhu, chairman of Giant Interactive Group, spent $1 billion purchasing a 20% stake in Wasu Media.
YOUKU
April 28, 2014
Jack Ma teamed up with Yunfeng Fund, spending $1.22 billion to purchase an 18.5% stake in YOKU.
April 16, 2014
Tencent announced an interactive entertainment strategy to consolidate literature, animation and games on a single platform for the first time.
June 18, 2014
Tencent announced "Tencent Video joins hands with Big Movies," representing its official entry into the movie industry.
Tencent

of public notice for some time, announced he would join Le Vision Pictures (Levp), which aroused hot discussions in many circles. Instead of Huayi Bros. Media Group, Enlight Media, or even Wanda, Zhang saw himself going to a company in existence for only three years, mostly because Levp had represented itself as "a film company for the Internet era."

When interviewed by magazine, Zhang Yimou admitted that this was the primary reason he chose Levp. "The future of film will belong to young people. And the Internet has infiltrated much of the lives of youth of this generation. It will change the film industry, and far more, the political and democratic process of this country," said Zhang Yimou.

That's a strong signal that the closed loop of the film industry—where directors, film producers and performers were flowing through small circles—has been broken. "That used to be the protection mechanism for the film industry when it was vulnerable. Insiders were intuitively distrustful of newcomers stepping in," said ZheErwei, president of Angel Wings (Beijing) Film And Television Investment Co. Ltd. The film industry has had its market value inflated by the rapid influx of capital. But BAT will not hesitate to spend big money on its entry into the industry because they see it as a strategic investment.

"Alibaba Pictures Group Ltd. acquired the film resources of some top-level directors including Wong Karwai, instead of acquiring just one traditional filmmaker. This would be unimaginable if it had happened two years ago," said one observer of the film industry.

He noted that it used to be coal mine tycoons, mostly from Shanxi Province, who threw their money into the industry just to have some fun; they had no knowledge of the film industry, or they just invested in it for the opportunity to socialize with the beautiful women found in film circles. All resources were flowing within a closed loop, which was not considered a "bad thing" in this field. Lack of transparency could be considered perhaps the best barrier to entry in the film industry. But here come BAT that first will overcome such barriers and then create a greater sense of crisis among existing industry players.

At the Shanghai International Film Festival, at least five film forums covered topics related to the Internet, including film financing, sales, promotion and circulation, and film production. And at each of these forums, public figures of the Internet industry were the icons. As it turned out, Liu Chunning, president of Alibaba Digital Entertainment Group, grabbed more attention than Gong Li, winner of the Best Actress award at the festival. Moreover, people from the Internet circle and the movie industry are seen more and more at the same gatherings.

"In the future, film companies will be working for BAT."
—Yu Dong, chairman, Polybona

"I noticed that BAT made their appearance at many gatherings among film critics," said Zhou Liming, a well-known film commentator, at a private party of his circle. This included "iQIYI.COM, Tencent Online Video and Alibaba Pictures. They used to be little known to us," he said. And Li Xingwen, a renowned TV series critics, even claimed that online TV soap operas would revolutionize the TV industry in the future.

Besides impressing key opinion leaders as film and TV soap opera series critics, BAT are also good at winning over experienced film experts to act as their "external brains." "To be honest, we are new in the film and TV industry. We are adults in Internet products but we are three-year-olds in the cinema area. So we hire a bunch of very experienced people to be members of our Expert Consultants Group," said Mi Yufeng, deputy project director of Alibaba Yulebao. Mi Yufeng also told China Entrepreneur magazine that Yulebao would ask these external consultants for advice when selecting projects in order to reduce risk. "We email our Expert Consultants Group when we have new projects. We will combine our big data with their recommendations before making the final decision," said Mi Yufeng.

From "luring" others' employees with higher salaries and competing for creative talent, to winning over opinion leaders and bringing together external experts, BAT have clear views on the film and TV industries. They are going to take action.

Deng Shao, a senior observer of the radio and TV industries and CEO of www.lmtw.com, described BAT's route as clear and easily understood: hiring talent first; injecting capital next; and finally changing or even setting the rules.

Breaking Old Rules

"Do not ever exaggerate the statement that you are 'working for BAT,' or the industry could get hurt," said Liu Chunning to China Entrepreneur, responding to the great public's reaction to Yu Dong's pronouncements. Tencent and iQIYI.COM also demonstrated an attitude of "Dedicate yourself to your work and mind your words," which stands in sharp contrast to their high-profile actions.

According to Gu Jianbing, director of public relations of Alibaba, the company has two strategic directions over the next 10 years, i.e. the healthcare industry and the cultural entertainment industry. "People have more spiritual needs after the economy has developed to a certain level," Gu Jianbing said.

That's the reason why Alibaba invests in the cultural entertainment industry. Before getting listed, Alibaba invested in almost the entire chain of the cultural entertainment industry, purchasing 60% of the shares of China Vision Media Group Ltd. for $32 billion to form Alibaba Pictures Group Ltd., and buying 18.5% of the shares of Youku Tudou Inc. for $1.22 billion. Alibaba is not just

standing at the threshold of the film industry; rather, it's already armed and fighting to be an insider.

It used to be that film companies just viewed the Internet as a new "channel." In addition to traditional theaters, they put their movies on new media platforms such as video websites to gain extra exposure. But the deeper their inroads to the film industry, the more Internet companies want to go beyond becoming just another channel.

At the Shanghai International Film Festival, Liu Chunning commented that China has a population of 1.3 billion, who in total possess nearly 1 billion smart phones and 500 million TV sets; these form the foundation for the rapid future development of the digital entertainment industry.

According to Yu Dong, the only choice left for traditional filmmakers is to build up their size and production capacity as quickly as possible. "A film company without sizable scale is also without a future. Independent film-makers will all be taken in by BAT, which are restructuring the industry in a disruptive way. The next step is to restructure the content companies. This provides a real chance for the industry, and the coming decade will be the period when the Internet is leading the industrial revolution." As an executive of Polybona, a traditional film-making company, Yu Dong thinks in a way that agitates the rest of the industry.

Cloud Funding

How will BAT lead the industrial revolution? Just look at Yulebao. The first round of financing of Yulebao was launched in March 2014, with nearly 300,000 users snapping up shares worth $11.5 million, which could support the production of four films. On June 13, the second round was launched. By 2 a.m. on June 14, nearly 160,000 users had bought up shares worth $14.7 million, which would support production of another five films.

"We provide our Yulebao users with a return of 7 percent [fixed] plus X. And Yulebao takes all the risks on these films," a Yulebao director said.

But things are not as simple as they seem to be. "Film financing used to be like private equities. For example, 10 trusted insiders invest more than a million dollars each and take the profits or losses themselves, which is highly risky. But at Yulebao, it is like 10,000 people investing $16 each, with much less risk [because it is] averaged out," one observer said. According to one private equity manager, Yulebao is absolutely subversive.

This subversion is possible because of the open platform and large consumers' pool on the Internet, which will invigorate the film industry with greater creativity, from film-making and circulation to financing. "Movie directors are still talking about the fourth- or fifth-generation film languages and ways of expression learned from film academies, while the market and young people are choosing newer styles of films which we would not have cared about previously," the manager said.

From Yu Don's point of view, it would have been totally unimaginable in the past, but the film Dad, Where Are We Going, which was shot in just four and a half days, made a box office record of $112 million; Tiny Times, which cast no big stars as has been traditionally been defined, made nearly $80 million. Productions and results like these would not have been imaginable in the past. "Should we stick to our traditional process and mechanism when making films? I'm desperate to know the answer myself, Yu Dong wondered. He thinks the traditional way of thinking in the film industry is collapsing, but this old way of thinking within the industry still has its own momentum.

Mi Yufeng believes that the industry has a strong intuitive sense of self-protection; new participants have difficulties in entering their circle because industry veterans would not allow outsiders to invest in good projects within the industry. Mi Yufeng used to represent Yulebao in it lobbying efforts for the film The Continent, directed by Han Han, but was rejected anyway despite lobbying for over a month.

"We didn't reach consensus on the rights and interests of users. A film company cannot control its cast of movie stars."

"A film company without sizable scale is also without a future."

—Yu Dong, Polybona

According to Mi Yufeng, Yulebao will not only be an Internet financing product, but also a platform for users to have high engagement with the film-making. When a film project is initially set up, users of Yulebao can vote to choose their favorite acting cast, and decide how the plot goes. Customized film tickets may even be made, on which users are named producers, to create a specialized sense of identity.

On the other hand, the Internet will provide the largest circulation platform outside of cinemas. Traditionally, film companies recover their costs and gain profits through box-office performance. But one of BAT's future goals is to develop online cinemas to enable people to pay for watching movies in their own living room. 4K TV and high-quality stereo equipment can to some extent replicate the visual and audio effects that real cinemas provide, and a monthly film subscription package payment of $4.80 is much cheaper than going to theaters. According to Sun Zhonghuai, 100 million users of paid online theater platforms would create a market valued more than $1.6 billion.

"The existing business models are out-of-date and the future belongs to the IP address-based operating model," said Zhang Zhao of Levp, who points to Disney spending $4 billion to buy Marvelas an IP address-based operation. To be specific, Internet companies put users before directors and movie stars as they operated under the old model. "You meet users' needs by allowing them to choose the content, directors and actors they like. The Internet is the future battlefield for film companies, which is also the core for the Chinese film industry to be able to stand up against Hollywood," he said.

"BAT cannot completely monopolize the content market."
—Huayi Bros. Media Group executive

Distribution channels for film tickets is another area that has already been taken on by the Internet. Wanda spent over 10 years and nearly $1.6 billion before it took a 20% share of the film market. And ticket-selling websites such as maoyan.com (under meitu.com) and Gewara almost caught up with Wanda in just one year. Gewara sold nearly $160 million in tickets last year, better than most cinemas.

Xu Wu, product director of maoyan.com, said that his website sold nearly $256 million tickets last year, making up 10% of the Chinese market, and that that would rise to 13% or14% this year. In the future it might be common for 3-year-old companies to surpass 13-year-old ones in performance.

Not So Fast

But there are also different opinions. "BAT are unlikely to dominate the film industry. Good projects in the industry do not worry about funding, so why would they let Alibaba and Tencent in so easily? BAT cannot completely monopolize the content market," an executive of Huayi Bros. Media Group said, adding that it was a positive influence that BAT are entering the film industry now, because they help expand the pie and provide pressure for industry reforms. However, she also felt that sometimes she "cannot comprehend the industry," for example, how Levp, a company very different from any traditional film companies, actually managed to grow so strong in the film industry.

An Yugang takes an interesting point of view that, due to the nature of the political system, mergers, acquisitions and restructurings would be restricted in the traditional media industry, and that's why there are no comprehensive entertainment groups. But BAT in the future will serve as the actual integrating parties, becoming the three giants in the overall entertainment arena. In the foreseeable future, BAT will even take direct part in industry competition armed with their investment capital. In March 2014, Huayi Bros. Media Group announced it would invest $120 million to $150 million in shares of Studio8, an American company. But Huayi lost its potential deal to Fosun International at the final stage in June. Insiders said Alibaba was among the bidding competitors, and Jack Ma was once known to be a shareholder of Huayi Bros. Media Group.

BAT want to be more than "small partners" in the film industry, but instead may become the "barbarian insiders." Will Huayi Bros. Media Group, Enlight Media, and Polybona be on BAT's future lists of acquisitions, in addition to UC, dianping.com and Didi Taxi?

SHIFTING STRATEGIES FOR CHINESE PROPERTY FUNDS

There is another choice in the turbulent property market for those participants who are gun-shy: Property funds are accumulating cash and waiting for their chance to bid on assets, particularly big ones for some players. Are they crazy, or are these the funds that will lead in the future?

By Wang Fangjie

The day darkened suddenly. Lightning flashed outside the office of Su Xin, executive partner of Go High Property Capital, and soon there was a downpour.

"The fear of a crash in the property market has shifted from third-tier cities to second-tier, and now to first-tier cities," said Su Xin, casting a glance outside his window. He's right. The storm is coming or has already arrived. In May, statistics on property sales volume showed year-on-year declines in all three tiers of cities. "The Chinese property market is the Titanic that is about to hit the iceberg," said Pan Shiyi, whose Iceberg Theory has generated paroxysms of fear.

And many are thinking about abandoning the ship before it actually crashes into the iceberg. In May, prices and trading volumes of properties in first and second-tier cities fell, indicating there was less new investment in the property market. Those who want to abandon ship believe they are making the right decision. After all, unlike economist Yi Xianrong and market observer Niu Dao, Pan Shiyi, the property developer who owns large amounts of housing inventory, will not benefit much from his own negative comments about the situation in his industry. Look! Ren Zhiqiang, that famous (or infamous, depending how you define him) sworn believer in taking long positions, is also changing his tune, saying, "The property market will definitely go downward when the macro economy is not going well."

"At a time of panic, people tend to choose to believe in what brings them more gloom," said Su Xin. Indeed! Most media did not include the rest of Ren Zhiqiang's remarks that "the property market will soon rebound."

Even so, we must wait to see whether Ren Zhiqiang again correctly predicts what will come to pass. If the market really goes up, there is space between the upward and downward fluctuations where arbitragers can reap their profits. And private equities are like hungry sharks smelling blood when it comes to opportunities for arbitrage. They are choosing to stay aboard the ship, quietly stockpiling cash, hoping to catch some big fish swimming at the bottom of the sea.

Su Xin is already hunting for money for a new fund of $320 million for Go High Capital. And other real estate funds are also preparing for their journey through the storm.

When this interview ended, the rainstorm outside had also ceased. The sky was as crystal clear as could be when I walked out of Su Xin's office. The storm had discouraged many people from going out during rush hour, so the third ring road was easily passable as there wasn't much traffic on it. Property funds may also be expecting a smooth road on their path to arbitrage which could potentially lead to great wealth.

Get Ready For The Big Fight

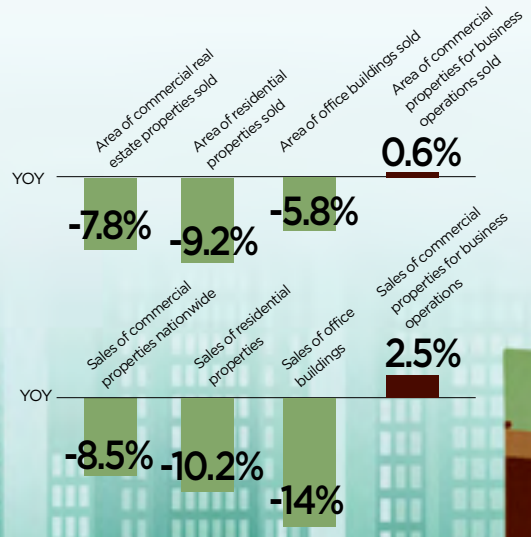
On June 20, Lu Lin, president of CURA Investment Management (Shanghai) Co., Ltd. (hereafter referred to as CURA Investment), shared a few photos of his Moments at Wechat, displaying the road shows of CURA Investment in Shanghai and Beijing. This was for a property investment of $320 million, the largest CURA Investment has ever made.

Back to two months before, on April 23: Gathering at Xingguangyu Club, Zhenru Sub-CBD, Shanghai, were a batch of the wealthiest people in the Yangtze River Delta Region, who are actually LP partners of Star Capital. This is a property fund jointly initiated by a management group involving Fosun Group, E-house China, and Zhao Hanzhong's team. Star Capital has an LP Dream Team of over 170 members including such famous business tycoons as Jack Ma, Shi Yuzhu, Wang Jianlin, Zhang Jindong and Guo Guangchang.

That day, the 57-year-old Zhao Hanzhong, president of Star Capital, went around and toasted those present, all smiles on his face. He also has a big project in hand, which is to complete the third stage of Star Capital by the end of this year. This

DOMESTIC REAL ESTATE PROPERTY FUNDS CAN BE CLASSIFIED INTO TWO TYPES

National sales data for commercial property from January to May



Data : China National Bureau of Statistics

A Development funds

Star Capital

Fundraising

Responsibility for completing all development processes from land acquisition to sales of properties

Development costs for Star Capital will inevitably fall alongside the downward trend in prices in the land market.

In May, the average land transaction price in first-tier cities is $841 per square meter, down 13.3% from the previous month.

CURA Investment Management

Fundraising

Mainly responsible for developer financing as a financial investor

Development funds that aim at developer financing are more popular when the real estate market is weak. With a loose monetary policy and a good market, developers can gain low-cost financing without relying on funds.

CURA Investment Management follows a mainstream operating model for investing development property funds.

B Value-added funds

Gaohe Capital

M&A of commercial buildings

Increasing the value of commercial buildings through asset reconstruction

Launching for sales

The market entry costs of value-added funds are more closely related to the housing market and directly related to housing prices.

stage is worth as much as $784 million, far more than the first and second stages.

It would have been much more understandable if these busy preparations in the real estate market had taken place half a year earlier. Over the past several years, the property market had generally been heading upward, despite a few fluctuations. Capital could profit simply by entering the market alongside such upward momentum and doing little else. But that momentum was interrupted at the beginning of this year when the fast-rising property market began to look somewhat weightless. According to statistics from the R&D Institute of E-house China, in May trade volumes for commodity housing in first-tier cities fell by 30.9% year-on-year, while those in 15 key second-tier cities fell by 2% and those in 11 third-tier cities fell by 19.8%, year-on-year.

Housing developers begin to retreat, as seen in May data that showed the traded area of urban land for buildings in first-tier cities was 3.886 million square meters, a new low in volume over the previous two years, representing a month-on-month fall of 35.6% and a year-on-year fall of 41.6%.

And things were worse for commercial real estate. By CBRE Global Investors statistics, the cumulative supply of new office buildings over the next three years will exceed the current inventory in the market. If all projects are delivered in time, it is expected that the supply of office buildings in 14 major Chinese cities will rise sharply by 40.8 million square meters in the 2014-2016 period, which will almost double the total inventory in the market in 2012. In second-tier cities such as Tianjin, Shenyang and Chongqing, the total inventory in the market for office buildings will be quadruple the current level, with the supply far exceeding demand.

In addition, many shopping centers today have few visitors due to over-construction. Rumor had it recently that Hangzhou WAOW Plaza, the first commercial property project of Wahaha Group, has been losing money. Wahaha has been defaulting on rent for as long as half a year and is prepared to terminate its contract and walk away. The contract was signed for 16 years at a price 70% below market value.

According to Lu Lin, "When property developers are having a hard time, investors are there to take advantage." This is easily understandable, as a sluggish market means low entry costs.

China's property market has only 16 years of history, and property funds are even younger; for example, both Go High Capital and Star Capital were established in 2010, while CURA Investment was small in scale until this year. But that doesn't mean they are green in their upstream strategies, because the long-established foreign property funds are putting a covetous eye on China's property market as well.

Recently, after five years of silence, CBRE Global Investors made an unexpected large move by raising a foreign fund of $470 million which it plans to use to make inroads in the China market. "The Chinese property market will keep heading downward in the next six months to a year, so it's a good time for us to enter now," said Richard Vandebo, who is the general manager of CBRE Global Investors in China, in a recent interview.

CHANGE IN REAL ESTATE INVESTMENT FROM JAN TO MAY (YOY)

Source: CNBS

Forum Partners, a global property company that owns assets of $6 billion, also thinks there are still opportunities in China's property market. In March, it announced that it would invest in more Chinese property developers, believing that the China market would revive over the next two years.

As the public is paying much attention to the sell-off of properties in China by Li Ka-shing's family, what they are ignoring is that its counterparty in these sales is Gaw Capital Partners, which paid $924.8 million for Richard Li's Pacific-Century Center in Beijing. The average price per square meter was incredibly low for properties in Salitun, the busiest district in Beijing. And Gaw Capital Partners may think it is living in a gold-nugget era.

Property funds are currently accumulating cash and waiting for waiting for their chance to bid on assets, particularly big ones by some players. Su Xin is just such an example. He thinks the reform in state-owned enterprises will lead to the release of some property asset packages to the market, and he plans to learn from the Blackstone Group in looking for such chances. Lu Lin is another example. He is waiting, looking for certain enterprises that get into trouble, which is already a highly probable situation. "Then my fund will merge, acquire and integrate with some other firms, just like Gome did with Yolo," said Lu Lin.

U or L?

The turning point has arrived, but people are having a different feeling this time around.

"That downturn in 2008, driven by the panic of the global financial crisis, was V-shaped, with very short cycles of decline.

But the market was soon lifted by the [$640 billion] stimulus policy." Su Xin is trying to consolidate the latest three business cycles in the property market. He described the most recent cycle beginning in 2011 as a small U-shaped curve. The decline was relatively long—lasting about 9 months—and caused by restricted quotas for both house purchases and mortgage approvals. The market came back up as money from shadow banking flowed into the market.

Su Xin believes the current cycle will be a large and U-shaped, with a longer period at the bottom, because this time, the market is in a double bind: Investors are highly panicked and banks are tightening credit very hard. But Su Xin doesn't believe there will ever be an L-shape with a fracture because urbanization is still advancing and high demand for housing still exists, thanks to the large population in China.

With his basic judgment of a U-shaped curve, he also thinks that the markets in different tier cities will diverge: first-tier cities will soon pass the downward section of the cycle, with its net population inflow; property markets in second-tier cities will have a longer period of no growth; while those three- and four-tier cities with net population outflows will have difficulties digesting their large inventories.

"The window phase for buying commercial properties in the core areas of first-tier cities will be the next six to twelve months," said Su Xin, whose Go High Capital targets commercial properties in vital areas of first-tier and some fifth-tier cities. Buildings in these areas are relatively old; their value can always be raised using refined interior decoration.

At the end of 2013, Go High Capital spent $126.4 million for the China Enterprise Building in the Jing'an District of Shanghai. After the "interior redecoration," the average rental fee of this office building went up from 64 cents to $1.12 per square meter per day. The post redecoration process cost over $16 million, but Su Xin believes that money will be paid off with an above-average annual return which is currently in the range of 15% to 20%.

"At a time of panic, people tend to choose to believe in what brings them more gloom."
—Su Xin, Go High Property Capital

Different Goals

In the interview, the reporter noted an interesting phenomenon—that managers of different types of property funds view market information from different perspectives. Go High Capital is a value fund that mostly buys assets low and sells them high; that's why Su Xin talks more about the rebound.

CURA Investment is different. Its major business is property financing with both equity investments and loans. Its returns are not positively correlated to the market situation and, sometimes, are even negatively correlated. Lu Lin talks about the downturns. He thinks the situation this year is worse than in previous down cycles, because the Kuznets Cycle and Kitchin Cycle overlap this year. For countries with a 100-year-old property market, the Kuznets Cycle is 15 to 20 years. But the Chinese property market has a history of only 16 years.

Moreover, empirical evidence shows there is a Kitchin Cycle (about 40 months) every three years in China's housing market. 2014 comes just three years after 2011 when the last downturn occurred. The overlapping of these two cycles leads to "resonance effects," so the depth, seriousness and breadth of this downturn will apparently increase.

"No one knows how low the price can be and no one is sure that cycles always last for three years. History never follows the same path," said Lu Lin. He disagrees with the premise of funds established to finance a single project. This is too risky, and "this is not bottom fishing but speculation."

CURA Investment is more of a portfolio fund that combines different projects with low risks and high risks, long and short cycles, and equity shares and loans. Lu Lin believes this is necessary for hedging risks, especially at a time when the market is going down.

A portfolio can be constructed in different ways based on different market tendencies.

With a combination of projects of short and long financing cycles, a dynamic equilibrium can be achieved; stability is the core strategy of CURA Investment in a falling market. "In the first year of a downturn, we may build short-cycle projects. And then we begin to do long-cycle projects as the market keeps going down. We will add more long-cycle projects and reduce short-cycle ones, when the market price is lower than a certain level." This is Lu Lin's strategy for operations at CURA Investment.

As there are two kinds of project financing, equity and loans, Lu Lin prefers that his fund will mainly have loans in a downward cycle, and switch to more equities once the market hits the bottom. The logic is that low-risk and low-return loan projects should be selected for downturns which in effect are accumulating risk, whereas equity investments are more profitable when the market is at or near the bottom, as total risks are scaled smaller.

"This is not going to be a V bottom, but rather an L or W. You never know when the market hits its real bottom and you have to test, such as, going in with loans, turning to transferrable loans and eventually ending with equity," said Lu Lin.

On the other hand, Zhao Hanzhong, who runs a full industry chain, doesn't talk about the downturns or the rebounds, but rather looks for a "safety zone" under the current circumstance, which is close to real estate developers' reasoning. Star Capital targets first- and second-tier cities with an economy of over $160 million. People pay close attention to Hangzhou and other provincial cities whose markets are falling, because, according to Zhao Hanzhong, they have not looked into the third- or fourth-tier cities where "things are worse."

The same view comes from Zhang Dawei, chief research officer of Centaline Group. He thinks falling prices are no full demonstration of an imbalance of supply and demand. Areas with high demand for housing such as Hangzhou are price-sensitive, where people will buy when prices are being cut. But there is a real impasse with supply chasing demand in third- or fourth-tier cities, which cannot be solved through price-cutting alone.

Experts predict it will be harder for third- or fourth-tier cities to recover.

"When property developers are having a hard time, investors are there to take advantage."
—Lu Lin, CURA Investment

To reduce the cost of land acquisition, Star Capital is not likely to fight close battles with others in open markets. "We will negotiate with local governments on urban compound projects," said Zhao Hanzhong. Now Star Capital's has a ratio of 5:5 for residences versus commercial properties.

Money Factor

The $640 billion economic stimulus plan in 2008 brought in plenty of money to the market. Large amounts of money enter the property market not only through regular credit approval but also via the shadow banking system. Though lacking a clear definition, shadow banking can be said to include trust funds and private equity.

"There is no denial that the shadow banking system, though not the fundamental reason for this round of adjustments, acts as a driving factor," said Du Lihong, partner of Beta Fact Consultancy Center in Beijing. Du Lihong also believes the onset of a down cycle brings opportunities but also intensifies risks for property funds.

Taking CURA Investment as an example, the company had an investment sum of only about $ 1.6 billion in May 2012. Today that figure is as high $4.8 billion, and the company still has an asset management balance of $2.56 billion.

"Three years later it will be very likely have an investment sum of [$9.6 billion]," said Lu Lin. Whatever risks there may be, however, he will not slow down, and neither will other property funds.

Many property fund managers responded in their interviews that it is harder to raise funds this year under the impact of the business cycle.

"In China, new investments in the property market each year amounts up to [$1.6 trillion], which is beyond comparison with other industries. But the total scale of property funds is just [billions of dollars]," said Lu, who thinks the room left for property funds is so vast that there will surely be many players.

INDIAN HOTELS FOR ONLINE BOOKING!

Travelers heading to far-flung towns and the interiors of India no longer need to rough it out—they can book hotels online.

By Vishal Krishna

Vacations for many in India translate into traveling to places of worship. But unlike what most people expect, these spiritual journeys are far from a walk in the park and present innumerable challenges. To begin with, finding suitable accommodations in holy places, mostly located in small towns and remote districts, is still a logistical nightmare—even in this day and age of online booking!

That is because owners of most hotels in such places have been slow to adopt technology, making it difficult for hotel aggregator sites to integrate them into their web service platforms.

Yogendra Vasupal, a software engineer, decided to address this gap by bringing hotels in small towns and zillas (districts) on to the online service platform. Along with batchmates Rupal Surana and Sachit Singhi from MNM Jain Engineering College, Chennai, Vasupal began work on connecting Indian travelers with hotels in small towns using a $99 smartphone.

Registered in 2010 as Stayzilla.com, the hotel-booking site today has a network of over 12,000 ultra-low budget hotels. "When we started, it wasn't easy to get the hotel owners from small towns to sign up," said Vasupal, adding, "We were just a bunch of kids."

The trio started working on the idea within a few years of graduation from college. In between, they briefly worked in different fields. Vasupal founded Inasra, which created affiliate websites to drive the business of online retail giant Amazon from India. Surana and Singhi worked with IT giants Infosys and TCS, respectively.

It was during a trip to the interiors of Karnataka that Vasupal came up with a business plan—using the Web to connect hotels in small towns. "I visited a set of small hotels in the vicinity, and all of them were ready to sign up. But they had no computers," said Vasupal.

Over the next two years, the trio visited several cities in Rajasthan and Maharashtra and built a network of 250-odd hotels for the booking site under Inasra. In 2007, pleased with the network and confident about the

business, they opened the website for public bookings.

Soon after, they received a hotel booking order from an American woman traveling to a small town in the Mangalore region. The trio thought it was a big achievement for them, but it was not to be. Even though the booking was confirmed with the hotel and the sum paid, the room was not delivered to the woman on arrival. "We found out that while these hoteliers made entries in their books, they often forgot to record information. They had to be constantly reminded over the phone about the booking," said Surana.

After that fiasco, they took a three-month break before resuming their business. They created a process where all hotel managers would get an SMS on the bookings made, so they had a record, said Singhi. Meanwhile, bookings gained momentum and the trio closed 2008-09 with a turnover of $16,440.

In 2010, the network grew to over 2,000 hotels. That's when the trio decided to separate the hotel booking business from Inasra and set up Stayzilla. Today, more than 750 rooms a night are booked on the website, compared to 250 a day a couple of years ago.

E.M. Sivanandan, owner of Hotel EMS Maurya in Mettupalyam—a small town between Ooty and Coimbatore—had only locals visiting his hotel until he registered with Stayzilla. Now, travelers come all the way from the northern and western regions of India. "We take bookings from Stayzilla; it transfers money through net banking when we accommodate the guest," said Sivanandan. Stayzilla keeps 18% to 25% of the booking cost as its fee, he said, adding that he doesn't mind that as all the 48 rooms in his hotel are occupied on a regular basis, thanks to Stayzilla.

In 2012, the company caught the attention of the Indian Angels Network (IAN), which invested $500,000. "They are a unique business. There are [many] small-town hotels in India, and Stayzilla is addressing a travel segment that is waiting to be discovered," said Ravindra Krishnappa, board representative at IAN. Stayzilla used the funds to solidify its technology platform for understanding customer data and focusing on targeted customer campaigns.

Within a year of the IAN funding, Stayzilla received another $5 million from Matrix Partners, which believes the business can scale up in the metros as well since budget hotels there need a platform to sell their services. "The three founders have understood where and why the real Indian middle class travels. That is the amount of data they have generated," said Tarun Davda, vice-president, Matrix Partners India.

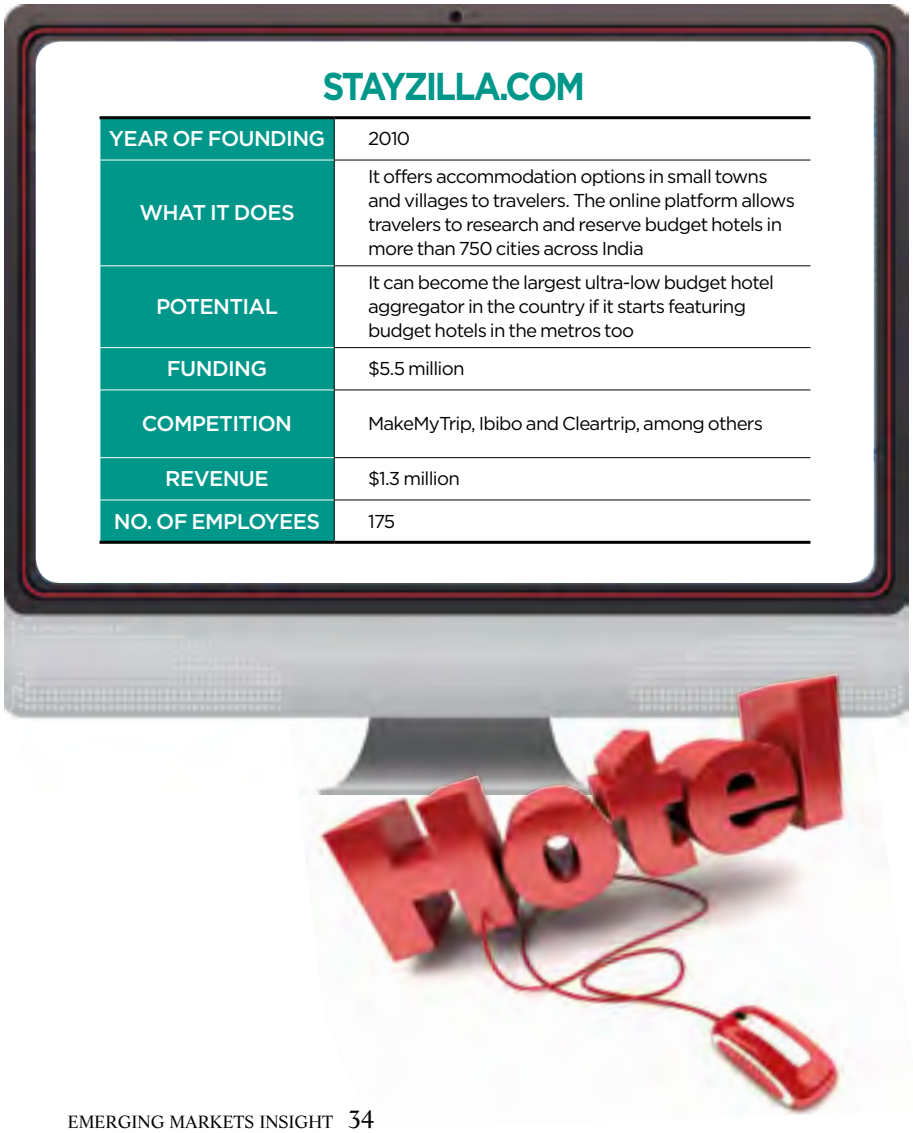
According to Brand Equity Federation, the hospitality industry in India is currently pegged at $36 billion, with 84% of the money being spent by domestic travelers. This figure is poised to go up to $72 billion in 10 years.

Going by the projections, there's an immense opportunity for growth for Stayzilla in the budget hotel segment across India. But the founders are currently happy making it big in the small towns.

"Stayzilla is addressing a travel segment that is waiting to be discovered."
—Ravindra Krishnappa, India Angels Network

STAYZILLA.COM

YEAR OF FOUNDING	2010
WHAT IT DOES	It offers accommodation options in small towns and villages to travelers. The online platform allows travelers to research and reserve budget hotels in more than 750 cities across India
POTENTIAL	It can become the largest ultra-low budget hotel aggregator in the country if it starts featuring budget hotels in the metros too
FUNDING	$5.5 million
COMPETITION	MakeMyTrip, Ibibo and Cleartrip, among others
REVENUE	$1.3 million
NO. OF EMPLOYEES	175



Indonesia's Credit Guarantee Agency (LPS) says that two-thirds of savings in national banks is owned by only about 75,000 depositors with savings of more than $200,000.

THE BEST, FOR THE BIGGEST

The number of Indonesia's premium depositors has increased slightly over the past five years, mainly thanks to booming commodity prices. Local banks compete to indulge them with privileges and luxuries. **By Albert W Nonto**

An executive lounge at Bank Rakyat Indonesia's (BRI) headquarters in Jakarta is no common workplace. Instead it is furnished with high-class facilities, and a stylishly-dressed female bank officer meets and greets guests as if they were first-class customers in a five-star hotel. Guests can sit and relax while bank staff members deal with their business.

On a one-week trip to London last year in which *GlobeAsia*'s sister publication *The Peak* participated, some of the very rich enjoyed all the premium facilities that Bank Mandiri offers for its high-end customers. Eleven couples were treated like kings and queens, taken shopping in posh department stores, driven in luxury cars and served in first-class hotels and restaurants.

These were among the premium customers of the largest bank in Indonesia. Internal sources at Bank Mandiri whispered to *The Peak* that the participants had deposits of well over $16 million and some might even have deposits above $80 million. "Some of them just seem like normal people and nobody notices they are rich because they are very modest in public life," said a source at Bank Mandiri.

On another occasion this year, Bank Mandiri hosted a special seminar in Bali for the second generation of Indonesia's big business families. The seminars alone were not so important since those who were invited already had a good understanding of the economic situation.

Instead, it was an opportunity for the rich to get together in a comfortable venue, a rare event amid their tight schedules. For Bank Mandiri, the event was a way to convince their first-class customers to stay with the bank. To become a premium customer of Indonesia's banks, customers need a deposit equal to at least $100,000. And since the number of depositors of that scale is increasing, so is the need for skilled fund managers to cater to this important segment. In 2010 the funds managed in priority banking schemes such as Mandiri Prioritas was around $8.1 billion.

The figure has now hit around $10 billion, equal to 11% of total third-party funds kept at banks. The most profitable bank in 2013 with net profit of about $1.6 billion was BRI, which has now left behind its image as a farmer's bank to add premium depositors to its customer base. Late to enter the market, BRI had about 30,000 top-end customers with total funds of about $333.4 million by the end of 2013.

It is estimated that more than 450,000

Indonesians have bank deposits of at least $100,000, with the sector demonstrating annual growth of about 10% per year. Some 5,000 have deposits of over $1 million. They include businessmen and women, top executives and high-profile professionals.

In Asia Pacific outside Japan, according to one private bank in Jakarta, more than $11 trillion in funds are managed through priority banking facilities. In Singapore alone, nearly 30% of high-profile customers come from Indonesia. A recent survey by Swiss-based investment bank Julius Baer on high net-worth individuals indicates that by 2015 at least 2.7 million individuals in Asia will have a combined total net worth of about $16.7 trillion. Indonesia, along with China and India, contributes more rich people than most other countries.

Indonesia's Credit Guarantee Agency (LPS) says that two-thirds of savings in national banks is owned by only about 75,000 depositors with savings of more than $200,000. That number swells dramatically if the cut-off point is lowered to $100,000.

Tight Competition

In the current situation with a growing number of rich people, banks are competing with each other to issue new services and products to attract the wealthy. While increasing the number of branches and the facilities offered is one obvious way to reach customers, banks also need to offer a wide range of investment instruments that can be combined within a single portfolio, such as bonds and bancassurance.

Schroder Investment, for example, offers Schroder Dana Likuid, a fixed-income mutual fund. Indonesian government retail bonds—ORI Indonesia II and Manulife Obligasi Negara Indonesia II—and many more examples are offered for BRI customers. "BRI will keep providing benefits and privileges to our customers to keep in this game," said one executive at BRI on condition of anonymity.

Bank OCBC NISP's president director Parwati Surjaudaja noted that increasing the number of funds available at the bank is also dependent to a large degree on the customer's viewpoint. Some customers, she says, have tended to quit the banks, attracted by the soaring stock market. By the same token, when the market falls, they'll return to the banks, hopefully having made a profit. "It is the bank's duty to explain in detail about investments," Parwati stressed.

The luxuries are an important part of the premium-account business. BRI offers first-class services from helicopter taxis, a pickup service from hotel to airport, free check-in facility at the airport, personal travel assistance and consultation on children's education plans. As information technology has also become a part of the daily life of depositors, banks have to provide good Wi-Fi services and secure, attractive websites. Scorpio Partnership research shows that high net-worth people spend around seven hours per week online checking their investment portfolios.

According to research by McKinsey Global Institute, by 2030 Indonesia will have become the seventh biggest economy in the world, up from tenth at the current time.

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HIGH NET-WORTH DEPOSITORS IN 2013

Bank	Customers	Managed funds (in USD)
Bank BCA	110,000	10.4 billion
Bank Mandiri	60,000	9.1 billion
Bank Permata	30,000	3.7 billion
OCBC	19,000	23.3 billion
Bank BNI 46	16,000	23.3 billion
Bank BRI	20,000	20.8 billion

Banker and columnist Ryan Kiryanto says banks will have to be more alert to the needs of high-end customers in order to retain them.

His research shows that the rich will allocate their money in at least 10 areas: (1) saving and investment; (2) food and beverages; (3) leisure; (4) apparel; (5) education; (6) transportation; (7) housing and utilities; (8) telecommunications; (9) personal items; and (10) healthcare.

Saving and investment ranks first, reflecting the reality that customers want to grow range of products. Indonesia's central bank has warned that banks need to be more vigilant about priority banking products which can turn out to be fraudulent.

In 2011 Citibank faced serious problem with its priority banking funds, which were being misused by one of its customer relations staff, who was spending customers' money on items like fancy sports cars. Citibank was forced to cover the losses. Banks also need to educate customers about managing their funds properly.

Standard Chartered Bank Indonesia has conducted meetings for potential customers about wealth management that guide customers to choose prospective investments that suit individual financial plans.

"We have to provide a broad range of tools and knowledge for rich people on how to invest their money in financial instruments to grow their assets," said one wealth trainer in Jakarta. This is the key to managing risk and growing their investments.

SELLING HIGH END TO THE HIGH END

With no experience in retail, two businessmen from São Paulo established the largest high-end supermarket chain in Brazil, where a tray of tomatoes costs $6.

By Ana Luiza Leal and Vicente Vilardaga

Entrepreneurs Victor Leal Jr., from São Paulo, and Bernardo Ouro Preto, from Rio de Janeiro, are unlikely retailers with an unlikely success. For decades, selling food and beverage to wealthy Brazilians was a thing for people who aimed small. The country's two most traditional high-end food markets, São Paulo's Casa Santa Luzia and Rio's Lidador, were established in the 1920s and have always kept their feet firmly on the ground.

The risk of expansion was always too great: As the country's currency has never been the most stable, prices could change to the point of making a big business deal impossible. Thus, it can be said that Leal Jr. and Ouro Preto, two executives with no experience in retail, achieved an unprecedented feat—embracing the rich, but not aiming small. The result was the largest high-end supermarket of Brazil in the number of stores: St Marche. As is usual in such stories, the whole thing happened by chance. Just over a decade ago, they were introduced by a mutual friend and heard about a high-end food market in the Morumbi neighborhood of São Paulo that was in bad shape. The foodie duo, interested in retail, invested their own money and requested help from friends and family. They collected about $294,000 to buy the food market and turn it into a supermarket, which was reopened in 2002.

The idea was to sell everything from French wines and artisanal ice cream to detergents and fresh fruit, prioritizing the most popular brands among the rich. In its first year, the store made a profit. Today, with 16 stores, St Marche makes $155.4 million and is undergoing its most ambitious expansion project yet—to reach $420 mil-

Such rapid growth is the result of the right model at the right time.

SYNDICATION/EXAME

lion in revenue in 2018, with 40 stores. Since 2007, the two men have also been the owners of Empório Santa Maria, another high-end supermarket in São Paulo.

Such rapid growth is the result of the right model at the right time. No retailer captured the last decade's so-called Brazilian foodie zeitgeist—above all São Paulo's—as well as St Marche. It was the decade of—some say exaggerated—sophistication of everything: Buying beer, coffee, olive oil, meat, and even salt got a bit more complicated. By selling tomato trays at $6, coffee packages at $18, and olive oil at $63, St Marche has become a kind of symbol of this trend. Its marketing embraces this idea shamelessly; St Marche even has a manifesto that defines itself as the supermarket "of the people who want curatorship and less nonsense." Think it's too much? Wonder who would want to go to a curated supermarket? Well, it's been working...

Cases like St Marche's are rare worldwide. In most countries, there are small high-end markets that sell sophisticated products, but everyday grocery shopping is done in supermarkets. A famous exception is the Whole Foods chain, with its posh organic approach, which grew wildly in the United States, and because it is so expensive, is called "whole paycheck." Another successful example is the Italian chain Eataly that has 27 giant stores with restaurants and spaces for events and cooking classes in five countries.

"We want to debunk the myth that the bigger and uglier the market, the cheaper it is."
—St Marche owners

There's a reason owners of high-end markets fear growing too much: it is much more difficult to organize the logistics to supply sophisticated products than for everyday items such as rice, beans, washing powder and canned tuna. Some are craft-produced by a single company while others come through importers and are subject to exchange rate variations and delays at ports (remember, it's Brazil). St Marche's strategy to handle this is to have products with guaranteed exclusivity and long-term contracts for the most critical segments.

Supermarket Myth

Moreover, there are products that may be placed and removed from the shelves whenever necessary. Every month the company changes about 300 of the 10,000 items sold in its stores. The owners of St Marche did not wish to be interviewed, but replied by e-mail that they want to grow in their current scheme, keeping control of operations. "We want to debunk the myth that the bigger and uglier the market, the cheaper it is," they wrote. "We have a dedicated team researching our competitors to ensure our basic and special products are always offered at a competitive price."

According to estimates by industry executives, St Marche's profit margin is around 5%, whereas competitors like Pão de Açúcar— that sell almost everything—have a 3% profit margin. Growing from zero to more than $155 million in 12 years was a great achievement, and with 16 stores in the fanciest neighborhoods of São Paulo, the company still has a size that enables it to bypass the difficulties of the premium market. But to more than double that number will be much more complicated.

First, investment must be increased. The company has no distribution center, which means suppliers have to deliver the products from store to store. To do this, they currently charge an average of 5% of the total amount of the order, but this figure may grow depending on the number of stores. St Marche says it is planning to build a distribution center in 2015.

Another problem is the increasing rent of real estate in affluent neighborhoods where its stores are located. Rent has increased an average of 50% since 2009 and there are no signs they will decrease anytime soon. Because of these difficulties, the owners have postponed plans for expansion. In

THE PLAN IS TO DOUBLE IN SIZE

The company profits more than its main competitors.

Revenue
$155.4
Million

Profit Margin
5%
Larger Than The Main Supermarket Chanins.(1)

Number of Stores

There are two main obstacles to St Marche's growth plans, according to market experts:

LOGISTICS
The company has no distribution center. Suppliers have to deliver the products from store to store.

REAL ESTATE
Price of real estate in upper-class neighborhoods, where their stores are located, makes it difficult to open new stores.

(1) estimate source: St Marche, Food Retailers

St Marche partners have postponed the opening of an Eataly store in São Paulo.

2008, they announced they planned to achieve profits of $420 million by the end of this year but this goal has been postponed to 2018.

Long Road Ahead

The most noticeable stumble came with their most ambitious action: the attempt to take Eataly to Brazil. St Marche has already rented a space of over 43,000 square feet in the Itaim neighborhood in São Paulo, and planned to open the store in November of this year but has pushed it off until 2015. The owners say the opening will be in the first quarter of the year and that the delay is due to the need of detailing the project and training staff. Industry executives, however, expect the opening will be later in 2015 because of problems with importing the products.

Another problem is the increasing rent of real estate in affluent neighborhoods where its stores are located.

St Marche sells olive oil $63, coffee at $18 and tomatoes at $6; but the owners say they offer "competitive" prices

Life is likely to get tougher since no pioneer is left alone for long. The so-called gourmet wave that explains the success of St Marche is making room for several neighborhood stores that sell special kinds of meat, cheese from Minas Gerais, tea, bread and so on. They are direct competitors. And finally, the large supermarket chains have decided to invest heavily in neighborhood stores. Pão de Açúcar, for example, began investing in the "Minuto Pão" model: small, sophisticated stores in neighborhoods with high purchasing power. Therefore, competition will come from everywhere. Those seeking curatorship will need even more help to make choices.