THE 1 HOUR CHINA BOOK

TWO PEKING UNIVERSITY PROFESSORS EXPLAIN ALL OF CHINA BUSINESS IN SIX SHORT STORIES

JEFFREY TOWSON
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“This quick, fascinating book will give readers who know little or nothing about doing business in China—everything they need to know or remember about how to succeed in business in China. One hour with this book will make you an expert on business in China.”

Dick Gephardt
Majority-Minority Leader
U.S. House of Representatives
1989–2002

“The One Hour China Book offers an even-handed and well-illustrated insight into the seemingly chaotic and often self-contradictory China prospects in a pleasantly easy read.”

Rui-Gang Li
Chairman, China Media Capital

“Without question the best 60 minutes you will spend on China.”

Jonathan Anderson
Emerging Markets Advisors

“The superlatives typically used to describe China’s economic rise over the past two decades fail to do justice to its historic significance. In their refreshing speed-read of a book, Jonathan Woetzel and Jeffrey Towson take a simpler approach and let the facts speak for themselves. In doing so they capture, clearly and concisely, the magnitude of China’s transformation.”

Tom Mitchell
Beijing Correspondent, Financial Times
“I heartily recommend this volume. It succinctly describes the six megatrends reshaping Chinese society today and does so in an engaging and thoroughly enjoyable fashion. As a faculty member who also likes to tackle huge subjects and distill them to their essence, I congratulate the two authors for their effort. The book makes for essential reading on your next trip to China.”

Lawton Robert Burns, Ph.D.
James Joo-Jin Kim Professor
Chair, Health Care Management Department
Director, Wharton Center for Health Management and Economics
University of Pennsylvania

“The authors, fully aware of the challenge of their conceit, educate and entertain the uninitiated about what makes modern China tick with both wit and charm.”

Leo Chu
Creator/Executive Producer, “Supah Ninjas” & “Afro Samurai”

“This beguiling book manages to boil an enormous amount of complexity down into a fully digestible capsule compendium that is centered around a series of “mega-trends” that are exemplified by actual Chinese entrepreneurs and their concrete businesses. As such, it is both a very accessible and fascinating tour of contemporary Chinese business, and of China itself.”

Orville Schell
Arthur Ross Director, Center on US-China Relations,
Asia Society, New York City and co-author of
“Wealth and Power: China’s Long March to the 21st Century.”
“Anyone on the planet who has any hesitation about the importance of establishing a foothold in China should read this book.... the six China mega-trends that Jonathan and Jeffrey so thoughtfully describe have forever changed the global playing field....there is no denying that the world has become one massive marketplace and the commercial implications are fascinating and seemingly endless.”

Karen D. Seitz
Founder and Managing Director
Fusion Partners

“If you’re trying to find that secret decoder ring to the biggest business trends in China, this book is the authoritative guide you’ve been looking for.”

Peilin Chou
Former Creative Executive, Walt Disney Feature Animation
ALSO BY THE AUTHORS


*Capitalist China: Strategies for a Revolutionized Economy*, by Jonathan Woetzel (December 18, 2007)

*Operation China: From Strategy to Execution*, by Jimmy Hexter and Jonathan Woetzel (December 18, 2007)
China is big.

That’s our attention-grabbing opening. China is really, really big. It’s important to be provocative in publishing.

China is also really complicated. By economy, by industry, by population and by just about every other metric, the country keeps getting more and more complicated. China is now both really big and really complicated—not unlike, say, the United States.

So the idea of a one-hour China book is kind of ridiculous. How could you possibly explain such a big and sprawling topic in an hour?

But it’s not actually a theoretical question. We both do “China-to-the-world” thinking for a living. And more and more, we have found ourselves getting asked about China in places like Ohio, Brighton and Lima. Places that 5 years ago didn’t really care that much about this topic. And the questions are not just coming from business people. They are also coming from colleagues, concerned parents, and local politicians. China has become a global topic—but most people don’t really have the time to read lots of weighty China books. Some prominent American politicians know shockingly little about China by the way.
So this book is our answer to that question. If we had the undivided attention of someone from Ohio, Brighton or Lima for just one hour, this little book is what we would say.

And we took it a bit farther. Not only is this book our one-hour explanation of China business, it is also written so that it can be read once, thrown away (please don’t) and remembered easily. That was our goal: a speed-read China book that explains most everything and sticks in the brain.

If we have done our job well, you should be able to read this in 60–90 minutes. You can read the main points in an hour. If you read absolutely everything, it will take closer to 90 minutes. And after one reading, you should have a reliable framework for understanding China business. Most China headlines (say in the Wall Street Journal) should make obvious sense. In fact, they should be fairly predictable.

ABOUT US: THE VIEW FROM THE LAOWAI TRENCHES

We both live and work with one foot in China and one foot in the West. We do China-to-the-world thinking for a living. Our main careers are in management consulting (Jonathan) and private equity deals (Jeff). But we also write and teach at business schools.

Jonathan is a senior partner at McKinsey & Company in Shanghai and was the guy that opened their Shanghai office in 1994. If you want to know the answer to a ridiculously specific question like “what was Baosteel working on in 1995?” or “what was Honeywell’s automation initiative in Sichuan in 1988?” Jonathan probably knows the answer. And there is a good chance that he was the guy in the Board Room answering it.

Jeff is an investor focused on emerging market investments, mostly US to China private equity deals. Jeff’s background was shaped by 8 years working as an executive / slave to Prince Alwaleed. Prince Alwaleed is usually known as the Saudi Prince who bought Citibank,
News Corp and the Four Seasons. He is also occasionally known as the guy building the one-mile skyscraper in Jeddah (Jeff’s old project) and the Prince who turned an Airbus A380 into a private plane.

We both work in the trenches of China business. We spend our days digging into companies and industries. We are bottom-up analysts and our view of the world is based on studying and working with thousands of individual companies. Jonathan is also known for his ability to speak Mandarin so fluently that it shocks Chinese. Jeff has an accent that produces much the same effect.

As professors, our academic home is Peking University’s Guanghua School of Management in Beijing. Although it desperately needs a Starbucks, it is otherwise a great place to teach. Our students are a mix of MBAs and Masters of Finance students that have come from virtually everywhere: China, South Korea, Singapore, Norway, Los Angeles, New York, Azerbaijan, Egypt, Germany and so on. Generally speaking, they are crazy ambitious, which we respect. It is completely normal for MBA courses in China to run until 10pm on Friday night.

An important note: Some of our 2012 MBA students were involved in this book. We have highlighted the team at the end of this chapter. If you are a CEO, Managing Director, HR head, or headhunter, please take a look at these students. These are newly minted MBAs that you should absolutely have on your radar.

THE ONLY 6 STORIES YOU NEED TO KNOW TO UNDERSTAND CHINA

A lot of China business has a mysterious quality. This is not uncommon in new industries or markets. Our first assertion is to relax. There is nothing mysterious or complicated about Chinese companies or markets. In business, there is really nothing new under the sun. Consumers behave pretty much the same everywhere. Competition
is pretty much the same everywhere. You just need to ignore the hype and stay focused on the basics.

**And in China today, the basics are 6 big trends.**

That’s it. Six big trends that shape most of the industries. These six trends are also driving much of China’s impact on the world. They are like tectonic plates moving underneath the surface. If you can understand them, the chaotic flurry of activity on the surface becomes a lot more understandable—and even predictable.

However, we are talking about trends that move businesses on a daily basis. These are revenue or cost drivers that show up in income statements today. That is somewhat different than the high-level, “trends” that are typically discussed by economists, politicians and other macro analysts. Our trends are phenomena that are generating revenue, creating big companies and minting new Chinese millionaires today.

You will probably notice that we have little to say about Chinese politics or state capitalism. For some reason, Western business people who normally study customers and competitors shift their focus to politics and regulations when in China. Our experience is that these topics are wildly over-emphasized by Westerners in China. The business of China is mostly business.

Our big assertion is that six mega-trends are driving most of China’s business today—and its interaction with the West. The deals, the newspaper headlines, and the rising and falling wealth of companies are mostly manifestations of these six mega-trends—which we show below.

This is our simple framework. If you remember one thing from this book, it should be this chart. We will repeatedly come back to it throughout the book. In each of the following chapters, we will be talking about one of these six mega-trends. And we will be telling a
story for each. We will tell the stories of six individuals that rode these trends to staggering wealth.

**The 6 China Megatrends**

So you can look at business in China as either six mega-trends or as six short stories, depending on how your brain works. That is our basic proposition. **You give us 60–90 minutes and we will give you six stories and a chart that explain most of China business.**

However, let us make an important caveat. These are powerful trends that are driving business activity today. It does not mean they are necessarily good things. Or that they are sustainable. Most lead to profits, or at least revenue. Some may be stable. Some lead to bubbles that may or may not collapse. We are only arguing that they are big and are driving economic activity on a very large scale.

**OUR THANKS FOR READING OUR BOOK**

This book is the result of the expertise of +30 people—including MBAs, McKinsey partners, China writers and many editors. While small, it represents a lot of expertise that we have tried to distill down to a speed-read that sticks in the brain.

We hope that our enthusiasm for this topic also comes across. The rise of China and its increasing collision with the West is a fascinating
topic. And it is something we live on a daily basis. It’s a thrilling life. Dynamic. Fairly chaotic. Often anxious. But that is the way of a life lived on the frontier.

Our thanks for reading our little (literally) book. We hope you find it helpful or at least a good way to kill a taxi ride home. We tried to keep it to one hour (and the price of a latte).

We would appreciate any feedback. Please stay in touch by signing up at www.jefftowson.com. We use this site for gathering feedback and for testing ideas for new books and papers.

Our thanks and cheers,

Jonathan and Jeff
December 2013
MBAS YOU SHOULD HAVE ON YOUR RADAR

Please take a moment to look at the MBAs who have worked on this project.

CHAPTER ON URBANIZATION:
Edan Kaplansky. Born in Manhattan and raised in Jerusalem, Edan holds an L.L.B and an MBA from Hebrew University, with studies at Peking University’s Guanghua School of Management. He currently works at Shibolet and Co., Advocates & Notaries, and is Managing Director of the ‘Brera Center’ Foundation, which provides free legal and educational services to underprivileged populations.

Ron Klein. Born in Chicago and raised in Israel, Ron holds an L.L.B. from Hebrew University Faculty of Law, where he served as Deputy-Editor of the Faculty Law Review. He also holds an MBA from Hebrew University and Peking University, majoring in International Finance. Ron currently works at the Israeli Securities Authority, focusing on Corporate Governance and Securities Regulation Policy.

Wang Xinran holds an MBA from Peking University and has over 6 years of experience in business operations and strategic management. Currently working for SMIC (Semiconductor Manufacturing International Corporation) as an investment manager.

Yinan Zhang. Yinan is currently an MBA student concentrating in Strategy and Investment at Peking University. Prior to attending business school, Yinan worked for several multinational firms including Kraft Foods, Unilever and Nestle, focusing on supply chain management. Yinan earned a Bachelor’s degree in engineering from Beijing Normal University in 2005.

CHAPTER ON RISING CHINESE CONSUMERS:
Scott Hicks. Scott earned his MBA at the University of British Columbia, where he specialized in Finance, Strategic Management, and International Business. Holding a CFA charter, he has worked for the Canadian Federal Government and most recently in the treasury department of Finning International.
Denis Lenz holds a Bachelor’s degree in Business Administration from the University of St. Gallen, Switzerland. He is currently enrolled in the Master’s degree program in Banking and Finance. Born and raised in China, he has strong international exposure and a great interest in Asia’s dynamic societies.

CHAPTER ON MANUFACTURING:
Christopher L. Amador is a 2013 candidate in the Master of International Affairs program at the University of St. Gallen in Switzerland. He has experience in the automotive and consulting industry through internships with BMW Group and Bain & Company, where he worked on China-related topics.

Jangyoon (Johnny) Kim. A native of Seoul, Korea, Johnny is an established consultant and project manager. He is intrigued by China’s potential to shape the global economic landscape.

Maria Elena Kolesch earned her Bachelor of Science in Business Administration from Germany’s leading business university, Mannheim, in 2011. She is currently completing her Master’s in Corporate Management and Economics at Germany’s “Zeppelin University.”

CHAPTER ON FINANCIAL SERVICES:
Juuso Makinen is an economics major from Helsinki intrigued by the challenges of emerging markets—particularly financial liberalization and asset pricing issues. As a student at Peking University, he gained insights into social and economic topics pertaining to China.

James Liu

Kexin Zheng is a part-time MBA student at Peking University’s Guanghua School of Management. She holds a Bachelor’s degree in Economics and Sociology from Peking University. She is currently serving as a credit analyst at MetLife China and previously worked as a banking analyst at CCXI, the largest local credit rating company in China.
CHAPTER ON BRAINPOWER:

**Theresa Gessner.** With a background in corporate communications and management studies, her field of interest lies in cross-cultural management and international communication strategy. She earned her MSc from Stockholm University in 2013.

**Spence Nichol** is an associate with a global management consultancy, and a former strategic advisor to one of the world’s best performing school systems. He has studied at London Business School, the China-Europe International Business School in Shanghai, and the University of Alberta in his native Canada.

**Xiaoyi (Fenny) Wang.** A senior software engineer, Fenny has been working in a multinational telecom company for 8 years. She graduated from the University of Toronto with a Bachelor’s degree in Computer Science, and later studied in Peking University’s MBA program.

CHAPTER ON THE INTERNET:

**Peter Lehmann** is a digital business professional with German roots and a global mindset. By following market trajectories and technology trends, he aims to build the products and services of the future. The insights he contributed to this book are the result of his studies at Peking University.

**Stephan Maluck.** Born 1986 in Germany, Stephan studied Management at universities in Germany, China, and Chile. He holds a Master’s degree and works as a management consultant in the financial services industry while pursuing his Ph.D. Prior to graduate school, Mr. Maluck completed an apprenticeship at Deutsche Bank and developed an entrepreneurial mind-set as an executive assistant of a German start-up.

**Mathis Wilke** holds an MBA from CEIBS in Shanghai. During his studies he won the China Final of the CFA Institute Research Competition in Shanghai, and placed as a Semi-Finalist at the Asia-Pacific Regional Final in Hong Kong. Prior to business school, he worked as a Senior Associate in the Leveraged Finance departments of RBS and Mediobanca for 5 years, financing private equity transactions across Europe. He speaks German, English, Spanish and Mandarin Chinese.
Janet Yurasova. Originally from Russia, Janet recently graduated with an MBA from the UCLA Anderson School of Management. Before attending Anderson, she ran a small web-development company and started three successful Internet endeavors. Janet has a diverse educational background in business, IT, law and social sciences from US, Russian, French, Cyprus and Chinese universities. She lives and works in Silicon Valley, California.

GENERAL RESEARCH:
Stian André Kvig holds an MSc. from Copenhagen Business School. Mr. Kvig has held several internships involving international capital markets during his studies, and he manages a private portfolio of investments. He has working proficiency in German and conversational ability in Mandarin.

Also thanks to Luke Masuda for his help with this project. Finally, a special thanks to Glenn Leibowitz of McKinsey. We are both greatly appreciative of his invaluable support and his generosity with his time.
China is currently witnessing the largest migration in human history. Hundreds of millions of people are flooding from the countryside into the cities. And while over 300 million people have already migrated in the past 30 years, McKinsey predicts there are another 350 million yet on the way.

This urbanization phenomenon is adding an average of 18.5 million people to the cities every year. That is equivalent to adding the population of the Netherlands to China’s cities annually. Or the equivalent of adding the entire population of Japan every 8 years.

This process began in earnest in the 1980s when government controls on where people could live were loosened (to some degree). Prior to this, the Chinese population had been somewhat frozen in place. For example, in 1980, only 20% of the Chinese population was located in cities. In the US in 1980, it was 70%. So this massive urbanization process is a lot about China catching up. It is about transitioning from an agricultural to an urban industrial society.

Such a huge migration of people changes almost everything: cities, required infrastructure, environmental impact, required resources, the economy, etc. As cities contain virtually every aspect of life, such a migration changes virtually everything in China. However, this is
not just an economic and demographic trend (which we will discuss). It is also a cultural phenomenon.

For many Chinese, the move from their home village to the city is a key moment in their lives. Workers, young college graduates and even entire families have strong memories of leaving their village for the first time and taking the train ride to Shenzhen or Shanghai. As in America’s great migration West in the 1800’s, this movement into the cities represents the search for opportunity and a better life.

Urbanization is our first China mega-trend. We have placed it as the starting point in our chart (below)—as it is the most important phenomenon shaping China. We will make just a few key points about this trend (helpfully noted as Key Points) and we will tell a short story about its impact. This will be our process for each chapter—one story and a few Key Points.
On national holidays, workers return to their villages from the cities. Rain delays during these periods can cause massive congestion—as in the Guangzhou railway station in January 2008 © Tian Qingju/ChinaFotoPress

The 6 China Megatrends

- Rising Chinese consumers
- The brainpower behemoth
- Money - and lots of it
- The Chinese Internet
- Manufacturing scale
- Urbanization
KEY POINT #1: THERE WILL SOON BE 1 BILLION CHINESE CITY DWELLERS

From 1980 to 2010, China’s urban population grew by approximately 400 million. That is more than the entire population of the USA. This brought the number of Chinese city-dwellers to about 700 million and the overall urbanization rate to 50%. However, this is still far below the 70–80% urbanization rate seen in Japan, the US and Europe. So we still have a long way to go.

In 2009, the McKinsey Global Institute (and Jonathan specifically) published a widely cited report, “Preparing for China’s Urban Billion.” It showed how by 2030, there will be over 1 billion Chinese city dwellers. That’s the number to remember: 1 billion city dwellers. Chinese urbanization is increasing at a fairly linear rate toward this big milestone.

When this happens, China’s cities will be more populous than the entire North and South American continents combined. The implications of this are profound. And 1 billion is a good number to keep in mind. It’s also pretty easy to remember.

KEY POINT #2: LOTS OF CITY DWELLERS MEANS LOTS OF CITIES

Not a big surprise. All these people moving into the cities have to live somewhere. So they need apartments. And they need buses and subways to get to work. And they need water and electricity. And then they need things like police, parks, roads and sewage treatment. These are not little challenges.

Obviously, a lot of Chinese cities just got bigger in response. Most added new districts. We can today count 160 Chinese cities with over 1 million people. In comparison, Europe has 35. And McKinsey predicts this number will increase to about 220 by 2025. So think 220 cities like Tucson, Arizona.
Some cities got a lot bigger. China currently has 14 cities with over 5 million people—and this will increase to 23 by 2025. So think 23 San Francisco’s (yes, a scary thought for conservative America). And these will constitute 40% of the world’s cities with over 5 million people.

And finally, we are seeing the emergence of mega-cities. These cities, usually several cities linked closely together, contain 30–40 million people each. And many will reach 50–60 million people. These are fascinating and we will discuss them more in the key point on clusters.

Our point here is that there is a ton of building going on to handle the inflow of people. And it is not something that any country has ever attempted before. It also occasionally produces some unusual situations. An example is Shenzhen, often called a “city without memory”.

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Shenzhen is today, by any definition, a world-class, first-tier city. Located directly across the border from Hong Kong, it has several modern business districts, great parks, more than 10 million people, and a subway system that has grown from nothing to very large in about 10 years.

It is also a “city without memory”. It is a place where you always ask where someone is from, because nobody is from Shenzhen. The city was only a series of villages prior to 1980. The total population then was about 100,000. And as recently as 1995, the central business district Futian was empty fields. Building a thriving city from scratch in just over two decades is an impressive feat.

If Shenzhen is a city without memory, Ordos in Inner Mongolia is a “ghost city,” another unusual situation created by this trend. Mostly empty Ordos was built from scratch for 1 million anticipated inhabitants who, by and large, did not show up. So today it’s a big, impressive and empty city. There are communities of empty apartment blocks. Modern government buildings and retail spaces are deserted. Ordos and other ghost cities get a lot of media attention—especially when discussing China’s real estate bubble.
Our point is that all of this is to be expected. If you are building cities at a breakneck pace against a huge urbanization inflow, sometimes your supply gets ahead of your demand. That, plus some real estate speculation, gets you a ghost city. And sometimes your demand gets ahead of your supply and you get congestion (e.g., crowded Beijing). Sometimes you get it about right (e.g., Shenzhen). These things should be expected and are not as significant as newspaper headlines would have you believe.

KEY POINT #3: IN CHINA, URBANIZATION = WEALTH

Human beings are social animals. Putting us in close proximity to each other, such as in cities, changes us. And urbanization is fundamentally changing the Chinese people. How they act. How they shop. How they communicate. It is also changing their economic status.

In China, urbanization equals wealth. Going city-by-city across China, urbanization has directly coincided with approximately 350 million Chinese moving out of poverty since 1990. GDP per capita just
goes up way faster in cities. And not only have 250 Chinese cities tripled their GDP per capita since 1990, but disposable income per capita is also up 300%. So what you are seeing in Chinese cities is both an increase in the number of people in cities and an increase in spending power per person.
This is not necessarily a causal relationship. And in most countries, urbanization does not directly lead to wealth (hello Latin America). More likely urbanization is necessary for wealth, even if by itself it is not sufficient. We make no claim for why this is happening in China. But the data is overwhelming. Note the chart below.

**Chinese urbanization (%) vs. GDP / capita (RMB)**

[Chart image]

Source: McKinsey & Company

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That’s the end of the numbers for this chapter. Some people relate better to numbers (Jeff wants his obituary to be a PowerPoint presentation). But most people relate better to stories. And for Chinese urbanization, a good story is that of Wang Shi and his company, China Vanke.

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**THE AWESOME STORY OF WANG SHI AND CHINA VANKE**

China Vanke is a real estate company that has no equivalent in the West. The company’s revenues are greater than the top four American real estate developers combined. It has built more apartments than any other company in history. And Wang Shi, the founder, is now the world’s largest real estate developer. He is also the person who has provided a defining event for millions of rising Chinese: the purchase of their first home.