

POSTCARDS FROM

China.

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Earlier this year, I put my Mandarin to good use on a self-guided investment trip through the Middle Kingdom. The Chinese internet platforms have radically altered how people live and work in the country. Having focused much of my research over the past two years on their remarkable impact, I wanted to step back and consider the human aspect of rapid change on individuals, their communities and society. Here are my reflections on the China I encountered on the streets and in the businesses of three of the cities I visited.

China Trip 2019



JIAXING

YIWU

SHENZHEN

Yiwu.

If the label says, ‘Made in China’, there’s a good chance that the merchandise will have come from Yiwu. A city in the Zhejiang province of just over a million people, it is home to one of the most multi-cultural, vibrant trade hubs in China, Yiwu International Trade City. As the world’s largest small commodities market, it is the place to go if you are a buyer wishing to source cheap, mass-market goods or are a factory owner eager to produce them.

This was my destination one rainy Thursday morning in April as I travelled the 300 kilometres south from Shanghai aboard a high-speed train. Every year, up to 70 per cent of the world’s Christmas decorations and several billion pairs of socks are dispatched from here. But for how long? Despite its 80,000 traders, Yiwu is finding itself increasingly irrelevant. The rise of Alibaba, owner of the world’s largest ecommerce platform, could spell disaster: the advent of online trading models means a large physical presence is no longer the competitive advantage it once was. Overseas buyers can connect with factories and merchants without the need for a physical location. So, I wanted to see for myself if the ‘warehouse of the world’, as it has been called, was adapting to the digital economy.



Exactly 20 years prior to my trip, in April 1999, Jack Ma and his 17 colleagues co-founded Alibaba.com with the mission to make business easy to do, anywhere. Over the past 20 years, the company's gross merchandise volume has gone from zero to US\$853 billion, and there's no sign of it abating.

Unsurprisingly, the mood on the ground is mixed, "I lost all my money because I invested in a Yiwu offline business just before Alibaba came", a migrant from Hubei province, now a taxi driver in Yiwu, laments. "We all thought Yiwu's physical market had such strong position that we moved here with our whole families, we didn't see it coming."

As I head back to the train station, another taxi driver says, "I moved here with my whole family to sell trinkets from my home town's factory to the whole world, but everyone is buying

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online on Alibaba now. My niece studied business and takes care of the trade now. I prefer to drive people around."

Some of the anecdotal evidence is sad, but visiting Yiwu was uplifting. It offered a glimpse of a China that is mid-transition to a modern, digital economy. Yes, there will be casualties and it would be all too easy to conclude that Yiwu's past glory is spent. Yet I

would not be too quick to judge the seemingly empty streets. Forty per cent of merchants are trading both online and offline, with most revenues now generated through Alibaba's Taobao, Pinduoduo and JD. The merchants are proving their resilience.

The provincial government is also looking to the future. I discovered that earlier this year Yiwu's government agreed to cooperate with Alibaba on the ecommerce giant's Electronic World Trade Platform (eWTP). Doing so will improve China's digital infrastructure, integrating digital payments and digital customs clearing technologies.

I am feeling positive as I board the train. Might those traders who have successfully adapted to digital flourish in this brave new world, with the help of the provincial government and Alibaba? I'd like to think so...

Jiaxing.

Located on China's Grand Canal, and bordering the mega-cities of Hangzhou, Huzhou and Shanghai, Jiaxing's history, gardens and waterways stand in contrast to its more recent industrial heritage. Over 2,000-years old, this city of four million has been known for many things, from the 'land of fish and rice' to the 'home of silk'. It was the founding place of the Chinese Communist Party in 1921, and latterly became home to two of China's largest nuclear power plants. This is a city adept at reinventing itself according to the times.

Since 2016, Jiaxing's local government has been pushing to diversify the province's traditionally resource-heavy manufacturing base with a more high-tech and environmentally-friendly economy. Small, local businesses are teaming up with the digital platforms to revolutionise every aspect of their business model, from how they source products to how they find and retain customers. I decide to spend the day speaking with small businesses to see what difference the digital giants are making to them.



“One day 13 months ago an agent from Alibaba’s Ling Shou Tong initiative showed up. I had no idea who he was, but I am glad I tried to use what he was offering,” says the owner of a 20sqm general store. It proved a turning point. The shopkeeper now orders all his goods online using Alibaba’s app and, added bonus, his orders are aggregated with other local stores, making him eligible for group discounts.

As well as better logistics, inventory management and a ready-made payments system, the Ling Shou Tong platform offers data-driven insights as to what to sell and how to sell it. The shop owner has made changes to his store layout in response and appears genuinely happy. Alibaba let him feel that he is in control, despite being almost exclusively reliant on one aggregator supplier.

Alibaba’s new retail initiatives have the potential to embed it within small businesses across China. With 10 per cent of China’s six million independent general stores already signed up, the combination of digital know-how and physical presence gives Alibaba access to some of the 85 per cent of retail sales currently offline.

A director at a local travel agency was equally sanguine about offline/online partnerships. “For overseas trips, in particular, it wouldn’t be possible without Ctrip,” says the agency director, sipping tea.

Many of his clients turn to the agency because they want the convenience of group travel. Plus,

The shopkeeper now

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the agent can provide this for less than they would pay online, thanks to its ability to buy packaged tours from Ctrip (China’s leading online travel agency) at a significant discount. It is a symbiotic relationship: Ctrip needs the agents to access groups, especially those who have recently retired and prefer face-to-face interactions over online searches, and the agencies need Ctrip because it has the most comprehensive coverage.

Talking with the agent encourages me to believe in the potential for the in- and out-bound tourism market to grow substantially. In 2017, 50 per cent of trips taken by Chinese tourists were to Greater China. Less than 10 per cent of Chinese citizens hold a passport and very few take more than one holiday per year. As incomes rise and visa restrictions lift, it is likely that Chinese holidaymakers will venture further afield and do so more often. Companies, such as Meituan, Ctrip, Tongcheng Elong and Fliggy, are exploring this secular growth opportunity.

Shenzhen.

Next stop: Shenzhen. It seems fitting to visit a Luckin Coffee shop here, in a city that has grown 12-fold in three decades to a population of 12 million today. As well as being Hong Kong's neighbour, Shenzhen is also China's start-up heaven. Mainstays of the Chinese economy Tencent, Ping An Insurance and ZTE began their rapid rise to fame from here.

Luckin Coffee is the new kid on the block. It is a recently listed, cashless, app-powered coffee chain, beating the US coffee giants at their own game. Its 'new retail' model merges online and offline channels to create a seamless customer experience. But, if you're picturing Starbucks, don't. Think, less is more. We're talking no frills, a quick grab-and-go coffee pre-ordered and picked up from a conveniently-located coffee shop, which costs loyal customers around half what it would cost them for the privilege of lounging around in a coffee shop with friends.

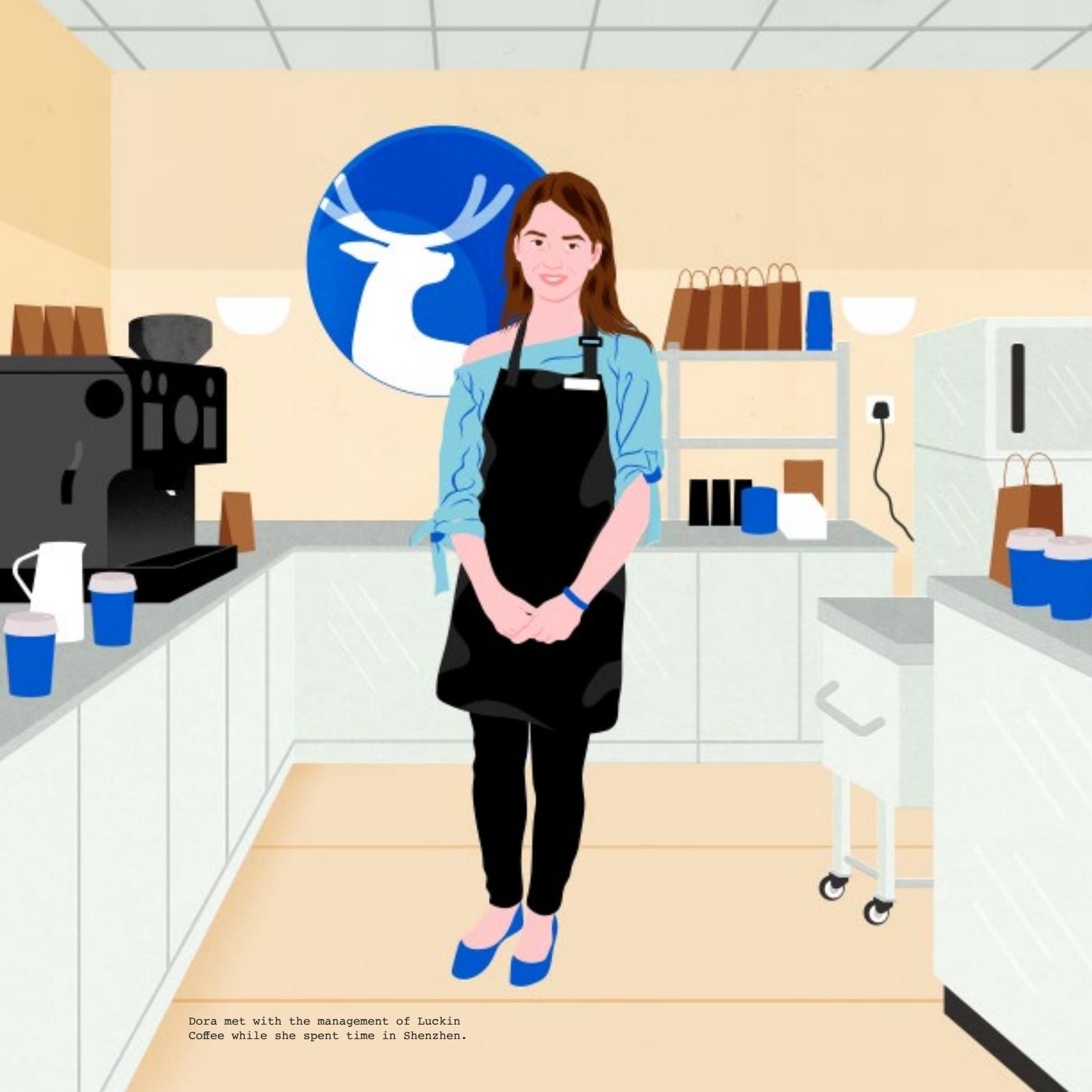
Luckin Coffee was founded in October 2017 in China's Xiamen. In the space of 18 months, the chain amassed 16 million customers across 2,370 stores. How so? Giving away lots of coffee. As well as offering free delivery, it gave free coffee to anyone who downloaded its app, recommended the app, ordered at least two cups of coffee or followed Luckin Coffee's social media account.

Its minimalist navy-blue stores are found in the lobbies of high-rise office buildings in densely-populated cities such as Shenzhen. Here, it has access to millions of young office workers. Their offices are situated too far away from the shopping malls and prime real estate locations favoured by its competitors to be a viable option during the working day.

When I spoke with staff, it was clear that this underserved segment of the population is its target market. It seems to me that it is this cohort – those who work long hours and are not looking for the full coffee shop experience – where there is the greatest potential for growth. The average coffee consumption in China is a measly five cups per person per year (20 in first-tier cities such as Beijing, Shanghai and Guangzhou), compared to 360 cups in Japan. If anyone can establish a coffee-drinking culture in a nation synonymous with tea drinking, it is Luckin Coffee, which has identified and addressed the sticking points – the relatively high price of circa 30 renminbi (approximately US\$4.20) per cup and the long queues and wait times in busy locations – upfront.

However, a large growth opportunity and an interesting business model do not automatically translate into a great investment. Because it continues to invest in expansion, the business is also heavily loss making, and Starbucks, the cash-rich incumbent for which China is strategically the most important growth market, will not go down without a fight. Nor should we assume that this will be its only challenger. How long could it withstand a price war with others backed by deep-pocketed investors?

There is plenty for us to consider, including how this might affect other consumer-facing businesses in China. Following my trip, I will be spending more time thinking about how Luckin Coffee fits into the broader consumer ecosystem. What, if anything, would be the source of a durable competitive edge? Is its ‘new retail’ business model sustainable? And, if so, can it become a truly successful business?



Dora met with the management of Luckin Coffee while she spent time in Shenzhen.

Final thoughts.

Back home, my suitcase unpacked and my Mandarin a little less rusty, I have had longer to reflect on my China experience. I return to my colleagues with a better feel for the scale and scope of the opportunities that are emerging as new business models evolve. I believe it is hard to grasp the level of disruption that the Chinese internet giants have unleashed on society without witnessing it first-hand. That's why taking perspectives from both ends, the big companies and the individuals whose day-to-day lives have been radically altered by them, was so important to me. Having done so, I was struck most by the goodwill and positive attitudes that are to the fore.



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