Big screen star

China is expected to have more cinemas than the US by 2017.
In early 1942 the producer Hal B. Wallis bought the film rights to a play set in Morocco. He initially assigned the brothers Julius and Philip Epstein to turn it into a screenplay. When they quit to work on another movie, Howard Koch picked up the baton and did a rewrite. Casey Robinson also added his ideas to the mix, before the Epsteins returned to finish the project.

This messy process – which lasted almost five months – resulted in one of the finest films ever made: Casablanca. Moreover the script those four men penned produced some of the most quotable lines in film history.

While most movie lovers remember Humphrey Bogart and Claude Raines delivering the choicest bits of their dialogue, few will know that Koch, Robinson and the Epsteins were the vital cogs churning out the likes of “Maybe not today, maybe not tomorrow, but soon”. Yes, the role of the scriptwriter has long been a somewhat thankless and anonymous one.

That is especially true in China, where WiC has reported in the past on screenwriter complaints about their low pay and lack of recognition. But if professional scriptwriters in China thought their lot couldn’t get any worse, they had a rude awakening at the weekend when Alibaba Pictures said it would dispense with their services altogether.

The Jack Ma-owned company proposed a radical new strategy during a panel at an industry forum. One of its top executives Xu Yuanxiang said the studio had devised “a completely subversive method and we will not hire professional writers from now on”. Instead Alibaba Pictures said it will select a dozen young writers from online forums, and in a gladiatorial process have them compete and eliminate each other as they work collectively on a script. The last person writing will then receive a prize.

Predictably the reaction from seasoned scriptwriters was not positive. China Daily described
RMB. THE STRENGTH OF A RELATIONSHIP IS ALL IN THE DETAIL.

Knowing how people in different countries work, makes a world of difference. Our relationship managers in more than 52 cities across China could help you navigate doing business in this growing market. Find out how we could help you discover new local and global opportunities with RMB.

Find out more at www.rmb.hsbc.com

CHANGE MORE THAN YOUR CURRENCY.
them as “deeply offended” and “riled”, while screenwriter Yu Fei lambasted the Alibaba plan as “using capital to enslave online writers”. Xiduorui Media, a firm that represents 70 scriptwriters, said it will not work with Alibaba until it abandons the plan to ditch old-school screenwriters.

Once again China’s most high-profile company is seeking to shake up yet another industry. But could it be onto something? Alibaba estimates that 85% of Chinese cinemagoers are aged between 19 and 29, and that older scriptwriters are out of touch with the sorts of plots that appeal to this demographic.

Alibaba, like its major rival Wanda, knows the stakes are high when it comes to putting those bums-on-seats. That’s because 2015 has seen another year of explosive growth in the domestic box office. In fact, the cinema industry looks to be one of the contrarian bright spots in China’s slowing economy.

Big screen promise?
HSBC recently published a report on the cinema industry in China, specifically focusing on the theatres showing the movies rather than the studios making them. The data is striking. “China has become a land of moviegoers,” the report begins, “with box office takings growing 36% last year, five times faster than GDP, to nearly $5 billion. This trend is set to continue with the number of cinemas expected to overtake the US total by 2017, driven by screen expansion in smaller cities.”

Local media concur that the growth of Chinese cinema has been nothing short of phenomenal. Huaxi Metropolis Daily points out that in 2002 the local box office generated just Rmb950 million. By 2013 that figure had surged to Rmb21.5 billion, an increase of 22 times. As of last week this year’s box office stood at Rmb38.6 billion ($6.1 billion), with Huaxi Metropolis Daily describing it as a “virtual certainty” that 2015 will break through Rmb40 billion and achieve 40% growth.

“It is estimated that by 2018 China will overtake the US as the largest box office market,” the Sichuan-based newspaper adds.

HSBC points out that the growth numbers signal that – in spite of worries about slowing GDP data – Chinese consumers are flocking to multiplexes: “A single number tells the story – 55 million people went to the movies during the Golden Week holiday in October this year. Box office receipts for the week totalled Rmb1.9 billion, up 70% on the corresponding period a year earlier.”

HSBC estimates that the total box office will grow a further 38% next year and in 2017. What is driving that? New cinemas is the answer – particularly those opening in the third and fourth tier cities. In 2003 China had just 2,285 cinema screens; by 2014 that had risen to 24,317; by 2017 the bank estimates the figure will touch 45,000.

Such stellar growth is thanks to the rapid urbanisation of smaller cities (China has 337 cities). First-tier cities like Beijing and Shanghai are already somewhat saturated with cinemas – the population per screen is 49,000. In fourth-tier cities the equivalent ratio is 80,000, suggesting the potential for the number of screens to almost double.

And as inland urban incomes begin to catch up with coastal areas there is major potential for increased cinema-going. Currently Beijing has the most frequent moviegoers (of all provinces and municipalities): its citizens watching 3.7 movies on average annually. Compare that to bottom-ranked Guizhou where the locals average just 0.2 flicks per year.

The major beneficiaries?
The single biggest theatre operator in China is Wanda Cinema, a unit of property conglomerate Wanda Group (also the owner of the American cinema chain AMC). By June it had 191 venues with 1,694 screens, mostly in city centres and concentrated in its parent firm’s shopping malls. It has been growing rapidly too: it only had 83 cinemas in 2011.

Thanks to its operating efficiency and brand Wanda Cinema earns the highest revenue per screen (Rmb2.5 million) of the country’s top 10 operators (by comparison the 10th ranked China Film Digital makes...
just Rmb700,000 per screen).

After its Shenzhen listing in January this year Wanda Cinema’s market capitalisation has since climbed nearly five times to Rmb110 billion. It is now seeking to grow both organically and via acquisitions, purchasing, for example, Shimao Theatre and its 122 screens. The company has also benefited disproportionately from another trend: a tendency among younger Chinese to favour higher margin formats like IMAX.

Indeed, IMAX looks to be among the big winners from a burgeoning box office. In 2010 there were just 10 IMAX screens in China. Last year there were 234. HSBC says that in the first three quarters of this year another 42 were installed and in this quarter it expects at least 30 more. IMAX’s management hopes that it will have 1,000 screens in the country by 2020 and will benefit from the termination in 2017 of China’s imported film quota (which currently limits Hollywood to screening 34 individual films per year).

HSBC adds that IMAX screens enjoy revenues five times higher than standard screens and IMAX estimates that this year it will generate 20% higher revenues from its screens in China versus the US. “The utilisation rate of IMAX screens in China is 30% higher than that of the US, which is forceful evidence that IMAX is more popular with Chinese than US consumers,” write the HSBC report’s authors John Liu and Chi Tsang.

Thanks to its technical superiority and ability to source films IMAX enjoys premium pricing versus Chinese competitors X-Land and China Giant Screens.

HSBC estimates that the IMAX version of local blockbuster Monster Hunt (see WiC291) contributed as much as 20% of the year’s box office so far – a result of the format’s ability to charge higher ticket prices.

Some less impressive statistics...

When it comes to building occupancy China has shown form in a variety of industries. And the construction of cinemas may not be immune either.

Of the current stock of 5,000 cinemas about 60% are making a loss, reckons HSBC – an assessment that implies there are quite a lot of struggling cinemas. These have either been built too close to rivals or serve populations less able to afford frequent theatre visits. Growing disposable incomes might improve the latter situation, although the forecast increase in the number of screens may worsen the oversupply problem in the next couple of years. So paradoxically while the overall box office take looks set to continue to rise, many cinemas will remain barely viable.

HSBC predicts industry consolidation with bigger players such as Wanda, Shanghai United and Xing-mei buying smaller chains.

21CN Business Herald believes Wanda is the most likely of the chains to buy and to thrive. It’s best placed to raise additional revenues too from advertising, merchandise sales and on-site dining. 21CN says its acquisition of Movie Media will enable it to sweat its existing assets more effectively too. A big data company, Movie Media has been able to capture audience preferences in different parts of the country. This information on regional characteristics means Wanda will be able to optimise the scheduling and screenings at individual cinemas, predicting which films will be hits with local audiences.

Other disruptive influences?

Regular readers of this publication will be fairly familiar with LeTV, which sells a set-top box able to stream TV content. WiC has been
unable to decide whether this company is a ‘gamechanger’ or just very good at making lots of noise (for example, in its spats with Xiaomi and Qihoo, and in its announcement of a push into electric cars).

This month LeTV was grabbing headlines again, as well as upsetting cinema bosses. A new blockbuster Vanished Murderer, produced by the filmmaking unit of LeTV, was planned to debut on November 26. But days before its premiere, news began to emerge that LeTV’s premium subscribers could pay to watch the thriller – before it had even shown on a single Chinese cinema screen.

This would have been the first instance of an online media firm disrupting the usual order of things in which a top film is released exclusively for the big screen, only to later be accessible through the small screen and the web.

In a last-minute twist – three hours before Vanished Murderer was due to air – LeTV sent an apology to its subscribers saying it had been cancelled. Local media reports that the embarrassing volte face was the result of a potential boycott from major cinema chains. LeTV was told that the theatres would either suspend showing Vanished Murderer, or reduce the number of screens it would appear on, thus denting its box office.

The chains took this drastic action to “safeguard the interest of cinemas”, Chinese media says, with iDoNews explaining that the chains were anxious not to let LeTV set a precedent with its new service. The fear: that LeTV’s proposed business model might start draining audiences from theatres into living rooms – posing a major threat to cinema box offices, especially in the case of films less reliant on special effects and the lure of the big screen.

This episode shows two things. First, when it comes to the marriage of internet distribution and media, China is pioneering new models more rapidly than the US or Europe. But it also demonstrates that the big theatre chains still retain the market clout to thwart the ambitions of upstarts like LeTV...
President Xi Jinping was in Paris for the 2015 Climate Change Conference on Monday. The conference, known as COP21, has ambitious plans of finalising a universal agreement to tackle climate change. Meanwhile in Beijing, air pollution reached its worst state since 2013 when the severity of the situation was first brought to international attention. Some of the PM2.5 readings this week breached 900, which is almost 20 times the WHO’s upper limit for healthy air.

On Monday the IMF approved the addition of China’s renminbi to the fund’s special drawing rights (SDR) basket. The yuan will join the currency reserve with a weighting of 11%, placing it third – behind the US dollar and the euro. The yuan’s entry indicates that the IMF now considers the currency to be ‘freely usable’, whereas before its inclusion was denied on the grounds that it was too tightly controlled. The inclusion won’t take effect until October 1, 2016 (for more see page 8).

A consortium of private equity groups led by China Media Capital (CMC) and Citic Capital paid $400 million for a 13% stake in City Football Group – the parent company of Manchester City FC, which Xi Jinping visited during his recent trip to the UK. Speaking of the deal, chairman of CMC Li Ruigang stated, “Football is now at a fascinating stage of development in China.” Regular WiC readers will know that CMC recently bought broadcasting rights to the Chinese Super League (see WiC302) for a record Rmb8.1 billion ($1.3 billion).

Anhui Conch, one of China’s largest cement producers, is proposing a takeover of another Hong Kong-listed company, West China Cement. The convoluted deal would see West China Cement issue Anhui Conch enough new shares to raise its stake to 51%, in exchange for four of Conch’s subsidiaries. Taking a majority share would trigger a “mandatory general offer” from Conch which is likely to be approved.

Ant Financial Services, a sister firm of Alibaba, received preliminary approval from the South Korean government for the launch of K Bank – an online financial service developed in partnership with local telco KT Corp. In October, Alibaba-backed Paytm – an Indian mobile payment app – also received permission from India’s central bank to launch an online bank. All the members of BAT (Baidu, Alibaba, Tencent) have expanded into online banking this year, but Alibaba is the first to extend the service abroad.

Burger King closed stores in Hong Kong this week. The bulk of its restaurants in the city (admittedly only five out of seven) were shuttered when the franchisee failed to pay rent. Falling numbers of mainland visitors are spending less in Hong Kong, leading a variety of shop owners to demand lower rents, says the South China Morning Post. Hong Kong’s retail sales dropped 3% in October and the territory’s GDP is expected to slow to 2.4% this year.
What are the chances of Holland’s consular-general in Istanbul becoming a Chinese internet sensation?

Until a few days ago virtually zero, WiC reckons. But then Robert Schuddeboom signed into his Twitter account and typed out a few words that have become one of the most widely-forwarded messages in China’s social media.

“Often angry Turkish demonstrators mistake us for our close neighbours [the Russian Consulate]. Like tonight, throwing eggs,” he tweeted.

The local activists were protesting against Russian airstrikes in Turkmen-controlled regions of northern Syria. However, confusing the flags of Russia and the Netherlands, they were egging Dutch windows rather than Russian ones.

The message soon went viral. On the Global Times’ weibo account alone, for example, it was shared nearly 5,000 times with more than 2,500 comments as of Thursday. A majority of the remarks were emoticons of laughing faces, although some netizens recalled another blunder in July when a group of Turkish nationalists – protesting against China’s Xinjiang policy – confronted a group of Korean tourists in Istanbul, thinking they were Chinese.

Beijing’s relations with Ankara have been awkward recently (China is irked by criticisms from Turks of its Xinjiang policy, see WiC290).

But the main draw for patriotic comment online currently is the standoff after the shooting down of a Russian warplane by the Turks near the Syrian border last month.

WiC has reported before that the strongman style of Russian leader Vladimir Putin plays well with his Chinese admirers (see WiC229). A Sina Weibo account called “Putin’s fan group” has nearly 300,000 followers. And mirroring what happened after Russian intervention in Ukraine last year, many netizens again seemed to support Putin in his retaliatory measures against Turkey.

“Can’t wait for the polar bear [a popular moniker for Russia in Chinese social media] to give Tuji [‘dirt chicken’, Turkey’s Chinese nickname] a lesson,” crowed one popular comment on weibo.

“Chinese netizens have helped Putin devise 37 different ways of dealing with Turkey,” Xiang Xiaotian, a financial columnist, wrote sarcastically on his own weibo this week. “And 19 of these could send the A-share key index above 5,000.” (The Shanghai Composite is currently trading at around 3,500.)

The remark underlines a related trend: local investors have been buying into military-related stocks in the belief that any conflict will boost arms sales.

The Chinese foreign ministry steered clear of the war of words between Putin and Turkey’s Recip Tayyip Erdogan. “China is paying close attention to the incident and many circumstances need further clarification,” a spokesman told reporters last week, before adding the usual tonic that it also supports the international community’s counter-terrorism efforts.

The state media still sounded more sympathetic to the Russian side, however. “The border between two nations is rarely a straight line. It is absolutely okay for a person to walk slowly along the border without trespassing, but for a fighter jet which travels several thousand metres up in the sky and at a speed of several thousand kilometres per hour, the violation of airspace may only have lasted for a split second,” the People’s Daily commented, implying it wasn’t such a big deal if the Russian plane had temporarily crossed into Turkish territory.

“This was not a mistake,” the Global Times added more aggressively of the Turkish action. “This is a NATO member shooting down a warplane of its major rival.”

It also reminded its readers that Putin’s strongman image is at stake if he opts not to retaliate forcefully. So far he hasn’t (militarily) although he has ordered economic sanctions against Turkey, and discouraged Russian tourists from visiting.
This week shareholders at the International Monetary Fund voted to include the yuan, also known as the renminbi, as the fifth currency in the IMF’s special drawing rights (SDR) currency basket alongside the US dollar, the Japanese yen, sterling and the euro.

The announcement is no great surprise. Christine Lagarde, the IMF’s managing director, flagged that it was recommending the move a few weeks ago. Now the executive board has approved it, with Reuters reporting that the vote in favour was unanimous.

Created in 1969 as an alternative store of value for central banks, SDRs can be exchanged for “freely usable” currencies. The goal is to improve financial liquidity: holders of the currency can exchange it between themselves, and the IMF sometimes designates countries in better financial shape to purchase it from those in worse condition.

Under the changes the yuan will take on an 11% weighting in the basket from October next year – leapfrogging sterling and the yen, which will be reduced to 8% each. The euro is the biggest loser in percentage terms, dropping six points to 31%, while the dollar’s share remains broadly unchanged at 42%.

Real-world usage of SDRs is minimal (one of the exceptions noted by The Economist this week: the billing of transit fees for ships passing through the Suez Canal). That means that companies won’t be rushing out to buy renminbi to hedge their exposure. The immediate impact on yuan-denominated investment is likely to be limited as well, with investors waiting to see whether China dismantles more of the controls relating to funds moving in and out of its economy.

But in the longer run the changes are going to increase the demand for renminbi at central banks.

This process is still in its early stages. An IMF survey of its 188 member countries last year found that just 38 held any of their foreign currency reserves in renminbi, according to the Financial Times. That was about 1.1% of the world’s assets.

Nonetheless, the IMF’s decision is an important symbolic step, confirming that the yuan is a liquid asset in which governments can safely park their wealth. Thus the state news agency Xinhua noted approvingly that the currency had “ascended to the heart of global finance”, highlighting the changes as more evidence of China’s newfound status on the global stage.

“Without the inclusion of the yuan, the representativeness of the SDR and the legitimacy of the IMF would have been questioned,” it warned. “By allowing an emerging-market currency into the SDR basket for the first time, the IMF showed its willingness and ability to adapt to global economic reality.”

Critics of the decision snipe that the IMF has succumbed to political pressure and question whether the renminbi can be classed as “freely usable” until it is left more to the determination of the market.

Plenty of institutional investors are still furious at Beijing’s massive intervention in the Chinese stock markets over the summer too (there were periods in which they were blocked from selling shares).

But the IMF’s definition of “freely usable” currencies relates more to how they are made available and traded internationally, rather than a purer focus on whether they are freely floating.

To meet these yardsticks Beijing has pushed through a series of reforms, including wider access for foreigners to the domestic currency markets, more frequent issuance of debt and an increase in trading hours.

In another key step this summer, policymakers tied the yuan’s opening exchange rate to its previous day’s close. Previously the starting quote of the new trading day had been set by the central bank (see WiC292).

The IMF has given China “a big hug for its painstaking and determined financial reform”, Xinhua argues. But the IMF also expects that the Chinese will do more to free up their currency. “It’s a milestone in a journey that will include certainly more reforms,” Lagarde told reporters after this week’s announcement.

Yi Gang, China’s deputy central bank governor, said “the decision has made us very happy” and on Tuesday ruled out another bout of yuan depreciation.
Food for thought

China turns to cloned cattle to keep up with food demand

In Noah’s Ark the animals were reputed to have gone in two-by-two. Now China’s first commercial cloning company, Boyalife, is planning to bring them out one-by-one, potentially saving endangered animals and even resuscitating long extinct ones. Unsurprisingly, global news organisations have not been very enthused by news that Boyalife is in the final stages of building a factory, which could mass-produce up to one million genetically identical cows per year.

Cloning has never ended well in the realms of popular culture. In both the films Never Let Me Go and The Island, clones rebel when they realise they have been created to provide body parts for their ‘owners’. Likewise, in the Jurassic Park series, genetically engineered dinosaurs run amok over the span of four films (very lucratively for their producer Steven Spielberg).

The first two films address fears of what might happen if the noble idea of fixing genetic mutations is pushed beyond the ethical boundaries of ridding the world of inherited diseases. The latter film distills concerns about the consequences of accelerating evolution and breeding. By comparison, scientists generally agree that it took millions of years for wolves to become domestic dogs and more recently about 600 years for cows to quadruple in size.

These deeply embedded anxieties are now being superimposed on two very specific China-related fears. Firstly, how much trust can be placed in a country where a large number of companies have generated public health scares by taking shortcuts where safety and ethics are concerned?

Secondly, the sheer scale of anything that takes place in China means there will be very large numbers of cloned animals. Any ‘unintended consequences’ of large-scale commercial cloning could also very quickly end up in the food chain. (Though China isn’t the only party to tinker with our food chain. American firms such as Monsanto have been mass-producing genetically modified food and seeds for years, see WiC208.)

Xu Xiaochun, the CEO of Boyalife, has spent the past week telling reporters such critiques are just rubbish. At one press conference he advised journalists that cloning is just like tipping half a glass of orange juice into a new empty glass and creating two glasses of orange juice.

But Boyalife’s plans are rather more ambitious. It has invested Rmb200 million ($31 million) in a joint venture with South Korea’s Sooam Group, as well as Peking University’s Institute of Molecular Medicine and the Tianjin International Joint Academy of Biomedicine. Phase one involves the production of roughly 100,000 cloned cows in 2016, before ramping up to one million cattle in the coming years.

The Tianjin-based factory also plans to produce cloned and genetically modified primates, pet dogs and sniffer dogs (which will be better at rescuing people trapped under rubble and uncovering drugs).

The venture has already cloned a Tibetan Mastiff, one of the most expensive dogs in the world (last year a pure pedigree sold for a record $2.4 million).

The Sino-Korean factory will be able to commercialise cloning and genetic modification because of advances in a genetic editing technique developed by US scientists in 2013. It is called Crispr (clustered regulatory interspaced short palindromic repeats) and is based on way bacteria protects itself from viruses. An enzyme called Cas9 uses a guide RNA molecule to hone in on the part of DNA that needs to be altered or replaced.

Chinese firms have been at the forefront of using Crispr. Recent instances include genetically modified Shanbei cashmere goats, which have longer hair and larger muscles, plus beagles with double the normal muscle mass, after scientists deleted the relevant gene.

Pigs also feature prominently. Shenzhen-based BGI, the world’s...
largest genomics organisation, recently began selling miniature cloned pet pigs (one sixth their normal size), at a cost of $1,600 each. A BBC report on the company’s surgical procedures echoed many of the wider concerns which in September led the EU to ban livestock cloning on animal welfare grounds.

The Korean JV partner of Boyalife, Sooam meanwhile specialises in dogs after successfully cloning the world’s first canine, called Snuppy, in 2005. It has since produced 600 cloned puppies for grieving dog lovers although as US news organisation NPR reports, the success rate may be as low as 30%.

Hyun Insoo from Case Western Reserve University says even successful clones can end up dying young because the process does not involve completely resetting the DNA to its embryonic state.

Hyun also flags concerns about Sooam’s head, Hwang Woo-suk, who was charged with faking research that credited him as the first person to clone human embryos and produce live stem cells back in 2005. “I just don’t think someone like him can be trusted to follow the rules appropriately,” Hyun concludes.

Wei Yusheng from Peking University School of Life Science argues that China’s scientific community does not have a different ethical system from others. He tells the Financial Times the nation is just new to a field where different countries apply a myriad of conflicting rules. Though the EU has banned the commercial cloning of farm animals, the US has allowed their sale since 2008.

In fact, some of the most advanced cloning activity has been happening in Argentina. Crestview was founded there in 2009 and it has focused on cloning polo ponies. Indeed, one of the partners in the firm is top rider Adolfo Cambisso who will ride at least four cloned ponies at the Palermo Open in Buenos Aires (which is set to conclude on December 12). The crowd will know which of Cambisso’s rides are cloned because they will have serial numbers referencing his original pony (e.g. Cuartetera B01).

A rival cloner in Argentina told the UK newspaper The Independent that the ponies are “85% as good as the originals”.

The ‘elephant’ in the room, of course, is not ponies but people. A conference on human genome editing next week will bring together scientists from the US National Academy of Sciences, the UK’s Royal Society and China’s Academy of Sciences. Nature Magazine says this may be the first step towards creating international guidelines.

Bai Chunli, president of the Chinese Academy tells the FT he would welcome them. “We would like to work together with the international community for the proper regulation of such techniques,” he stresses.

Meanwhile Chinese social media comment regarding Boyalife’s cloning factory in Tianjin have been largely negative. “Please serve cloned beef to our leaders first,” wrote one netizen, according to the New York Times.

The paper’s own subscribers do not hold back either. “With 117 boys for every 100 girls in China, one would guess that it’s only a matter of time before its 117:117,” one American reader speculates.
His was a deceptively simple question. “What exactly is the purpose of a Chinese SOE?”

I had just finished speaking to the Asian management committee of one of the more successful Fortune 500 companies operating in China. It has done profitable business with large SOEs (state owned enterprises) in China for years. That business has begun to evaporate. Having just heard me summarise the deteriorating situation at many SOEs, and the decision last month by the Chinese government to quietly shelve plans for a root-and-branch restructuring, one senior executive wanted to know what the SOEs are now in business to do. Make money? Provide and protect jobs? Project national power?

I reminded him Chairman Mao was a keen student and devoted follower of Lenin. He fully embraced the Leninist concept of the state and Party controlling the “commanding heights” of the economy. China’s SOEs are still very much in that business: owning most – and sometimes all – of China’s large-scale assets in petroleum, gas, electricity generation and distribution, coal, banking and finance, transport, steel, aluminium and a wide range of industrial chemicals.

But the executive reminded me that Mao has been gone a long time and that Deng Xiaoping began dismantling state power 35 years ago to create the conditions in which today’s vibrant private sector could emerge. These private firms are China’s best companies and the source of all net new job creation in China. They contribute far more to GDP than the SOE segment. What, the executive, insisted, were SOEs in business to do?

It was obvious he wasn’t going to accept an answer based on Leninist theory. “Why don’t they just privatisethe state-owned sector?” he pushed back. That, I told him, was out of the question, at least for now.

Looking for time to collect my thoughts, I steered him towards the coffee machine. Above all, I told him again, an SOE is an instrument to achieve the policy goals of the Chinese government and the Party. This is as true today as it was at their origin. Sometimes those policies, at least originally, were high-minded, even socialistic, like providing energy at an affordable price to everyone. But while energy is plentiful in China today, it’s not cheap. Subsidies have been eliminated and prices hiked to levels generally well above those in the US. The money paid to the petroleum and power monopolies is a transfer of private wealth to the state, or in other words a mechanism for hidden tax collection.

Most SOEs – especially those in heavy industry, shipping, steel, coal – are not quite so lucky. Rather than earning monopoly profits, they are chronic lossmakers. They rely on subsidies from other SOEs, mainly China’s state-owned banks. The banks too were originally conceived as a way to provide a safe home for the masses’ savings. But over time, the SOE lenders have evolved into a machine that shovels up those private savings and hands them over, in the form of subsidised loans, to other SOEs. And the beneficiaries of this mispriced bank credit have done what other institutions often do when they are offered deals like this – they use the subsidised lending to invest in projects with limited scope for profit, leaving them progressively less capable of repaying the loans.

Chengdu Airlines celebrates receiving its long-overdue ARJ21 aircraft

Photo Source: Imagine China
Since the bankruptcy of an SOE is not an outcome that’s possible in the current system, the less solvent SOEs become, the more the SOE banks need to lend to them. SOE banks exist, in part, to throw good money after bad.

In a few distinct cases, the socialist vision for SOEs is still untainted. I’m thinking here of China Mobile and its two sibling SOE mobile networks, China Unicom and China Telecom. They all offer good service, with a reliable signal anywhere you go in China, from trains and highway tunnels to office elevators, on the climb up Mount Everest and even on the half-submerged Spratley Islands now patrolled by the Chinese navy. Prices for voice and data packages are still lower than the US or just about anywhere else too.

Providing jobs, both lowly and prestigious, is another important SOE function. SOE bosses are usually chosen from senior bureaucrats, often as a reward for loyal service, and top executives get a big bump in pay when they become chairman or senior manager. The fact that most of them have no experience in that industry, or in running a large, complex enterprise, is not cause to be disqualified for consideration. Rather, it’s often seen as a plus.

The revolving door can move in the opposite direction: after a fixed period at the top of generally four to six years, many of the same bosses go back into government, sometimes as the heads of the regulatory bodies that oversee their former employer and its competitors.

For ordinary Chinese who land jobs at an SOE – something that’s becoming more difficult as state firms cut back on hiring – the jobs tend to be less well-paid than in the private sector, but they offer a cosier guarantee of lifetime employment, lighter workloads, and ancillary benefits that might include subsidies for housing, healthcare and schooling for children.

A workers’ paradise? Hardly, but still a kind of frozen-in-amber reminder of how most Chinese spent their working lives until about 20 years ago when the private sector began its remarkable ascent.

It would be tempting to say that everything about China’s SOE sector is a living fossil. But at least one SOE monopoly has done a great job of changing with the times. Broadcast media, especially China’s 60-plus television stations, was originally started to give the Party and government a way to circulate news and propaganda. But SOE broadcasters these days carry only a few hours of mandated programming each day. Instead, they fill up all their airtime with popular variety shows and racy tele-serials larded with advertising. The SOE broadcasters rake in money. TV ads are among the most expensive anywhere in the world.

Another example of a highly lucrative industry monopolised by SOEs is alcoholic drinks. The major beer and spirits brands are all state-owned. China is the world’s largest market in volume terms. Tobacco is another SOE monopoly. Over 40% of the world’s cigarettes are made and smoked in China, and virtually every one is produced by a single SOE, China Tobacco. There is no more valuable licence to print money in the world than to be China’s monopoly cigarette company. Why the state wants to manufacture and sell, rather than just tax, sin products is a conundrum. But the goal certainly does not appear to be to discourage their use.

SOEs also occasionally operate as tools through which the state seeks to achieve goals related to China’s prestige and national security. A notable example was this month’s debut of China’s first home-produced mid-sized jet aircraft, the Comac C919. The jet is designed to compete with the Boeing 737 and Airbus A320. If things go to plan, the first C919 will take to the air with paying passengers in 2019. But the same SOE has been working on a smaller jet, the ARJ21, for years. Its launch has been plagued by long delays and it is still uncertified to fly anywhere outside China (Chengdu Airlines says it will begin flying the ARJ21 domestically in the next few months).

At least these two new aircraft made it off the drawing board. The same can’t be said of one of the highest-profile SOE engineering projects of all, a decades-long multi-billion-dollar effort to produce a Chinese-made jet engine for civilian and military aircraft. Years overdue, and still untested, the engine programme has turned into a significant embarrassment and a colossal money sink. Had it been allowed to try, China’s private sector would likely already have an engine in service, at one-tenth of the cost in time and money.

All the more reason, the European executive concluded, to privatise China’s SOEs. After all, privatisation worked wonders in turning around similarly-feeble state-owned companies in eastern and western Europe, as well as Japan and Korea.

Impeccable logic. But privatisation happens when a government, usually driven by fiscal or ideological reasons, decides it wants to cash out. China’s government simply doesn’t feel the need. It will continue to tinker around, selling minority stakes through IPOs at home and in Hong Kong while talking up the value of private sector investment. But the SOEs will stay on the government balance sheet because they are assets whose value is calculated in terms of enhancing state power and economic control, not generating shareholder returns.
On the afternoon of October 24, 1929 – now known as “Black Thursday” – five of the most influential bankers in the United States gathered at 23 Wall Street, the headquarters of JP Morgan. Hoping to prop up the market, the financiers pooled their resources and bought stocks in index heavyweights such as US Steel. The bailout worked but only briefly. The rout resumed and the Dow Jones Industrial Average plunged another 35% over the next three weeks.

China’s financiers likewise turned to similar tactics to fight their own market meltdown this year. Following a 30% plunge in stocks over just three weeks in July, the country’s top brokerages joined hands to invest Rmb120 billion ($19 billion) in large-cap stocks (see WIC288).

The intervention by the (soon-nicknamed) ‘national team’ was launched by the state-controlled brokerages and led by Citic Securities, the investment banking arm of China’s most pedigreed financial conglomerate.

Since then Citic Securities has come under heavy scrutiny from financial sector regulators, despite heading the rescue effort. At least eight senior officials from the brokerage have been detained or put under investigation for insider trading. And the probes culminated in the announcement last month that its long-serving chairman Wang Dongming will retire next year in a move that surprised many in the industry.

Why? Well, although Wang cannot claim to come from a banking dynasty quite as illustrious as John Pierpont Morgan’s, he does hail from one of the families that helped build the Communist Party of China (CPC). According to Dangshi.people.cn, a website that deals with the CPC’s official history, Wang’s father Wang Bingnan joined the Party as early as 1926 as a staffer and special agent under Zhou Enlai (later the first premier of the People’s Republic of China). Wang senior also played a key part in plotting the Xi’an Incident in 1936, when the KMT generalissimo (and then Chinese leader) Chiang Kai-shek was kidnapped by two of his generals. (It was a crucial moment leading Chiang to cooperate with the Communists in fighting the Japanese.)

Wang ensured his family grew up with an international outlook. He himself had studied languages in Japan and Germany and was a career diplomat after 1949. His first wife, Anna Wong, a German, was the first foreign female officer in the Red Army. She also worked for Zhou, who got her writing articles for foreign publications and working as a go-between with Westerners (Ernest Hemingway included).

After they parted, Dongming was born to Wang senior’s second wife in 1956. Among the first students to return to college after the Cultural Revolution, he opted to study French at the Beijing Foreign Studies University, obtaining a bachelor’s degree in 1977. Soon afterwards he and his younger brother Wang Boming were on their way to the US, capitalising on a new programme in which China sent promising graduates to study overseas.

Wang obtained a master’s degree in international finance in 1984 from Georgetown University. His brother picked up the same degree from Columbia University three years later. The pair would become some of the earliest “sea turtles” or haigui (overseas-educated Chinese that return home to work) bringing with them their knowledge of international markets.

Wang Boming joined a core group headed by Wang Qishan (now China’s anti-corruption tsar) that founded the Shanghai and Shenzhen stock exchanges in the early 1990s (see WIC223). He would later create Caijing magazine, one of the country’s most influential financial publications.

Wang Dongming worked briefly as a translator for the China National Tourism Administration in Europe, before joining Scotiabank of Canada in 1987, where he worked as an investment banker for five years...
years. He returned home in 1992 and following brief stints at domestic brokerages, he joined Citic Securities as a deputy general manager when it was established in 1995. He was made a director in 1999 and by 2002 he had taken over as chairman.

At the time Citic was nowhere near the summit of China’s financial sector league tables. CICC was the undisputed champion: under Levin Zhu, the son of former premier Zhu Rongji, it won almost every IPO mandate for the key state-owned enterprises (see WiC257) approved to list in overseas markets such as Hong Kong.

But Wang Dongming sought to challenge CICC’s lead, ignoring a market downturn to push for a Shanghai listing of Citic Securities in 2003, and making it the first Chinese brokerage to go public. Thus better capitalised, he set out to expand its operations and take over its domestic rivals. “Wang Dongming has been the soul of Citic Securities,” reckoned the Economic Observer. “He helped transform a second-tier house into the leading Chinese brokerage.” Caixin Weekly is in agreement: “Wang is widely credited for a series of acquisitions and investments Citic Securities has conducted at home and abroad since 2005 that were part of his pledge to build the firm into a Chinese version of Goldman Sachs.”

Indeed, Wang commissioned a Chinese edition of Charles Ellis’ bestseller The Partnership: The Making of Goldman Sachs, making it required reading for new hires. “For Chinese investment bankers, what Goldman Sachs has experienced in the past is very likely what we will go through in the future,” he wrote in the foreword to the Chinese language version.

Going global was a core strategy. In 2007 Citic had negotiated a $1 billion deal to invest in Bear Stearns, making a narrow escape by pulling out just before the American bank’s collapse in 2008. But the experience didn’t derail Wang’s international ambitions. Citic Securities pushed for a secondary listing in Hong Kong in 2011 – again during a bearish market. A year later it sealed a landmark deal to buy Hong Kong-based brokerage CLSA from France’s Credit Agricole for $1.25 billion.

Its market capitalisation stands at about $33 billion as of this week. CICC, which went public in Hong Kong last month, trades at just $3.2 billion.

At 64, Wang is in the same age bracket as China’s current leadership. President Xi Jinping is three years younger and “has been his friend since childhood”, the Wall Street Journal reports. “He is also tight with the Party’s anti-corruption hawk Wang Qishan,” the Journal adds.

But the news of the investigations into the Citic executives seems to point to Wang’s waning influence. In fact there were suggestions that he was losing favour before this summer’s stock market meltdown. In an example from May last year he was fined two months salary – about Rmb1 million ($156,285) – for quipping in public that ICBC, the country’s largest bank, “made too much easy money considering the services it offered”. According to Caixin Weekly, Party officials assigned to ‘oversee’ the brokerage’s ideological purity penalised him for “hurting the interests and feelings of an important client [in ICBC].”

Now comes the revelation that Wang won’t be renewing his chairmanship next year “in consideration of his age”. On the contrary, a report in the Financial Times claims it was Chang Zhenming, the chairman of Citic Group, who forced Wang into retirement for failing to supervise his senior executives. Since August three of Citic’s senior officials, who all sit on the executive committee, have been detained by the central authorities (as have another four department heads). According to Xinhua, they are accused of using “advance knowledge of the central government’s market rescue plan to their own advantage”.

Wang hasn’t been named as a target in the investigation himself. But his retirement seems linked to the scandal, as well as media reports that the brokerage be more tightly controlled by its parent, Citic Group.

He was replaced as Citic Securities’ Party boss by Chang Zhenming. “Given his age [Wang] was allowed to have face,” an unidentified executive told the FT, before warning that more departures are likely. “The earthquakes in the financial sector are just beginning,” he predicted.

The crackdown has already led to the removal of a number of officials at the CSRC, the regulatory agency (see WiC297), and the authorities are extending their investigations to more of the state-run brokerages. Rumours about who may be detained next are commonplace, with the share price of Guotai Junan International, the Hong Kong listed unit of one of China’s biggest securities firms, under selling pressure since it reported that it hasn’t been able to contact its chairman and chief executive Yim Fung since November 18.

Executives at China Haitong, the fourth-largest brokerage, are also said to be under investigation.

Financial sector bosses are waiting nervously to see what happens next, although sections of the international media have been more forthright in their interpretation of events. One view: that the competence of the Xi administration was thrown into question in the summer, and that the subsequent crackdown is more about shifting some of the blame for the mishandling of the market meltdown.
China’s space programme has made remarkable advances in a short period of time – in fact, the China National Space Agency wants to have a permanently manned space station by 2020 and likewise send an astronaut to the moon.

But in Hollywood’s vision China’s ambitions in space are even more advanced. In Ridley Scott’s latest movie, The Martian – spoiler alert here for those yet to see it – the science fiction film becomes the latest to involve a crucial intervention by the Chinese that saves the day.

Cinemagoers will recall how in the climax of the 2013 movie Gravity, Sandra Bullock finds refuge in the Chinese space station Tiangong and then makes her way back to Earth aboard the spaceship Shenzhou. In The Martian, when an explosion destroys the food Mark Watney (Matt Damon) has planted, China steps in to help by allowing a booster rocket called Taiyangshen (god of the sun, or the Chinese translation of Apollo) to help him escape.

The country’s starring role as saviour of the NASA astronaut will certainly have helped receipts. The Martian took more than $52 million at the box office in its first six days in China, helping the movie surpass $500 million in worldwide ticket sales. Hollywood executives will be keen to see how it performs in the coming days, ahead of another ‘blackout’ period starting on December 7 during which only local movies will be shown.

The Martian was also heavily promoted in the Chinese market. Ridley Scott, Matt Damon, Sebastian Stan, mainland actress Chen Shu and Hong Kong actor Eddy Ko all attended the premiere of the film in Beijing.

Nor does the fact that it opened in China two months after its American debut seem to have dampened filmgoers’ ardour for the film. Chen and Ko star as leaders of the China National Space Administration. This even led China Daily to say the film was “a cut above Ridley Scott’s previous efforts Alien and Prometheus” explaining that “an additional treat for fans here is the key
role China plays in helping to rescue a stranded astronaut”.

Not everyone was so positive. “This is a forced loved relationship with Chinese aerospace. Ridiculous,” wrote one blogger. But the reaction has generally been upbeat and the review site Douban.com gave the film 8.5 out of 10.

One aerospace expert, Hu Xiao, wrote on Zhihu.com that he thought The Martian was simpler than Interstellar and more impressive than Gravity.

“The humour of the lead actor is very moving. There is no emotional exaggeration. The rescue on Mars is very impressive. The Martian doesn’t have massive space scenes or high-end technology, but it is real hard science fiction,” commented Hu.

Asked if he thought that the film reflected China’s rising international status, the 78 year-old Scott told the China Daily that expensive space exploration needed international collaboration.

That said, when Chinese fans were keen to get more scientific details during the promotional tour in Beijing, Scott answered their questions in a pretty generalistic way. “I’m not very smart... and might be a disaster in science. But I do everything in the way that I’ve learned to do,” he told a news conference.

At one point, director and cast went to Tsinghua University to meet students from eight universities in Beijing. During their visit they also met leading Chinese scientists including Jia Yang, deputy chief designer of the Chang’e-3 lunar probe, and who also led a team to develop China’s first moon rover, the Yutu, or Jade Rabbit.

Scott explained to Jia how the filmmakers shot scenes in the Wadi Rum (a valley in Jordan also known as ‘the Valley of the Moon’) and painted everything Martian red in post-production.

Meanwhile Damon got to meet the Chinese botanist Gu Yourong and discuss how he learned to grow potatoes for the movie.

“How is it that China can put up a new bridge in 43 hours but take 15 hours to get a gravely ill man from Beijing Capital Airport to a downtown hospital?”

That’s the question netizens found themselves debating last week as they marvelled at the speedy replacement of Beijing’s Sanyuan Bridge, but queried the chaotic response to a medical emergency on a flight from Shenyang.

The two events, separated by a few days late last month, showed how Chinese organisations excel at planning mega-projects but often struggle to respond to unique, emergency situations where there is no clear chain of command.

The medical emergency took place when Zhang Yang, a television reporter from Liaoning, boarded an early morning plane from Shenyang, boarded an early morning plane from Shenyang to Beijing.

Shortly after take off at around 8am he started to experience severe intestinal pain and alerted a crew member to his discomfort.

The traditional Chinese knot is a symbol of happiness and good fortune. The knot is made up of a single piece of silk and can be tied in a range of shapes. The most common knot is the ‘eight treasures’ knot, which is believed to bring good luck. The knot is often used as a gift during special occasions such as weddings and is sometimes used as a decorative element in architecture and interiors.
He was told the pain was probably due to air pressure changes and the flight carried on to the Chinese capital.

Ten minutes before landing, however, Zhang texted a friend to say he was in agony and needed to go to hospital. He also persuaded the crew to arrange for an ambulance to meet the plane on arrival.

The plane landed at 9.40am and that should have been the end of the story. However it took a further 50 minutes to open the aircraft doors and, adding to Zhang’s problems, no air bridge was available – meaning the paramedics were unable to bring a stretcher onto the plane.

A row between the cabin crew and medical staff ensued – each side claiming the other should carry Zhang off the plane because neither side wanted to be responsible for dropping him on the steps.

Writing on weibo after the event, Zhang says he summoned his last bit of strength to crawl off the plane and climb into the ambulance himself.

Yet his ordeal – now about four hours long – was far from over. He was driven to the airport hospital where the doctor correctly diagnosed him with a perforated bowel. The doctor advised he be transferred to one of two major Beijing hospitals for an emergency operation and called another ambulance.

Around 1pm Zhang set off to what he thought was one of those two hospitals. However, when he asked the drivers where they were going, to his surprise they said they were taking him to an out-of-town emergency rescue centre, which is operated by the Beijing Red Cross Society, as there was bad traffic in Beijing and they didn’t think he would be admitted to one of the big hospitals.

Too weak to argue, he agreed. Yet the doctor at the emergency centre spent three hours doing various checks, then disagreed with the first doctor’s diagnosis (wrongly) and accused Zhang of faking his symptoms to get access to strong painkillers.

“I cried, I really shed tears. I did not know what to say. I do not blame the doctor, I knew I was sick but he did not want to save me. This disease was beyond his knowledge,” Zhang wrote on his blog.

“I was in so much pain I hit the floor with my fist. I wanted to call my wife but I couldn’t,” he added.

Finally, one of Zhang’s colleagues tracked him down and with the help of two friends (both medics), Zhang was admitted to Peking University Hospital for a four-hour life-saving operation.

For Zhang Yang the whole ordeal lasted almost 21 hours – roughly half the time it took four mega-crane to dismantle Sanyuan Bridge and roll a brand new, prebuilt, 1,300-tonne flyover into its place.

The time-lapse video of the lightning-speed reconstruction garnered praise from inside China and out. One netizen gushed at his “pride in his motherland” (indeed, this was a fairly typical response to what was a genuinely impressive engineering feat and a reflection of China’s prowess in infrastructure). The international comments compared how long such an exercise would take in their country (someone in the UK said it would have required a five-year planning period and 3,000% cost overrun).

Meanwhile Zhang’s medical emergency left people shocked, with one Chinese netizen writing that it showed how the “life of ordinary people is thinner than paper”.

Another said Zhang’s tale had made him “feel powerless”, adding “how can those people take human life so lightly?”

In the last few days China Southern has apologised for its handling of the emergency and said the delay in opening the plane door was due to a failure with the aircraft brakes which meant it had to be towed to its dock. The airport and the emergency centre have also apologised and the latter has agreed to compensate Zhang for his poor treatment. “Throughout the event those who are supposed to be legally or morally responsible for the case, passed the buck at the critical moment. This highlights the need to strengthen the sense of responsibility and empower officials to cope with emergency incidents,” the Economic Information Daily said.

It seems safe to conclude the medical and airport authorities in Beijing would not have done a very good job of rescuing Matt Damon from Mars (see previous article)...
In a message popularly reposted online, a prominent terrorist explains why China is the only country in the world that he will never target. He says his organisation sent three bombers there in the past, but none succeeded. One had his remote control device stolen in Wuhan’s overcrowded train station. Another got lost near Beijing’s Xizhimen Bridge (a complicated web of highway interchanges). And the third aborted his mission following a two-hour traffic jam in Shanghai.

Of course, this was a macabre joke (and yet another example of the thick vein of black humour that does the rounds on Chinese social media).

But part of the punchline has just proven to be uncomfortably close to reality for Chinese security forces. According to a report in the Jiefang Daily last month, a squadron from the People’s Liberation Army was sent on an anti-terrorist drill in Shanghai. However, the troops arrived 40 minutes late at the scene because they were caught in the city’s notorious congestion.

“An elite anti-terrorist unit loses a battle because of traffic jam,” the PLA-run newspaper commented.

The setback soon became a popular topic for discussion online. How fast a PLA unit could rush through Shanghai’s financial hub on foot, or the kind of helicopters that might be sent in to deal with terrorists, were debated with gusto.

In fact, fans of the Chinese military are one of the most active groups in the country’s online chatrooms. One of the most popular military discussion forums is Tiexue.net (the term tiexue means “iron blood” in Chinese – it was inspired by Otto von Bismarck’s “blood and iron” speech). Tiexue’s fans can also play online military games and has attracted over 10 million registered users. In fact, its holding company, Beijing Tiexue Technology, just went public on Beijing’s National Equities Exchange and Quotations board (an over-the-counter market, see WIC289).

Most internet portals and online newspapers have forums dedicated to defence issues, and not all of the users are amateurs. Many PLA officers and soldiers – serving and retired – take part and this is sparking fears that foreign spies might take advantage of the information being discussed.

In one of the more prominent recent examples ThePaper.cn reported last week that an internet user in one military discussion group “deliberately talked down the performance of certain PLA equipment.”

The dismissive remarks provoked the patriotic instincts of an army insider, who tried to correct the “mistakes” with his professional knowledge of the true capabilities of the weapons being discussed.

“A spy is clearly ‘fishing’ for classified information here,” ThePaper.cn cited a senior PLA officer as concluding. “Fortunately the leakage was stopped immediately to prevent sensitive data from being exposed on the internet,” added the same officer.
Photo of the Week

Trying to mask their displeasure: tourists take a selfie in front of the 'Bird’s Nest' on an extremely polluted day in Beijing this week

In Numbers

100
The number of days Chinese artist ‘Brother Nut’ spent collecting smog in Beijing, using an industrial vacuum cleaner. The gathered dust was then turned into a builder’s brick.

$1.2 billion
The loan pledged by China to Zimbabwe in order to expand its coal-fired Hwange power plant. This week, Xi Jinping became the first Chinese president to visit the African nation since 1996, arriving straight from the Paris conference on climate change.

49.8
The manufacturing PMI for November, its lowest level since 2012, and the ninth month of manufacturing contraction. Meanwhile, a PMI specific to the steel industry for the same month hit a low of 37.

575,000
The number of people living with HIV/AIDS in China. The figure was released as the world marked International AIDS Day this week. The Centre for Disease Control and Prevention in China warned six in every 10,000 Chinese may be infected.

350,000 metric tonnes
The planned reduction in copper production over the next year, issued by 10 of China’s leading smelters. The association of firms claim the reduction is a “necessary measure to maintain healthy development of the industry”.

Where is it?

Some of the places referred to in this issue

China

Xi’an
Shenzhen
Shenyang
Shanghai
Liaoning
Inner Mongolia
Hong Kong
Guiyang
Chengdu
Beijing