

JESA INVESTMENT & MANAGEMENT CO. LTD.

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NEWS FROM JESA! Chinese Strategy wanted!

By Saro Capozzoli, Founder and GM of JESA Investment & Management Co., Ltd

We always repeat that China is not an easy Country where to invest due to the peculiarities of the market, of the economic and legal environment. This does not mean that investors have to be scared of coming to China and expand their business here. It is indeed a market full of opportunities where foreign companies are eager to get the biggest share possible.

But this is never easy and cheap. This does not mean that who is willing to invest huge amount of money in the market will have success.

So how companies can have success in China?

One of the first step to be successful is the definition of a clear strategy and the verification that such strategy is suitable for the market is a must. We will never stop repeating that successful strategies and business models in other countries are not automatically successful in China, on the contrary they can be a failure.

For this reason we always suggest our Clients to perform the analysis of the market situation to ascertain the feasibility of the strategy in China, adapt their products and services to the market.

It is worth saying that local advisors, with deep knowledge and experience in the market, may provide a useful support in the evaluation and reassessing of the business model in this country. This is valid also for well known and super successful brands that aim to replicate their success in China.

Lacking of such preliminary evaluation may cost failure, and higher investments to build a new image.

For this reason in this edition we give an account of the failure of some big companies and of the opportunities that can arise in other industries.

ITALIAN VERSION

Ripetiamo sempre che la Cina non è un paese facile nel quale investire a causa delle peculiarità del mercato, e dell'ambiente economico e legale. Questo non significa che gli investitori devono evitare di espandere il proprio business in Cina. È invece un mercato ricco di opportunità dove imprese straniere sono desiderose di acquisire la più larga fetta di mercato possibile. Ma questo non è mai semplice ed economico, ma allo stesso tempo non significa che chi è pronto ad investire un elevato ammontare di denaro avrà successo.

Dunque come le imprese possono avere successo in Cina?

Uno dei primi passi da compiere per avere successo è la definizione di una strategia chiara e la verifica che tale strategia si addica al mercato è indispensabile. Non smetteremo di ripetere che strategie e modelli di business di successo in altri Paesi, non sono automaticamente altrettanto di successo in Cina, anzi potrebbero rivelarsi un fallimento.

Per tale ragione suggeriamo sempre di effettuare una analisi preliminare del mercato per accertare l'applicabilità della strategia, adattare il proprio prodotto e i propri servizi.

È importante ricordare che spesso consulenti locali, con lunga e provata esperienze nel mercato, possono fornire un valido aiuto nella valutazione e adattamento del modello di business in questo paese. Questo vale anche per conosciuti e super rinomati marchi che aspirano a replicare il loro successo in Cina.

La mancanza di una analisi preliminare può costare il fallimento dell'iniziativa e investimenti superiori per la ricostruzione di una nuova immagine.

Per tale ragione in questa edizione diamo un resoconto del fallimento di alcuni marchi importanti e di opportunità che possono emergere in altri settori.

Barbie leaves China: the last failure of adapting to the Chinese model

The Chinese market is not easy to conquer and no exceptions are made.

One of the most recent news tells us about the shut of dolls' world-wide famous brand Mattel six-storey shop in Shanghai, just two years after opening celebrations.

The shut came into reality a couple of months ago; the store's website has already been taken down, replaced by a list of alternate places to find Barbie's merchandise in Shanghai and everything came despite most of the Barbie's productions is still held in China.

Although the company is facing positive trends in most of the countries its businesses are run (with a sales increase of 8% only in the last quarter of 2010), it appears to have been declining if comparing current performances to last outstanding decade. The solution had been sought two years ago through the bright pink, six-storey store built in Shanghai city centre that would have eventually strengthen the brand awareness in the fast growing Chinese market.

Shanghai has been always used as a test market from retailers to then further expand in the Chinese mainland . Particularly in March 2009, when the store opened, Mattel claimed it would

be an ultimate destination for plenty of female customers .



However, Barbie's approach failed, due to a wrong, arrogant strategy with which company's analysts approached the Chinese market and because of some locally-unfit product characteristics .

In United States Mattel brands could count on solid basis and a long successful path , being appreciated and recognized by generations of loyal loving. This was not the case of China, where the brand pays the weak attention put on local preferences, indeed failing to meet customer needs, a primary goal of market makers. The dolls, which were wearing western-styled clothes, have been perceived as too sexy and provocative, when young Chinese women tend

to prefer cuter design . The latter is not the only reason of the failure: the image of beauty been blonde and blue-eyes has never been liked in China and Chinese deemed overpriced most of accessories and items, exactly the opposite reaction of the Japanese, who proved to be the most enthusiastic about Barbie's stores.

Having a look on recent times Mattel seems just to have followed the negative path of other overseas successful foreign retailers .

The American chains Home Depot and Best Buy, among the others, closed their retail operations in China due to wrong competition choices with other, mostly local, sector players.

Been overconfident, they basically decided to provide services of higher-quality, in a reality where most Chinese are used to buy goods (electrical in this case) at cheaper prices from makers' agents, small local shops or established Chinese competitors such as Suning and Gome. They couldn't offer competitive prices when saddled with high operating costs, and local customers have always proved to be obsessed with low prices to care about service quality.

Not raising success with the Chinese consumers, Best Buy closed all its nine branded stores in the end of February. Home Depot also, has close five of its ten 2006-acquired stores.

The business environment in China is not easy at all and for large multinational companies, it translates into adapt or lose a substantial market. The context is increasingly challenging and the market is even more complicated to understand. Companies trying to implement business models elsewhere successful (also in other fast-growing markets like India or Brazil), fail to meet local habits and once they enter the market, they are either not patient enough to be successful or do not change enough quickly to adapt to changes in act.

The list of examples is long and the most remarkable one to consider still remains Google, which has struggled in China.

Google arrogantly took years to find out even some basic facts about its Chinese rivals Baidu and Tencent, which have nearly two-thirds of the domestic market in online search. It only began to offer the most attractive services to Chinese (i.e. free music download) one year ago, while more mature Chinese competitors were already launching new challenging plans.

Having a look on an Italian case, the three-floor Italian gastronomic shop of **Piazza Italia**, closed its operations in Beijing (2009) due to several factors:

1. Pretension of selling as high-priced products those overseas considered as common

hypermarkets products, not taking into consideration the now solid awareness of foreign goods values of Chinese raising upper classes.

2. Wrong location

3. Unreasonable financial planning

In general, the western model fell short and, although predictions, many rooted industrial models in China have not changed for the last seven years. Mattel is just the last example of arrogance and inability to adapt to local tendencies.

Lack of services for travelers in a booming infrastructure market

In the last twenty years China has embarked on impressive investment plans to develop and update its transportation infrastructures. The country now has the second largest highway network in the world, second only to the American Interstate Highway System and the total length of the China's expressway system is expected to surpass that of United States this year. China has also the biggest and most efficient high-speed railway network in the world, with a total length of 13,000 km planned for 2011 (considering also the Beijing-Shanghai

high-speed line expected to be inaugurated this year).

China, whose roads served less than one million privately owned cars just three decades ago, is channeling a considerable amount of investments to enlarge the expressway network which experienced an outstanding acceleration during the period 2004-2010, reaching a total length of 74,000 kilometers (China's first expressway was built in 1988 but until 1993 very few expressways existed). As a demonstration of the current development trend, during only 2010 a total of 9815 km were realized. Resources spent and devoted to new investments in network improvement are without rivals: \$US 17-19 billions annually invested in the period 2005-2010, and \$US 12 billion annual investment planned for the next decade.

The beneficiaries of increasing investments in the road network include companies that are toll road constructors, operators and all related service providers such as gas stations and service stations". In addition, increasing connectivity will stimulate demand for automobiles, gasoline, logistics services and tour services. An old Chinese saying - "**To get rich, build roads first**" - has never been truer.

On the other hand, train is till today the most used means of transportation in China and the

millions of people that crowded railway stations during the Lunar New Year last February is a clear evidence of that. Railways development will be among the priorities of the Government in the coming years, with investments filtering into the railway sector that will significantly boost the train infrastructure contribution on the total transport infrastructure value (from 52% in 2009 to 65,7% expected for 2015). According to the recent 12th Five-Year Plan, investment for the construction of new railways will reach CNY 3,5 trn (US\$ 525 bn), of which CNY 700 bn (US\$ 108 bn) will be allocated this year. Apart from the pharaonic infrastructure projects that have recently been presented, the upcoming opening of the high-speed line Beijing-Shanghai is on everyone's lips. The 1,318 km railway will connect two of the country's most prominent economic areas, improve journey times and ease pressure on existing railway corridors between the two cities.

Unlike the state-of-the-art of the new infrastructure projects, it's evident the lack of services for travelers. Interesting investment opportunities in the catering service along highways and in the train stations could be identified. Most highways in China are required to have a service area, which should include a fuel station, in every 50-60 km, and a rest area

in every 15-25 km, but there are entire parts of the highway network that completely lack of areas for refueling and refreshment. For example, the 122.8 km-long Guangzhou-Shenzhen Expressway may well be the busiest (more than 100,000 vehicles use it daily) and most expensive (70 Yuan in each direction for a small car) road in China, and yet there is not even a single gas station between the two ends. A driver who recently ran out of gas on it is suing Shenzhen Expressway Co. Ltd, the toll-collector, for providing defective services. Foreign companies which operate service areas in Europe or US may exploit the huge market potential and take advantage acting as first movers. Refreshment corners could be also opened for travelers in the main train stations where these type of services are currently scarce. Compared to the investment required for service areas on highways, the one necessary to open restaurants and self-services inside railways stations could be lower due to the fact that the infrastructure is already in place.

However, there are some barriers to overcome for foreign companies that want to set up operations in China. First of all, it's important to consider that the country highways are not managed by a single management company (as for example in Italy), but the system is highly

fragmented with provinces and local governments that regulated inside their districts. Second, companies willing to approach the Chinese market, should be aware of the different culture and tastes of the local population, especially regarding food habits; a simple replication of a western business model could experience an hostile welcome.

In conclusion, apart from some complications due to regulatory complexity and culture, this sector represent an highly potential opportunity since transport developments in China are proceeding at full speed: the China National Development and Reform Commission (CNDRC), as well as individual provinces, are announcing ambitious plans for the country's transportation infrastructure. The industry is also receiving a further boost under the fiscal stimulus plan, which is heavily geared towards the transport infrastructure sector.



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