

Welcome to the November 2009 edition of Pragma's China Newsletter, written by Jesa



News from Jesa: **Ranking of the 1000 richest individuals in China**



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While the economic crunch in the Western economies has affected many levels of the society, it seems that in China, rich are getting richer. Last October, the Hurun report was issued with the list of China's wealthiest people.

Hurun is a leading luxury publishing and events group, comprising a magazine and active events business targeted at China's high net worth individuals. The Wall Street Journal stated that "People often are not considered truly rich until mentioned in Hurun report" confirming this report is regarded by some as the foremost authority in tracking the rapid changes among China's high net worth individuals. The flagship product of Hurun report is the *China Rich List* that takes the pulse of the situation about who's who in China business environment.

Despite the crisis, the number of China's super-rich increased last year, with the number of US dollar billionaires jumping from 101 to 130. According to the analysis, the number of billionaires could actually be twice as high since many of them are suspected to be still out of radar screens. With these figures, China has more billionaires than any other country apart from the United States (359 billionaires in the USA).

The Hurun 1,000-name rich list shows that the average wealth of the listed individuals is 30% up on last year. China super-rich seem to have put the credit crunch behind them.

What are the golden industries that made the fortune of their entrepreneurs?

Massive urbanization programs are boosting the real estate market and most of the top-ten billionaires are involved in real estate and property business. The urban population is expecting to increase by 300 million people by 2025, laying the foundation for continued growth.

Mining is the fastest-growing industry and surprisingly, few of the Hurun 1000 are reliant on exports to western economies.

Some figures of the list are interesting points:

1. Less than 1% of the 1000 listed people inherited their wealth (compared with 25% in UK and 35% in the USA).
2. Compared with last year, there are 7 new faces in the 2009 Top Ten, among which the Number One who shot up 102 places.
3. The average "Rich Lister" is fifteen years younger than his/her European/American counterparts.

The current situation shows a fast growing wealth that relies more on internal market and potentialities than on western economies.

In this list, there are other interesting figures: China has 825,000 individuals with personal wealth of more than 10 million RMB (1 million Euro) and 51,000 individuals with more than 100 million RMB (10 million Euro). The average Chinese with personal wealth of 10 million RMB is 39 years and the one with personal wealth of 100 million RMB is 43 years old.

The Hurun report notes that these wealthy individuals are keen on travelling for leisure (their preferred travel destinations are Australia, the USA and France). They are spending 50% more time on leisure travel, whilst a third

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What is Jesa?



Pragma's and Jesa's logos in Shanghai

Jesa is a service company headquartered in Shanghai specialising in facilitating start-up of new industrial productions while providing reliable management and control solutions. We operate 4 main branches in China and a foreign office in Ulaan Baatar (Mongolia).

Since 1998, Jesa has built a team of 70 specialized employees in addition to 25 save technicians following "in loco" projects. Commercial relationships are exclusive and strictly confidential, ensuring the highest expertise on every single commercial and technical issue.

Jesa is a leader in managing manufacturing processes and eliminating any industrial and regulatory problems while helping our clients financial resources and time.

Jesa is currently expanding its services providing support to those companies seeking to develop distribution network and retail system in China as well as in Mongolia.

We also perform HR audit and investment analysis (trouble-shooting analysis) to verify performances in support to companies already established in China, and we provide tax and accounting consultancy.

now take more than twenty days holiday a year.

This mass of high net worth individuals needs more and more luxury and high end products. In the list of preferred brands, the richest only quote foreign brands (top-listed luxury brands: *Louis Vuitton*, *BMW*, *Mercedes Benz*, *Cartier* and *Patek Philippe*).

The increasing and widespread concern about “Made in China” products’ quality is also driving most of Chinese consumers’ behaviour, leading to an increasing attention towards consumer protection.

Luxury market in China

According to official statistics, on a global basis the market value for luxury goods has shrunk of 6.6% in 2009. Meanwhile the USA and Europe have been deeply affected from decreasing consumers spending, China’s luxury consumption has increased and represents today 25% of global volume. With a total value of US\$ 50 billion and a double digit growth forecast for the next 5 years, the time for Chinese austerity has long gone. The trend is that consumers are getting more and more attracted by foreign brands and are fostering internal demand towards a wide range of new products. As the surveys clearly displays, according to Chinese consumers, to possess luxury goods is often related to living a successful life as well as expressing good taste. Today, consumption is mostly driven from apparel and personal products, for instance dress accounts for 32% of total market value. But, as status plays a greater role compared to Europe and USA, the demand for watch, jewelry, home decoration and luxury car will represent a major stake within the next few years.

Today, the Asian country encounters with the presence of 1.6 million wealthy consumers, growing at the rate of 16% per year. At the same time, more than half of those who will be considered wealthy within 4 years are not in this category today. It is important to notice that 80% of current wealthy individuals are below 45 years old and only 30% of them are located in one-tier cities. Compared to developed countries, social and economical characteristics of this population are completely different and companies have to consider them when planning the strategy to enter this market.

Some foreign players are already making the most of early move advantage. Just to name few of fashion industry stake players, *Louis Vuitton*, *Hermes* and *Gucci* have all reported sales increase in 2009. At the same time in the automotive sector, *Rolls Royce* and *Lamborghini* are expecting China to become their major market after the USA by 2013. In general, all players with a stable presence in the market have been recently moving towards second-tier cities, as they are conscious that 75% of wealthy consumers will be living in these areas by 2015.

Future opportunities are also arising for both foreign and Chinese players. On one hand, Chinese consumers want their own luxury brands to fulfill the inner cultural pride; on the other hand, they are able to recognize the superior quality, design and brand image of international players. Tips for success are few, but may be useful. As experts suggest, it is strategic to create limited edition for customers who wants to set apart from the rest, to supply collectibles which appeal affluent shoppers and to provide excellent service that values the status of your clients.

As shown, the market has all the characteristics to be considered a unique opportunity, but at the same time, potential pitfalls have to be minded. First, consumer still lack awareness and loyalty to the brand. Therefore, it is crucial to investigate their needs, to invest in communication and to retain them once the purchase has occurred. But the main issue has to do with the counterfeit market which affects currently about 20% of total retail products. In this case, the best solution would be prevention in order to avoid time consuming lawsuits and the risk that someone else is already using your brand.

Shaping the young Chinese market is not going to be an easy task but at the same time it will be strategic for success. Time will be required to make consumer aware of the differences among brands and enforce their customer loyalty, but payoffs are expected to be outstanding for those who will soon enter the competitive area. Our advice is to rely on a strong brand and provide potential customers with exclusive products and services. The market has great potential but players can only experience and take advantage of them through the understanding of customers’ needs. As always, this is the main ingredient in the receipt of success all over the world.

Protecting customers: Food Safety Law

Food Safety Law (FSL) was recently enacted by the Standing Committee of China’s National People’s Congress. As result of years of drafting, this law, which is effective since last June, finally creates nationwide standards with the intent of protecting customers after recent tainted milk and pet food scandals that damaged the “Made in China” brand worldwide rocking public confidence.

FSL covers Food Manufacturers (producers and processors) and Food-business Operators (distributors and caterers) industries. The following processes are also included: manufacture and processing of food additives; food-related products (including manufacturing and processing of packaging materials, containers, detergent and disinfectant used with food; and tools and equipment used in production and processing food); Food Manufacturers’ and Food-business Operators’ usage of food additives and Food-related Products.

The standards

China's State Council establishes a national food safety commission to coordinate and oversee the new food supervision apparatus. In addition, standards required by FSL are formulated and published by the Ministry of Health (MoH), consolidating hundreds of regulations and standards covering many food-processing companies.

Inspection and record keeping

Under the FSL, the involved industries face new obligations for training, quality inspection and record keeping. Food Manufacturers cannot purchase or use substandard raw ingredients, food additives, or food-related products. They are required to effect and record final inspection as soon as food products leave the factory. Food-business Operators must inspect seller's permits and certification documents evidencing a compliance with safety standards. Records of purchase details and inspection are mandatory. Food importers need to maintain two years record of food imports and sales. In the past, some food industry giants were able to obtain inspection exemptions, but the new law abolishes any exemption for inspection.

Food importation

Imported pre-packaged food and food additives must have Chinese-language labels and instructions, containing information on the origin place, name, address and contact information of the domestic agent. Chinese-language instructions must satisfy the requirements under Chinese law, including the food safety standards. If the food to be imported is a variety which is not contemplated by the Chinese standards, the food importer should submit safety evaluation documents to MoH applying for approval before importation. In addition, food products claimed to have specific health benefits are subject to stricter supervision. Further, labels and instructions must list ingredients and information prescribing people allowed to consume a product. Also, misleading advertising of food products is banned, and advertisements cannot claim that a product may prevent or treat disease.

Recall

The FSL codifies a food recall system, which was previously regulated under administrative rules. Food products proven to be substandard are subject to: cessation of production; recall; notification of Food-business Operators and consumers; record keeping of the recall; and report to the county-level (or above) quality supervision authority. If a recall is not effected accordingly, the appropriate authority can order a recall or suspend the violator's business.

Several liability and punitive damages

Under the FSL, an expansive liability structure has been implemented. Food-related businesses need to take measures to prevent food safety accidents. FSL provides that if a Food Manufacturer produces, or a seller knowingly sells, substandard food, consumers can claim for punitive damages equalling ten times the original product price, in addition to normal compensation, ordered by the Court, for losses caused to the consumer.

Conclusion

China's FSL appears to be an umbrella law, which aims to establish a comprehensive supervision system resolving fights between various authorities and setting national guidelines. On top of the establishment of a national food safety commission and safety standards, producers and distributors are now subject to increased penalties if they produce or sell substandard food. Businesses will be required to maintain detailed inspection and purchase records to obtain particular permits. Meanwhile, compliance is likely to increase the cost of production. Although the adoption of this law will not immediately change the food safety landscape, the FSL promises to improve food quality and safety for consumers of Chinese food products, especially in the long-term period.

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